Memo on Fall 2018 Contracts Exam

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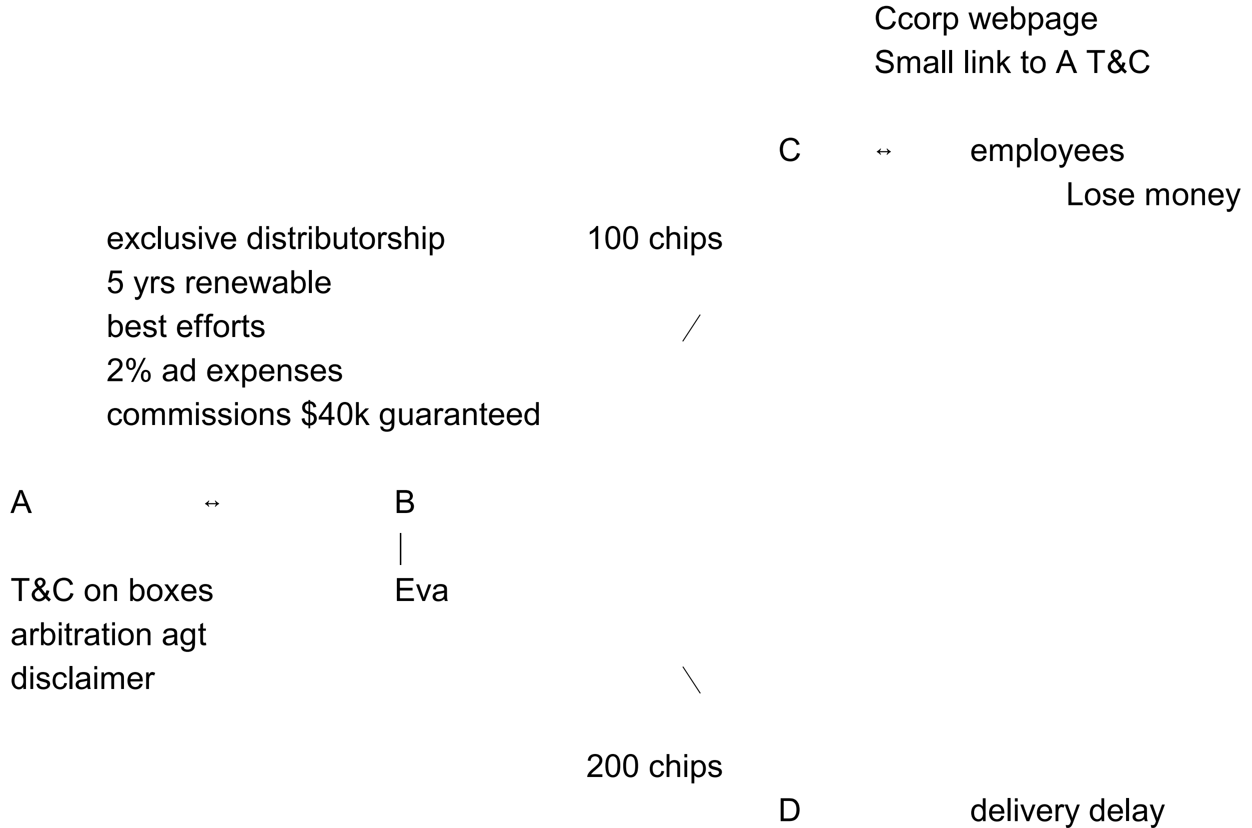
General Comments

Do not write “this is similar to [case name]” without explaining why. This is an unsubstantiated assertion rather than an analytical argument. You should aim to explain your thinking. And try to make sure that the cases you cite are cases that are relevant to your argument because of what they tell us about relevant legal rules, and not because there are merely some factual similarities between the case and the hypo.

Section A



1. Alphacorp and Betacorp: discuss the contract law issues relating to the exclusive distribution agreement between Alphacorp and Betacorp, including issues relating to Alphacorp's termination of the agreement. (20 points)

The exclusive distribution agreement is an arrangement which mixes goods and services: B is to arrange sales of A's microchips. We do not know if B is buying microchips from A to sell on to other purchasers or merely arranging sales from A to purchasers. We saw at the beginning of the casebook that lawyers have argued that franchise agreements including sales of goods should be considered under UCC Art. 2 in order to invoke the, perhaps more favorable, duty of good faith under Art 2. The remedies provided for in Art 2 are perhaps not ideally suited to the situation here where a number of the issues relate to the proper interpretation of the agreement and to the duty of good faith and fair dealing which is an implied duty generally in contracts.

Under the agreement, B is to use its best efforts to sell the microchips. Although B has made "significant efforts" including spending money in Arcadia on advertising, B has not been very successful. The microchips are a new product, newly being marketed in Arcadia. And, at the same time as we are told A is unhappy we also learn that A has found another firm prepared to be a distributor of the microchips for a lower commission. This raises the possibility that A's termination of the contract is not because of a lack of best efforts by B but to improve its own profits from sales of microchips. There is also a possible issue of breach by B in failing to ensure A's Terms and Conditions are communicated to end users of the microchips.

If B has failed to use best efforts and this is a material breach A may be entitled to terminate B's distributorship without paying damages (although it should compensate B for any commissions B has earned). If B has not failed to use best efforts it would seem that A's attempt to terminate is a breach of contract which would require A to compensate B. We do not know if there is a provision in the agreement dealing with termination, and we have no information as to whether Arcadia has a statute like the Wisconsin Fair Dealership Act (the Walgreens case). But terminating the agreement in order to avoid paying B and to get a better deal with another distributor would seem to be a breach of the implied duty of good faith (Market Street Associates).

If A is in breach, B may want to ask for specific performance of the contract by A. Here it would make sense to refer to Copylease. We know there isn't a developed market for the microchips, in contrast to the Memorex toner, and there do seem to be other manufacturers of microchips around, so the circumstances in the hypo are a bit different.

If A is in breach and specific performance is not available B can claim expectation damages by reference to the contract. But there are some ambiguities

here. We are told that A proposes to charge B $30,000 for advertising expenses and deduct this amount from the $40,000 guaranteed payment. It is not clear from the question whether this is the way the contract is supposed to work. Is the $40,000 a guarantee of payments after the advertising expenses are taken into account, or not? [There's an issue relating to pre-contractual disclosure here, perhaps (which I said was outside the scope of the exam)]. We do not know if $30,000 is in fact the amount which would represent 2% of A's national advertising costs. If the amount B is owed is $10,000 then this would seem not to be unreasonable. If the $40,000 is owed even where B sells very few microchips and A has substantial advertising expenses then there is an issue of whether the $40,000 is an excessively large amount. This is like the minimum quantity guarantee in Lake River, which we saw analyzed as an issue of liquidated damages/penalty (and see the UCC provision in UCC §2-718(1)).

Some answers discussed the guaranteed payment of $40,000 as if it involved the same issues as Hawkins v McGee, which is a warranty case. It is true that in that case the idea that a 100% good or perfect hand is guaranteed but that is a bit different from what is happening here. In the hypo the guarantee is more like the minimum quantity guarantee in Lake River.

In terms of expectation damages there would be a claim to damages for the entire term of the agreement, not just for the current year. We don't know what advertising expenses would be in future years or how much B would sell. But a possible calculation would be based on the $40,000 minimum guarantee. This would be subject to mitigation of damages and B should receive the net present value of 5 x $40,000 less mitigation.

A number of answers ignored an expectation damages analysis and jumped straight into reliance damages. I am not clear why this would be. There may be some ambiguities with respect to the financial provisions but for B there is the guaranteed amount. For A there is the contribution to advertising expenses (specified in the contract, thus expectation) and possible lost profits. A's Terms and Conditions limit A's liability for lost profits relating to use of the microchips but do not limit B's liability with respect to A's lost profits (e.g. with respect to a failure to use best efforts).

Some answers wanted to analyze B's claims under Paffhausen v Balano on the basis of quantum meruit. The contract may not be as beneficial to A as it hoped (and we don't have any information about whether the microchips are selling better anywhere else. B has the benefit of the guaranteed minimum amount (if valid) so this isn't obviously a losing contract for B. If B merely gets the contractual commissions earned (and not the guaranteed minimum) B may look for a different method of calculating damages, especially if B is treated as owing the advertising expenses. If A's

termination is the sort of material breach that would entitle B to terminate the agreement B might seek reliance damages. A restitutionary remedy seems not to be very useful if A could find someone else to act as a distributor at a lower cost to A. A number of answers used the idea of "unjust enrichment" seemingly as the basis for a damages claim that could generally be invoked.

Some answers discussed the applicability of the limitation of damages provision to B. But the provision limits A's liability "related to, in connection with, or otherwise resulting from any use of the microchips." What B is doing here does not seem related to use of the microchips. And even the damages B might incur to D relating to the delay in delivery does not seem to be limited by this language.

2. Alphacorp, Betacorp, Ccorp and Ccorp employees: discuss the contract law issues relating to Becorp's sale of the Alphacorp microchips to Ccorp, and the implantation of the microchips into Ccorp employees. (20 points)

The sale of the microchips to C is a sale of moveable goods under UCC Art. 2. The sale is to C, and we do not know if the sale is between A and C (concluded by B as agent for A) or B and C. We are not given any indication that the microchips are sold to C's employees. So, in terms of contractual relationships there is a contractual relationship between a or B and C and between C and C's employees (although we know that at will employment is often characterized as not contractual). It is not clear whether there is any contract between A and C's employees (the facts relating to the web pages would be relevant to this question).

There is a defect in the microchips, in that they deduct money from the employees' bank accounts. A number of answers suggested that there is also a defect in the goods because of the missing Terms and Conditions on some of the packaging. These answers wanted to analyze the applicability of UCC §§ 2-606 and 2-608 to the packaging defect. I don't think it really makes sense to see this defective packaging as an indication that the goods were non-conforming as there is no hint in the facts that C has any interest in the Terms and Conditions. Even less likely is an argument about substantial impairment of value. The question suggests C was happy to go along with implanting the microchips in its employees. The only suggestion of a problem is with respect to the payments issues. This is an example of a late developing issue with respect to the goods. The employees may want to have the microchips removed as a result of the issues. This may involve a substantial impairment of value to C if the employees are unhappy about the payments issues. Perhaps if C acts to revoke acceptance as soon as it learns about the issues it would have the right to do so. If C revokes acceptance the remedies specified in UCC § 2-711 come into play. Here we

would focus on the difference between the contract price and either cover price or market price plus any incidental and consequential damages. The losses caused to the employees would seem to be either incidental or consequential damages under the UCC, both of which are excluded by the limitation of liability provision in A's Terms and Conditions. C also has a right to claim damages for the difference in value between the microchips C was supposed to get and the defective microchips C received. Under UCC § 2-714 the buyer "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" including incidental and consequential damages "in a proper case." Does this provision allow for an interpretation of damages with respect to the unauthorized payments which would treat them as other than incidental or consequential damages ? This is unclear.

There are some issues here with respect to the Terms and Conditions and whether they are to be treated as binding on C and/or on C's employees. With respect to C, the Terms and Conditions are on the packaging of the microchips (each package of 10 microchips is meant to have a "notice of Terms and Conditions, which include an arbitration agreement with a class action waiver and a limitation of liability provision "). We do not know if C sees these Terms and Conditions before receiving the packages so here whether the notice is on the box (Dye v Tamko) or inside the box (ProCD v Zeidenberg, Hill v Gateway) should not make much difference. Although the cases we read suggested the Terms and Conditions should be binding notes in the Casebook tell us that other courts have seen this issue differently. The fact that some boxes do not have the notices should not make much difference as the facts in the hypo do not state that none of the boxes has the Terms and Conditions. It is likely the Terms and Conditions will bind C. Also, note that a failure to communicate the Terms and Conditions to C is a breach of B's obligations to A.

With respect to C's announcement to its employees that if they do not agree to be microchipped they will be fired we can consider whether this amounts to duress as in Mitchell v CC Sanitation, and which could constitute the basis that the employees should not be bound by the Terms and Conditions. In the context of non-compete agreements Courts have found that not terminating the employment of an at will employee can constitute valid consideration for the employee's promise not to compete with the employer, and this type of situation will not generally be seen as duress. But Mitchell was an example of a case where a threat to do something one has a legal right to do (fire an at will employee) can be duress. There's an issue whether requiring an employee to have a microchip implanted is something the employer has a legal right to do, or might be seen as a violation of public policy *(e.g. Wagenseller) : requiring this of

an employee who has religious objections could be prohibited discrimination. And the implantation of the chips is different from a dress code, or from requiring an employee to carry a company ID.

We are not told that the employees see the packaging of the microchips. They are asked to sign up to receive the microchips on C's webpage which "does have a very small link to an Alphacorp webpage but there is nothing on the Ccorp webpage to indicate that Ccorp employees should click on the link or that they are agreeing to any relationship with Ccorp by agreeing to be implanted with the microchips." This leads to a discussion of Meyer v Uber and Cullinane v Uber which apply the test in Specht v Netscape (was there reasonably conspicuous notice of the terms and unambiguous assent to them). There's a good argument that there was neither reasonably conspicuous notice or unambiguous assent here. But if C's employees don't have a contractual relationship with A they will have to focus on a non-contract basis for a claim against A, such as a product liability claim (which is beyond the scope of this course, and also the question, which asks about contract law issues.)

3. Alphacorp, Betacorp, Eva and Dcorp: dicuss the contract law issues relating to Betacorp's contract to sell Alphacorp microchips to Dcorp. (20 points)

The sale of the microchips to D is a sale of moveable goods under UCC Art. 2. The sale is to D, and we do not know if the sale is between A and D (concluded by B as agent for A) or B and D. The limitation of liability provision in A's Terms and Conditions relates to A's liability and not to B's. Even if the contract is between A and D there are some reasons to think that the limitation of liability does not apply based on these facts: (1) the wording of the limitation of liability refers to liability with respect to use of the microchips and D would be complaining of liability arising out of non-delivery rather than use; and (2) D does not receive the Terms and Conditions on the boxes (although we do not know if B communicated the Terms and Conditions at the time of the agreement to sell the microchips to D).

If the contract is between B and D there is no issue as to the limitation of liability based on the facts given. D wishes to claim damages with respect to losses on the contracts with the hospitals because the failure to deliver the microchips on time caused D to breach its own contractual obligations. Here D would seek a remedy based on UCC §2-711 (recovery of "so much of the price as has been paid") and UCC § 2-712 (cover) or 2-713 (market price) for any difference between cover or market price and contract prices together with any incidental or consequential damages. UCC §2-715 defines consequential damages as "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 facts given state that D explained to Eva (as B's agent) that delays would cause D serious problems including potential financial liability because of the contractual obligations D had to hospitals. The fact that D is considering an alternate supplier suggests that there may be another firm which could have met D's needs at the time of contracting. We are not told there was any attempt to limit B's liability for consequential damages here.

Because this is a sale of goods transaction it is correct to focus on the UCC language rather than answer the question based on Hadley v Baxendale. Some answers just cited Hadley v Baxendale, others cited the case and the UCC.

A number of answers cited Security Stove. But this is a reliance damages case, and not a consequential damages case, so it is not relevant to the issues raised in this question. Here it is clear that D stands to lose money on actual contracts if the microchips are not delivered on time, so the reasons for looking to reliance damages in Security Stove are inapplicable. And the question states that D "does not receive the microchips it ordered in time to produce the medical devices it had. contracted to sell to hospitals." There is a question as to whether D could have prevented any loss by cover or otherwise. As to cover we do not know if D could obtain other microchips in time to meet its contractual obligations at the point where it learned of the delay in delivery of A's microchips.

A number of answers considered whether Eva's role in the story raised issues with respect to promissory estoppel, citing Hoffmann v Red Owl. But here there are no facts in the question to raise doubts as to whether there is in fact a contract to sell the microchips to D (although the question does not specifically state they have a binding contract for the sale and purchase of microchips, we know B wants to sell microchips and the question refers to D having ordered microchips). If there is a contract promissory estoppel does not apply. And the fact that there is an agent in the story does not mean that we think about promissory estoppel. It just so happened that in Hoffmann there was an agent who was significant in the events which ended up giving rise to liability for Red Owl.

Section B

Three people answered both Section B questions despite the clear instructions to answer one question, instructions which were consistent with those on the past exams I provided. Many more people wrote about question 2 than about question 1. Excluding those who answered both questions, about 1/6 of those taking the exam answered question 1.

There were some very sophisticated answers to these questions, which made interesting arguments and effectively used the course materials.

I am setting out here some of my own thinking about the questions.

1. In ProCD v Zeidenberg, Judge Easterbrook said that a decision which might help Zeidenberg could have the effect of making consumers worse off in future. How do you think the public interest in achieving justice in a particular case should be balanced with the public interest in identifying a rule of law that will do justice in general?

The question suggests that there is a public interest both in achieving justice in individual cases and in identifying a rule of law that will do justice in general, and asks how these interests should be balanced. The question begins with a reference to Judge Easterbrook's suggestion that it would be wrong for the court to act to help out Zeidenberg because this would end up hurting consumers in general. In the context of that case this could be because consumers won't be given access to such products at a price they can afford. During the semester we thought about this type of issue with respect to some of the decisions we read. If we think about Hoffmann v Red Owl, for example, we would expect franchisors to be much more careful about excluding possibilities of promissory estoppel claims after the decision in the case. Similarly we know that franchsie agreements typically include liquidated damages provisions in favor of the franchisor that are upheld even though they may not in fact truly reflect the damages the franchisor actually incurs. Businesses with access to sophisticated legal advice will react to legal risks by finding ways to control them, and the controls may end up harming the interests of consumers and employees. In some senses the pervasiveness of mandatory arbitration is an example of this phenomenon.

Answers to this question could take a range of different approaches. One might be to focus on the way Judges see their role. Posner and Easterbrook seem in the decisions we read to characterize what they are doing as establishing general rules, rather than deciding the particular cases before them. And we can see Hadley v Baxendale and Balfour v Balfour as similar in that in both cases the Court seems to be concerned with establishing general rules (to limit consequential damages in a

changing world, to introduce a new doctrinal requirement of intention to create legal relations). And, in a sense, as common law is a system based on precedent, court decisions tend to have the characteristics of rules. This, of course, is what worries Easterbrook. Focusing on the specifics of the injustice of a particular case might lead to the development of the wrong rules.

2. Is there too much freedom of contract? Discuss this question with examples from the course materials.

Many answers to this question focused not on what the question is asking but on a contrast between enforcing contracts and focusing on fairness. Although I have in the past asked questions that contrasted fairness and efficiency as goals of contract law I think there is a good argument that enforcing contracts is often fair, and that fairness and efficiency may go together.

The first issue here I think is to discuss what freedom of contract means. We noted during the semester that it is often taken to include freedom to contract and freedom from contract. One should generally be allowed to enter into contracts, and one should not be subject to contractual liability unless there is actually a contract. Essentially the idea is that contracting is about voluntary transactions the parties intend to be binding.

Because the question asks whether there is too much freedom of contract I am not sure whether the cases which raise issues about freedom from contract are really relevant. I suppose they could be relevant if you think that the risks of being subject to liability on a promissory estoppel theory are not very great. And cases like Ricketts v Scothorn are arguably cases where the parties intended a binding transaction but failed to get the formalities right. We could argue that where promissory estoppel plugs a formalities gap it its really consistent with an idea of freedom of contract. McIntosh v Murphy might not seem to be as good an example here as Ricketts v Scothorn.

Based on the idea that contracting is about voluntary transactions, not enforcing contracts on the basis that it does not make sense to see them as being voluntarily entered into is not a problem for the idea of freedom of contract. So, fraud and duress are not really problematic because transactions procured by fraud or duress are not really voluntary. Issues of lack of capacity are also relevant to the idea of voluntariness. And arguably the liquidated damages/penalty issue and the idea of only enforcing reasonable non-competes are also about voluntariness. They can be seen as specific examples of a reticence to enforce contracts resulting from an inequality in bargaining position (note that Posner in Lake River would enforce the liquidated dames provision because the parties are sophisticated).

As to whether there is too much freedom of contract, I think that the fact that there are public policy limitations on what people can contract about, and that sometimes those limitations are not very clear, is a good argument for the claim that there is not too much freedom of contract. But the fact that courts enforce many contracts that are not in any real sense voluntarily entered into (for example the cases involving arbitration agreements with class action waivers) is an argument for there being too much freedom of contract (e.g. the Margaret Radin article). And given that these agreements may end up undermining our ability to make public policy effective (e.g. Meyer v Uber or Meyer v Kalanick is a case where the fact that the antitrust claims cannot be brought as a class action in court means that a possibility of enforcing antitrust law is removed) they challenge what I think is the strongest argument for our not having too much freedom of contract.