Caroline Bradley FALL SEMESTER 2015

CONTRACTS: NOTES ON THE EXAM

SECTION A (60% of the exam grade)

1. What contract remedies does Juno have against Draco for his failure to supply the studio furnishings? What additional facts would you need to know to answer this question? (15 points)

The first issue to address in the in the answer is whether the contract whereby Draco is to provide the furnishings is a sale of movable goods to which Article 2 of the UCC applies. This is the first issue to address because it tells us which rules apply to the facts. The question states that "Juno drew up a set of designs which she provided to Draco and he agreed that he would find a fabricator to make the furnishings." So in one sense Draco is providing the service of finding a fabricator of specially manufactured goods. However, it is clear that Draco is in fact going to provide the goods to Juno - he is an intermediary, but one who is going to sell the specially manufactured goods to Juno. Thus UCC Art. 2 applies here.

Faced with Draco's inability to provide the furnishings Juno contacts Jairo and tells him she needs the furnishings quickly and that "money was no object." The question also states that the required furnishings are for the "studio premises Griffin and Hob were due to open" (and Griffin and Hob are Juno's franchisees). As a disappointed buyer, under UCC § 2-711 Juno can recover any deposit she has paid to Draco (the question does not tell us about any deposit) together with damages under UCC § 2-712 based on cover or under UCC § 2-713 for non-delivery (she can choose which provision to use). In both cases she may also recover any incidental damages (although the facts do not identify any such damages) and consequential damages (note that under § 2-712 the buyer is to receive "any incidental or consequential damages" whereas under § 2-713 the buyer gets "any incidental and consequential damages") less expenses saved in consequence of the breach.

Juno does seem to be engaging in cover. Whether or not she covers in fact she may claim damages under either UCC § 2-712 or § 2-713. However, there are some issues with respect to cover: the fact that she told Jairo that money is no object means that she may have some difficulty in showing that her contract with Jairo is "in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller." The issue is really with respect to the reasonableness of the purchase from Jairo (there are no facts suggesting an issue with a lack of good faith, such as Juno having an interest in benefitting Jairo at Draco's expense).

If Juno were to wish to claim a remedy under § 2-713 she would likely have some difficulty in establishing the market price of these specially manufactured goods.

If Juno is not able to acquire furnishings in time for the opening of the franchised studios Juno may be liable in damages to Griffin and Hob and such damages would constitute consequential damages she could claim from Draco. Cover limits

consequential damages ("which could not reasonably be prevented by cover or otherwise"). The facts suggest that Draco knew of the franchising although it is not entirely clear that the circumstances fit the language of UCC § 2-715 ("loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know"). If Draco did have sufficient knowledge to make a consequential damages claim viable, Juno could claim any identifiable damages owed to G and H (these would not be speculative and would be able to be established with reasonable certainty). Other losses such as lost profits on the deals with G and H and lost opportunities to sell more franchises would be more problematic.
I don't think it was necessary to discuss whether or not there was a contract here. The question states that Draco "would be unable to perform his obligations under the contract" which suggests that there is in fact a contract. Some people referred to the possible need for writing, which I think made more sense. We don't know the value of the contract (if it is $500 or more), nor do we know whether the contract was in fact in writing (these would be facts we would want to know). But although it made sense to mention Statute of Frauds issues, I don't think it really made sense to discuss promissory estoppel as a possible solution in detail (as there was much else to write about relating to the remedies issue).

2. If Juno were to consult you and ask your advice on clauses A and B of the ATMP Confidentiality and Non-Competition Agreement how would you advise her? In your answer to this question focus on the drafting of the clauses, on any legal issues raised by the drafting, and on any legal issues raised by the circumstances in which the agreements were signed. (15 points)

The question asks about the drafting of the clauses, about legal issues raised by the drafting and about legal issues raised by the signing circumstances. The two clauses are a non-compete clause (Fullerton Lumber) and a liquidated damages clause (Lake River).

Here are the clauses:

> A. Employee acknowledges that the ATMP is solely the property of Juno, and Employee agrees that during his or her employment and for **five years** following the end of the employment Employee shall not engage in any Competing Business or render any services to any Competing Business. "Competing Business" shall mean any **for-profit or non-profit organization in North America that provides art classes or instruction.**
>
> B. If Employee breaches clause A of this agreement he or she shall be liable in damages to Juno in an amount equal to the gross monthly salary he or she received in his or her last month of employment by Juno, multiplied by 36.

We don't know what the rules are in Arcadia with respect to either non-compete clauses (we know there is some significant variation in state law in this area) or liquidated damages clauses. But both types of clause may be invalidated on the basis that they are unreasonable.

In Fullerton Lumber the court suggested that a 10 year period of non-competition was excessive. The case also discussed the issue of geographic reach of non-compete clauses (citing General Bronze). This clause applies for 5 years throughout North America. We do not know how courts in Arcadia would consider such a clause. In Florida the person seeking to rely on the clause must prove that it is reasonably necessary to protect the legitimate business interest or interests justifying the restriction. A period of restriction of an employee under 6 months is presumed to be valid and over 2 years is presumed invalid. Where trade secrets are involved the period may be between 5 and 10 years. We do not know whether the ATMP involves trade secrets. But the drafting of the clause is broad and does not seem to be limited to protecting any trade secrets of Juno's business. If the clause was only about protecting trade secrets the broad geographic reach could be reasonable but the clause is broader than that which raises questions about the reasonableness of the geographic scope of the clause. The fact that the non-compete extends to non-profit organizations also raises some questions about reasonableness.

With respect to liquidated damages we saw in Lake River that in Illinois such a clause must be a reasonable estimate at the time of contracting of likely damages and the clause must be justified by a likely difficulty of measuring actual damages. The Restatement says that for a liquidated damages clause to be valid damages must be in an amount that is reasonable in light of the anticipated or actual loss and difficulties of proof of loss, and that unreasonably large damages are unenforceable on grounds of public policy as a penalty. We don't have enough information to decide on the issue of reasonableness although damages representing 3 years' salary for an employee do seem to be rather large.

As to the circumstances in which the agreement is reached, the employees are asked to sign the agreement after they have been working for Juno for a while, raising the issue of consideration, although courts have accepted that continued employment of an at will employee does constitute consideration for such an agreement. Atlas' difficulties do not rise to the level of duress (e.g. The Selmer Company v Blakeslee Midwest Company). Many people wanted to characterize Atlas' situation as like that of the employee in Mitchell v CC Sanitation, and/or emphasized the inequality of bargaining position. But it seems to me that there is a huge difference between depriving an employee of an opportunity to be properly compensated for injury by threatening him with loss of his job and suggesting (expressly or impliedly) that employees who want to keep their jobs should agree to restrictions on their future freedom. Moreover, in the context of at will employment the inequality of bargaining position is a fact, and one that courts don't do a lot to remedy (e.g. Tallman).

3. What issues does Juno's termination of Bennu's employment raise? (15 points)

Juno terminates Bennu's employment after discovering that "is an undocumented worker who had borrowed a friend's social security number when he applied for the job with her." Nothing in the facts of the question suggests that Bennu is anything other than an at will employee. At will employees may be fired for cause or for no cause at all. They may not be fired for bad cause (e.g. Wagenseller (firing for refusal to commit a criminal offence may be bad cause)), and employers' handbooks/manuals may establish implied terms of a contract which limit the employer's ability to fire at will employees (Wagenseller). The facts of the question do not suggest there are any such terms. Moreover, as an undocumented worker, Bennu has no right to continue to be employed (e.g. Coma Corp). The fact that Bennu is fired two weeks after signing the ATMP Confidentiality and Non-Competition Agreement raise some issues about the enforceability of the Agreement, although as a worker now known to be undocumented it is not clear that Bennu will be able to obtain the sort of employment that would bring the agreement into play. Invoking the terms of the Agreement after two weeks without the issue of the use of someone else's social security number could raise questions about whether Juno was acting in good faith. But as Bennu obtained employment fraudulently (using a social security number that was not his to disguise the fact that he was undocumented) he is not in a good position to invoke the idea of a lack of good faith on Juno's part.

Juno's claim that she can withhold accrued wages because Bennu lied to her raises a different question. Cases such as Coma Corp suggest that an employer has to pay undocumented workers for the work they have actually done (at least at minimum wage) because to do otherwise would result in the employer being unjustly enriched, and requiring the employer to pay the workers creates disincentives to employ undocumented workers and is thus consistent with the policy of IRCA. We don't know whether Arcadia has a statute similar to the one at issue in the Coma Corp. case. And, unlike tie facts of the hypothetical, Coma Corp. did not involve the use of a fake social security number. So the question arises whether this difference should change the result in the case. I don't think so: an employer who withheld pay in these circumstances would have been enriched by the value of the work, and I think that this would be unjust enrichment which would justify a claim by the ex-employee for pay. But others might take a different view. In particular the court in Coma Corp. did rely on the idea that requiring employers to pay undocumented workers removed an incentive to hire undocumented workers in the first place. Juno did not think she was hiring an undocumented worker because of the fraud, so this reasoning may be thought to be less applicable in these circumstances.

4. What liability will Cat incur to Juno if she opens her own art studio and teaches at the Arcadia Art Institute ? (15 points)

This question raises two sets of issue. First, the issue of how the provisions of the ATMP Confidentiality and Non-Competition Agreement apply to this situation. To some extent this involves a recap of issues addressed in question 2, but it does not make sense for this answer to be entirely a repetition of the answer to question 2. Cat is to be involved in two sets of activity: opening her own art studio and teaching at the Arcadia Art Institute. The art studio might be considered to be a business competing with Juno's (if it is to provide art instruction, not if it is to focus on production of Cat's own art) and the work for the Art Institute could involve providing services to a competing business (whether or not it is a for-profit enterprise). The situation shows how unreasonable the terms of the ATMP Confidentiality and Non-Competition Agreement are, because Cat seems in this scenario to be trying to exploit her own skills (she has been a student at the Art Institute and is likely asked to teach there because people there are impressed with her rather than because of her connection with Juno). If the agreement were to be treated as invalid because of the unreasonableness then Cat would seem to be able to carry on her new activities without any liability in damages to Juno. If the agreement were treated as valid but limited to reasonable terms there could be some liability in damages to Juno. The liquidated damages provision might be justifiable on the basis that it would be difficult to quantify actual damages but the level of damages it fixes is high and not variable with the seriousness of the breach of contract. Juno could claim damages she could establish: for example if her business is less profitable after Cat goes into competition with her she could claim the lost profits. One answer suggested she could claim damages based on the value of teaching the ATMP to Cat, which was an interesting idea. A number of answers seemed to suggest that if the liquidated damages provision were invalid Juno would not be entitled to damages. It wasn't always clear if this was a result of misunderstanding (if a liquidated damages provision is invalid the non-breaching party can still claim damages for breach of contract just not calculated according to the provision) or a recognition that it could be difficult to calculate actual damages.

The fact that Juno "told Cat that she was happy for her success and that she would not hold Cat to the terms of the ATMP Confidentiality and Non-Competition Agreement" gives Cat another possible basis for avoiding liability, by arguing that even if the Agreement is valid, Juno has waived its application to Cat. We came across the idea of waiver in the DK Enterprises case (although the discussion of waiver in the case is dicta). There the Florida Supreme Court suggested that rather than thinking of the issue in the case in terms of whether an oral agreement might effectively modify an agreement required by the Statute of Frauds to be in writing on the basis of promissory estoppel, a contracting party might be treated as having waived its right to rely on a contract provision based on oral statements on the basis of the doctrine of waiver. The situation here is similar. The original agreement is in writing (it is "signed") and needs to be in writing as a contract which is not to be performed within a year. Juno's statement that she will not hold Cat to the terms of the agreement seems like a waiver. The

majority in DK Arena thought that waiver was different from estoppel (the dissent saw the doctrines as being related) and pointed out that detrimental reliance, which is necessary for promissory estoppel, was not required for waiver.

A number of answers relied on promissory estoppel and estoppel, and some answers wanted to characterize Juno's statement as a new contract. Where the discussion of estoppel seemed to relate to the idea of a modification of the original agreement (although what was left of the original agreement would be minimal based on what the question says) this was closer to an accurate analysis of the situation than where the discussion was focused on some new agreement between Juno and Cat. Some people suggested that the agreement would be a sort of settlement agreement and cited the Selmer Company case. However, a statement that a person won't invoke rights they have under a contract is different from a settlement agreement. There's no hint of consideration here and promissory estoppel would allow Cat to bring a claim against Juno rather than protecting her from a claim by Juno. What Cat needs here is an estoppel/waiver to protect her from Juno's claim that she had breached the agreement.

SECTION B (40% of the exam grade)
ANSWER <u>ONE</u> QUESTION FROM THIS SECTION

Answers to this sort of question are more effective if they are organized around an argument rather than a disorganized stream of consciousness. On the blog I gave a couple of examples of good answers to the essay question and wrote:

> What is going on in these answers is that the writers are addressing the question prompt, making an argument in response, and doing so bringing in cases to illustrate their argument. Sometimes students will react to questions like the ones posed here by saying something like: the duty of good faith is important in contract law. Here is a case where the duty of good faith was involved. Here are the facts, the court decided there had been a breach of the duty. Here is another case. Here are the facts. The court decided there had not been a breach of the duty…. So the duty of good faith is important. Notice how the two examples of good essays are different from this sort of outline.

Despite this advice a number of the answers I received pretty much followed the form I outline above. The point of this question is to demonstrate thought about the materials, making an argument using the cases etc, rather than to demonstrate that you have memorized facts about the cases. Some answers showed that people had put in work thinking about the themes reflected in the questions, and this work paid off.

1. Is contract law fair? Explain your answer and give examples from the materials you read for the class to support your argument.

Of the two questions in section B this one is more open ended. I think that during the semester we saw two different and sometimes competing ideas of what fair contract law would be. On the one hand contract law is arguably unfair when it is unpredictable: a fair contract law might emphasize certainty. However, contract law is also concerned to prevent opportunistic behavior, and sometimes this results in uncertainty. This tension comes out for example in the Selmer Company case. There is perhaps a background question whether it makes any sense at all to talk about "contract law" as a monolithic entity. What we read was a number of decisions by different courts exploring various issues in contract law. the cases in the book were selected as much for the questions they raised as for what they tell us about what contract law is. The cases were organized around particular contexts: sale of goods, franchise, employment, family contracts. We saw some examples of the idea that courts might think of contracts between sophisticated and unsophisticated parties differently. We also know that there are variations in contract law rules in different states. Specifically we know that the rules about promissory estoppel vary (McIntosh v Murphy contrasts with DK Arena) and that different states have different approaches to non-compete agreements (Fullertom Lumber, the Florida statute). Nevertheless, I do think it makes sense to start with a discussion of how we might evaluate whether contract law is fair or not. What does fairness mean here?

One way of answering this question could be to contrast cases which focus on formalities with cases which do not: formal contract law encourages people to ensure that they spell out in writing exactly what they are agreeing to, whereas promissory estoppel allows for the possibility of a remedy for injustice when there is no compliance with contract formalities.

A different take could be to focus on opportunism or taking advantage. Many of the cases we read could be explained by the idea that courts are reluctant to allow people to take advantage of others in the context of contracting. This could explain Lake River, Fullerton Lumber., Market Street Associates and many other cases. Even, perhaps, Peevyhouse. And this idea also links the formal contract and promissory estoppel cases.

It would be possible to answer this question with the remedies materials. The idea that remedies for breach of contract should compensate the non-breaching party, but not too much, is an example of a concern with fairness. See, for example Armstrong Rubber, where we see that reliance damages may be limited by reference to expectation. Sullivan v Cromwell illustrates the concern with remedial fairness: the court wants to compensate Ms Sullivan, but not too much. But we also read remedies cases where we might be concerned that the result was not fair: e.g. Peevyhouse, Plante v Jacobs.

2. When the common law of contract intersects with statutes, do you think that courts should always give effect to the priorities of the legislature as expressed in the statutes? Why or why not? Give examples from the materials you read for the class to illustrate your answer.

During the semester we read a number of cases where legislation raised some questions for courts. Some of the legislation was intended to regulate contracts directly (Statute of Frauds, Wisconsin Fair Dealership Law), sometimes the legislation imposed limits on the courts' ability to apply rules of the common law of contracts (Federal Arbitration Act) and sometimes the legislation was not intended to regulate contracting at all, or to limit the applicability of contract law, but the fact of contracting came into collision with legislation in some way (e.g., the cases involving illegality).

We saw a number of examples of cases where the courts stated that they must defer to the legislature (e.g. DK Arena, Tallman, Hewitt). These cases suggest a limited role for courts, at least in areas where the legislature has addressed the issue. In DK Arena the court noted that the legislature could have amended the Statute of Frauds to allow for promissory estoppel, but had not done so. Legislatures may have more capacity to think about the policy implications of particular rules because they are deciding on policy from a general perspective rather than based on a dispute between two (or more) parties to a contract. But the general rules might create injustice in particular cases (e.g. McIntosh v Murphy). Refraining from developing the law in deference to legislative prerogatives may also foster injustice (e.g. Hewitt, a case which has recently been considered again in Illinois in Blumenthal v Brewer (still not decided by the Illinois Supreme Court on January 5, 2016)). And we saw in the material in the Casebook on Collins Drug v Walgreens that the activities of legislatures do not necessarily conform to the ideal model of a legislature.

The arbitration cases suggest that determined application of legislative rules to limit the freedom of courts to pursue justice can be problematic (although the class action phenomenon is not itself unproblematic). Here we read Tallman and Extendicare.

We know that courts in different jurisdictions have taken contrasting positions on the extent to which courts should defer to legislatures. For example we could contrast McIntosh v Murphy with DK Arena, Marvin v Marvin with Hewitt. In the notes after Fullerton Lumber the Casebook notes the decision in Star Direct where the Wisconsin Supreme Court seems to have interpreted the statute in a way the legislature would likely have found surprising.

Illegality is one area where legislation and contract law intersect in ways which are sometimes surprising. If legislation makes activity illegal, its it always clear how courts should deal with the illegality in the context of contracting? The Karpinski case raises this question. The court in Wagenseller seems to think that some, but not all, failures to breach the criminal law would give rise to a bad faith termination of employment.

Lake River turned up in a number of answers, surprisingly, as it is not a case involving a conflict between courts and legislatures.