Memo on Fall 2019 Contracts Exam, Section A

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Question 1. Carter: discuss the contract law issues relating to Betta's employment of Carter, including his potential move to a competitor of Betta's (15 points).

There is some overlap in the issues relating to C and to F and G. BD treats the interns as employees and requires them to sign the employee contract. There are also some distinctions between the situations of C on the one hand, and F and G on the other (although G proposes to join C in his move to BD's competitor). In this memo I address the general issues relating to the validity of the employment contract provisions in the comments on the first question and issues relating to applicability and specific issues relating to validity in comments on both questions.

C receives consideration for entering into the contract: "[w]hen he signed the contract he also received a pay raise and his contract specified that the term of the contract was for one year, and was renewable for future one year terms." And the fact that he signed the contract shows that it was in writing (contracts that cannot be performed within a year must be in writing under the Statute of Frauds).

When C tells other employees that they must sign the agreement to keep their jobs, BD's refraining from terminating the employees is likely consideration for the confidentiality and non-compete covenants. Mitchell v CC Sanitation suggests that threatening to fire an at will employee may sometimes constitute duress, but the facts there were different.

The obligation with respect to confidentiality is the most readily enforceable type of non-compete provision. Here the question suggests the provision states that "BD employees must keep all details they learn about Betta and Betta Designs confidential." This is a broad provision and does not seem to be limited to information about B and BD designs learned during the course of employment (although the employment is the most likely context in fact for learning information about BD).

The contract also contains a non-compete provision which prohibits employees from working for any other clothing designer in Arcadia for 5 years, whatever the reason for the ending of the employment. From Fullerton Lumber we know that unreasonable non-compete covenants are unenforceable. Here the time period is quite long, and the geographic coverage is the entire state rather than a more limited territorial range. Fullerton Lumber contains some discussion of General Bronze which involved a non-compete with broader geographic reach than the court found to be appropriate. We also know that Florida Statutes § 542.335 provides that non-competes must be justified by legitimate business interests and presumes that non-competes which constrain employees for more than 2 years are presumed to be unreasonable, although 5 years' or less protection for trade secrets is presumed to be reasonable. B's work is described as unusual in the question, so some protection seems appropriate (generally there seems to be some basis for thinking that what B wants to protect is her own unusual work) but there is a risk that the non-compete here would be found to be unreasonable (with respect to term and territory). We don't have enough information to do more than

identify the risks here for BD and for C.

C proposes to go to work for a competitor of BD which has an office in Arcadia but also has offices in Urbania. C may be able to go to work for the competitor in Urbania. Does the fact of offices outside Arcadia mean that the competitor is not a clothing designer in Arcadia for the purposes of the non-compete (a question of interpretation of the contract)? If the provision must be interpreted as covering C's work for the competitor in Urbania, then it seems that it is less reasonable than if it does not cover this work.

The employment contract provides for a remedy in damages for breach "in an amount of five times [the employee's] annual salary in the year after leaving employment with BD." The remedy seems to cover either a breach of the duty of confidentiality or of the non-compete. Lake River distinguishes between valid liquidated damages provisions and invalid penalties, a distinction which takes account of the need for a liquidated damages provision on the basis that damages will be difficult to assess and whether the provision involves a reasonable estimate of damages. On the blog I noted some cases involving franchises where provisions for 3 times average franchise fees have been held to be valid, and we noted delay payments in construction contracts. In the franchise context a franchisor who loses a franchisee will also lose the franchise fees for a period of time so such a provision makes sense. Here, although it may be that it will be difficult to calculate damages from breach of these contractual provisions (so having some sort of liquidated damages provision could seem appropriate) a liquidated damages provision must not produce an unreasonably high level of damages. Here it is not clear that there is any connection at all between the loss BD will suffer in the event of an employee breaching the confidentiality or non-compete provisions and the employee's salary in the new position. In Lake River a provision that produced damages invariant to the amount of loss was invalid. And this formula seems to have the same problem (in contrast to the franchise multiple of fees provisions). The situation might be different if employees of clothing designers are always paid an amount that reflects their actual value to the business, where it might be argued that the value that C gives to the new employer is value taken from BD.

Question 2. Felipe and Gus: discuss the contract law issues relating to the interns' relationships with Betta Designs (15 points).

F and G, as interns, are in a different relation to BD than the regular employees. BD has a contract with AIF, rather than with individual interns, and the AIF contract "provided that the best of the interns would be offered permanent positions with Betta Designs." F is the AIF student who has obtained the highest exam results at AIF in its 25 year history, thus is arguably the, or one of the, best AIF interns at BD. There is an argument that the best interns are the ones that perform best while at BD rather than those with the best exam results. But the question states that in 3 years BD has not offered permanent employment to a single intern from AIF. Thus BD has obtained work from the interns without providing much benefit to them. The contract between BD and AIF may be an illusory contract (AIF encouraging students to work as interns for BD but deriving no benefit in return).

If the interns are prevented from using any knowledge they learn while at BD by the confidentiality agreement, prohibited from working from any competitors of BD in Arcadia, and have no realistic chance of employment with BD this is a very one-sided relationship which raises the question whether the confidentiality and non-compete provisions should be binding on F and G. The argument would be that whereas they are limiting their freedom of action and working for BD, BD is giving them nothing in return: it is an illusory contract with no consideration and therefore not binding on the interns.

If the contract is not seen as an illusory contract it makes sense to think about what contract issues arise with respect to F and G.

As to G, the issues about going to work with C at BD's competitor are the same as C's. But we are also told that G overheard a conversation between E and B about the illegal multicorn wool and that he then informed the Arcadian Examiner newspaper of this. The leak of this story seems to be linked to the AAM's decision to terminate its relationship with B. Thus, G's seeming breach of the contract seems to have harmed B. Even if the confidentiality provision seems broadly drafted it seems that G's overhearing of the conversation does have some connection to his work for BD so the conduct seems to be caught by the provision. So G has breached the confidentiality provision of the agreement and the damages provision of the contract comes into play (perhaps twice as there may be 2 breaches here, of confidentiality and the non-compete). That is discussed under question 1 above (concluding the damages provision is likely to be an invalid penalty). Whisteblower statutes do protect whistleblowers from being terminated, similar to the public polcy protections from termination under cases like Wagenseller. But here G is reporting the issues to a newspaper rather than to enforcement authorities, and the issue relates tro liability in damages rather than termination.

As to F, the BD commitment to hire permanently the best interns is made to AIF rather than to the interns directly. F might want to argue that he should be seen as a third party beneficiary of this contract as the best student (according to one metric) AIF has produced. We have no real basis in the facts given (or in the materials we studied) for thinking that G would be able to make this sort of argument successfully. But F has a stronger argument based on specific representations C made to F at a time when F had "a number of other attractive internship opportunities." The question states that C told F in a number of conversations "how unusual the training at Betta Designs would be, what an exciting place it would be to work, and how Felipe was exactly the sort of person Betta was looking to recruit to help her build the future of the business." Is this the sort of promise which C would reasonably expect F to rely on and where F suffered detrimental reliance (e.g. Hoffmann v Red Owl)? It is possible.

Question 3. Halle and the Arcadian Art Museum: discuss the contract law issues relating to Betta's contracts with Halle and the AAM (30 points).

There is a contract between H and BD for H to "supply all of Betta Designs' requirements of the highest quality multicorn wool for a period of three years." Multicorn wool is a moveable good under the UCC (and the contract involves a sale of this moveable good) therefore UCC Article 2 applies.

There are two problems with H's performance of the contract: (1) it is illegal for H to sell

this wool because it comes from farmed multicorns (" It is illegal to farm multicorns in Arcadia, and it is also illegal to sell products manufactured from the wool of illegally farmed multicorns in Arcadia.") and it is not as beautiful as it would be if it was from multicorns from the mountains ("Multicorn wool produced by unhappy multicorns is not quite as beautiful as multicorn wool from happy multicorns.") Sweaters produced using this wool are not as beautiful and are not selling as well. The illegality leads to cancellation of AAM's contract with B.

The "highest quality" multicorn wool is a contractual warranty (Hawkins v McGee). Although there may be some ambiguity as to what the term means, it seems likely that the wool provided by H to B should not be seen as of the highest quality (potential purchasers are not buying the sweaters). In addition, although the facts do not specify that the wool H is to supply is required under the contract to be able to be legally sold (and the facts say the contract price was favorable, raising some questions) there are implied covenants of fitness for purpose and merchantable quality under the UCC. If it is illegal to sell farmed multicorn wool this suggests that the sale of sweaters made from illegally farmed multicorn wool is also illegal. Thus H's sale of the wool to B involves not just a breach of the law by H but also a breach of the law by B, and reputational harm (illustrated by the termination of the AAM contract, although we noted with respect to Parker v 20th Century Fox that it would be difficult to claim contract damages with respect to such harm).

If B had realized the wool did not conform to the contractual specification B could have rejected the wool, or revoked acceptance (Colonial Dodge) but it seems that this did not happen. BD would be able in future to reject non-compliant wool. With respect to the accepted wool, BD has a remedy under UCC § 2-714 for "the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable" reflecting "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" and including incidental and consequential damages in a proper case. The facts show lost profits from lost sales of sweaters to customers (although there could be an issue as to how many sweaters BD would have sold had the wool been as specified in the contract (i.e. are these damages speculative rather than being able to be established with reasonable certainty)) and consequential damages from the terminated AAM contract. In order to claim consequential damages with respect to this contract I think that knowledge that the farmed multicorn wool is illegal should be enough to get over the H having reason to know of B's general or particular requirements and needs issue. B's problems with the AAM contract relate to B's use of the illegal multicorn wool and H has to know that use of illegal multicorn wool could cause problems for B. B does, however have a duty to mitigate: under UCC §2-715 recoverable consequential damages are those "which could not reasonably be prevented by cover or otherwise."

AAM contracted to have B as an artist in residence for two months for $500,000, subject to AAM's right to terminate the contract at any time for any reason on payment of $50,000 to B. Because of B's issues with the illegal multicorn wool, AAM terminates the relationship and says it should not have to pay B the $50,000 because of the harm

to its reputation. The relationship is an at will relationship subject to AAM's obligation to pay B the $50,000, but there does not seem to be any basis in the facts for B to challenge the termination, because the contract clearly provides for AAM's right to terminate subject to payment. Wagenseller discusses the operation of the implied duty of good faith in the context of at will employment, showing that terminating an employee to avoid paying sums due would be a breach of this duty. Here AAM wants to argue that withholding the payment is appropriate given that its relationship with B has harmed its reputation. But we are told of no relevant contractual provision that would justify this action. If AAM could point to a breach of contract by B that would entitle AAM to damages, this would be a basis for a reduction in the amount payable to B, although damage to reputation would be difficult to claim in a contracts case (and, in any case, terminating the relationship should function as a mitigation of damages, especially if public announcements can be made arguing that AAM had no idea about the illegality).

If we analyze the $50,000 as a liquidated damages provision, the fact that B has incurred expenses in anticipation of performance would be relevant to assessing whether this would be an unreasonably large amount of damages.

Comments on the answers:

A number of people wanted to analyze whether the contract between H and B was an illegal contract. Some suggested that B might want to argue it was. But if anyone wanted to make this argument it would be H in order to avoid potential liability under the contract, and the facts suggest that B is unaware of the illegality, although H is not. H should not be able to benefit from her own illegal acts. As I wrote above, I think the illegality here is relevant as a breach of contract by H, so the illegality is different from the cases we read. It is a contract for the sale of goods which involves 1 party in doing something which is illegal where the other party did not know of the illegality in advance.