

**CONTRACTS: NOTES ON THE EXAM****SECTION A (60% of the exam grade)**

**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)**

What Avocado loses as a result of MM's late delivery of the CHMS is the profit associated with the contract for sale to Better Life, any wasted advertising expenses and any lost opportunity to make future profits because of the negative impact on Avocado's reputation from its failure to deliver the CHMS to Better Life and because of Eggplant's development of a competing product.

The first issue to consider here is whether UCC Art. 2 applies to the contract for MM to produce the CHMS. The question states that "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." It sounds as though the product is a movable good - it has hardware and is capable of being sold to consumers in stores. So a sale to consumers would seem to be a sale of goods under UCC Article 2. But the original contract for production of the CHMS also has elements of a service. MM is to build the product according to Avocado's instructions and is to load it with Avocado's software. Many answers to the question asserted that the CHMS were movable goods without analyzing which of the facts were relevant to the question. Also it makes sense to distinguish between the contract to manufacture the CHMS (which has service aspects) and a sale of the CHMS to Better Life or to consumers (which would seem to be sales of movable goods). If you decide the UCC applies you should then analyze the question using the UCC - especially where relevant the language of the UCC (e.g. for consequential damages cite the language of UCC §2-715(2)(a) rather than the language of Hadley v Baxendale). Whether or not the UCC applies the analysis of the remedies should be similar.

The contract is for 1000 CHMS for delivery 14 September 2011, at \$100 per unit (total \$100,000) half payable on signing the contract (i.e. deposit of \$50,000). The relevant breach by MM is the late delivery. This is a failure of perfect tender (UCC § 2-601) and although MM has a right to cure, Avocado has the right to refuse the late delivery under the UCC. If Avocado accepts late delivery UCC § 2-714 provides that "(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." This should include damages resulting from the breach of the contract with Better Life which have been caused by the delay.

The question states that "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.” This is a liquidated damages clause ( UCC §2-718(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”). MM and Avocado will want to make different arguments about the validity of this clause. Looking solely at the contract with Better Life, the damages under the contract for delay are much higher than any loss Avocado is likely to incur. On the other hand, there are also possible future losses which will be difficult for Avocado to establish by evidence and this may make a difference. MM may want to argue that it is Avocado’s failure to monitor its own employees which contributed to the loss (this would be a component of the proximate cause analysis of consequential damages but is also related to his issue of liquidated damages versus penalty). Also MM may want to argue that it accepted the clause as a part of the contract because of duress and this should also be relevant to the question of enforceability.

If the liquidated damages provision is unenforceable, and if Avocado seeks damages, under UCC § 2-711 where the seller fails to make delivery the buyer may cancel, and gets back “so much of the price as has been paid” and damages for non-delivery. Under UCC § 2-712 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” and “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.” Cover may be difficult here. Under UCC § 2-713 “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 .. but less expenses saved in consequence of the seller's breach.” Candidates for market price could be the price at which Avocado contracted to sell to Better Life or the price at which Eggplant sells its product to Better Life.

In terms of consequential damages, the contract warns of consequential damages for the purposes of UCC §2-715(2)(a) (“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..”) The contract with Better Life for \$150 per unit (\$50 more than A is to pay MM suggests A stands to make \$50,000 on the CHMS products (though we don’t know about costs associated with delivery etc). We do know there are advertising costs, and that Better Life agreed to pay part of these. So advertising costs which Avocado incurs but which Better Life does not pay because of Avocado’s breach would also be candidates for consequential damages.

MM announcing the problem on September 1 gives Avocado an opportunity to try to cover (which is a form of mitigation).

**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)**

This is clearly a sale of goods under the UCC. We need to consider remedies for non-delivery under UCC Art. 2, much as was the case with respect to the first question. But because the questions are similar it would be a good idea to show in what ways the circumstances differ. The answer should refer to UCC §§ 2-711, 2-712, 2-713. Better Life may save advertising expenses if it is not obtaining the CHMS from Avocado, and if so this amount would be deducted from its damages. If the advertising expenses are not saved because they are incurred in advance, Better Life may have suffered from claiming to be about to sell a product it does not have. Such economic harm would be consequential damages but would be difficult for Better Life to establish. Better Life may incur incidental damages in trying to obtain cover. There is an issue with respect to using UCC § 2-713 as it is not clear what the market price for Avocado's CHMS system is. It is a new product. Eggplant's CHMS system may or may not be regarded as sufficiently similar to establish market price. The comment to UCC § 2-713 suggests that opinion evidence may establish the relevant price if there is no market price. If \$175 is the market price, Better Life should get the difference between \$150 and \$175 multiplied by 1000 (\$25,000) plus incidental and consequential damages less expenses saved. Consequential damages could be the profit Better Life expected to make on resale if the facts satisfy the requirements of UCC § 2-715. This is a more complicated calculation than for question 1. Avocado had a contract to supply 1000 CHMS units to Better Life so it is possible to quantify Avocado's lost profits in a way that is unlikely to be true for Better Life with respect to sales to its customers (especially as this is a new product).

If Better Life buys the Eggplant product it would have the product available to sell to customers so removing the lost profits issue (if Better Life sells the Eggplant product for the same price as it planned to sell the Avocado product (all other things being equal). The purchase from Eggplant would seem to allow Better Life to rely on UCC § 2-712 which provides that "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." and that "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." But the circumstances under which Eggplant produced its CHMS (stole information from Avocado to manufacture the CHMS, bought up supplies of necessary product for their manufacture) suggest there may be an issue about whether the cover would be "in good faith" and "a reasonable purchase". The question does not say whether Better Life has any knowledge about Eggplant's behavior, and it is arguable that any bad faith on Eggplant's part should not be attributed to Better Life.

Many answers to this question started with the idea that what Better Life had lost were profits of \$50,000 (what BL hoped to make, although this assumes that BL

expected to incur no costs in selling the CHMS). But the claim of lost profits may not succeed here because it is speculative - some part of this amount is recoverable anyway as being the difference between the contract price and market or cover price, and this should be the starting point.

**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)**

1. Is the contract enforceable?

i. the question states that “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.” Thus there is an illegality that affects the contract.

ii. threatening to tell Avocado (untruthfully) that Diana had been providing Fred with information for years if she did not provide the information amounts to duress.

Note that duress is invoked by the party who wishes to avoid the contract. Here Diana is the one who is in a position to claim duress but she is the one who would like to receive the money, so duress is unlikely to be raised as an issue in any dispute between Diana and Fred. Fred would be able to raise the issue of illegality to try to avoid having to pay Diana. On the other hand both might benefit from keeping the whole arrangement secret.

2. Should the contract be enforceable?

3. Can Avocado fire Diana? She has committed a criminal offence and breached a contractual obligation to Avocado to keep its product information secret. This is the sort of contractual obligation that tends to be valid (*cf.* Fullerton Lumber etc). If she were fired for failing to do something illegal this would implicate the public policy issue in *Wagenseller*, but this case is different. The question does not say whether there is any basis for Diana to argue that she should benefit from implied in fact terms from staff manuals etc.

**SECTION B (40% of the exam grade)**

**ONE QUESTION**

**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?**

The question raises a number of related issues. It is possible to see it as a

question about settlement agreements or about contracts more generally. And one could consider Posner's statement in the context of duress, or, more broadly in the context of various situations in which parties to contract seek to displace agreements they have made and courts consider whether or not to do so. During the semester we saw a number of cases where courts have refused to enforce contracts: for example liquidated damages provisions which are characterized as penalties, certain non-compete clauses, contracts which are illegal, contracts with minors, and contracts concluded through fraud or duress. Some answers to this question treated the question as being a general question about when and whether courts do and should enforce contracts as they are written, illustrating the answer with references to many of the cases we read. But as well as asking "[h]ow is what you have learned about contract law this semester consistent with an idea that the law should generally treat commitments as binding?," the question focuses on the long-run versus short run interests of a contracting party.

Posner contrasts the long run interests of a contracting party with his short run interests. And this is an example of specific versus general interests. Whereas a contracting party might in a specific case seek to have a court invalidate her contract she may have a more general interest in the courts upholding contracts. There is also an implication of a general societal interest in the upholding of contracts. On the other hand, we have seen many cases where courts are prepared to consider whether or not to enforce a contract. The question seems to raise an issue about whether courts in applying contract law should aim to do justice in individual cases or should focus on the development of general rules of contract law. The impulse to do justice in an individual case might conflict with a broader idea of general justice.

Focusing on the context of Posner's statement suggests that an answer to the question could usefully focus on the question of what sort of constraints on a contracting party's autonomy result in the court invalidating a contract. Who do we treat as incapable of contracting (minors, people suffering from mental illness), how much do contracting parties need to know about the deals they are making before we enforce those deals (e.g. fraud cases)? It might also make sense to discuss promissory estoppel as an example of a doctrine which allows courts to enforce promises where others have relied on them.

## **2. Write a critical analysis of any two cases we studied this semester. 13 answers**

Some of the answers were really descriptions rather than critical analyses of the cases.