

CONTRACTS FINAL EXAMINATION
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Santa Barbara/Ventura Colleges of Law
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QUESTION 1

Each year, the Great American Cross-Country Bicycle Race is held. The race starts in Los Angeles, California and ends in New York City. The promoters of the race, "Mellow Velo, Inc.," offer a first prize of \$100,000 to the rider who is the first to reach the finish line in New York City. They also offer a \$20,000 bonus for the first racer to reach Denver, Colorado and another \$20,000 bonus for the first racer to reach Chicago, Illinois.

Jock Cardio is a professional bicycle racer who has entered this year's race and is determined to win. The record time for finishing the race is six days. Riders typically spend 21 hours a day on the bike. Jock has purchased three bicycles, hired a three-person support crew and rented an RV for purposes of competing in the race. The Race starts on July 4th and Jock indeed is one of the competitors getting off to a fast start. He is the first competitor to reach both Denver and Chicago. On July 8th, when Jock is about two-hours east of Chicago and heading towards New York City, Mellow Velo determines that due to unforeseen financial difficulties, they will not be financially able to award any of the prize money, including bonuses to the competitors. They have no bond nor insurance to cover this contingency. They promptly notify each competitor by calling their respective support crew and telling them that they will be unable to pay any of the prize money and that they are canceling the race. Jock's team manager promptly relays the message to him. At this point, Jock has expended \$15,000 in costs to compete in the race. Jock expects to spend another \$2,500 each day he continues in the race in expenses. Rather than immediately cease competing Jock decides to forge ahead to New York City. All other competitors abandon the race. Two days later Jock crosses what would have been the finish line in Times Square.

Jock feels he is entitled to the \$100,000 first prize as well as the bonus money for being the first competitor to reach Denver and Chicago. Mellow Velo has refused to pay any portion of the prize money. Discuss fully whether or not Jock is legally entitled to an award of any compensation from Mellow Velo.

QUESTION 2

Moe was new to Stoogetown and needed a place to live. He particularly wanted to find an apartment that was no further than 10 blocks from his new place of employment, the Stoogetown Art Museum (SAM). Being new in town he had never actually been to his new place of employment, so he consulted a map to determine SAM's location. After pinpointing SAM on the map he then set out to locate an apartment. After diligently searching the classified ads he found what he believed to be the perfect apartment. He met with the landlord, Curly and decided to rent it. Curly produced a 36-page lease for Moe to sign. Rather than read the lease Moe decided to ask Curly a few questions. He told Curly he was the owner of a Great Dane and asked if pets were permitted. Curly told him that pets were okay. Moe went ahead and signed the one-year lease.

After taking possession of the premises Moe discovered that the map he had relied on was outdated and instead of being 10 blocks from SAM his new apartment was five miles away. Also, the day he discovered the true location of SAM, Curly sold the apartment building to Larry. The sale documents stated that all leases were transferred to the new owner Larry. That day Larry served Moe with a written notice advising Moe that he was in violation of the terms of the lease. In particular he said that dogs were not allowed. Moe then read for the first time the relevant clause of the lease which stated: "With the exception of rodents, hamsters and gerbils, no pets of any kind shall be permitted to occupy the premises." There was an additional clause of the lease which stated: "This written lease consisting of 36 pages constitutes the entire agreement of the parties. There are no other agreements or understandings or verbal representations with regard to the subject matter of this lease. Any party that says otherwise is a big fat liar. This writing may only be modified by another writing."

Can Moe be excused from the provisions of the lease? Discuss fully.

QUESTION 3

Jill, the owner of a vacant lot, hired Jack, a builder of custom homes, to build a custom home for her. Jill furnished the plans and specifications to Jack that Jack followed. The written contract of the parties provided that Jack was to be paid a total of \$1,000,000 for building the house to be paid as follows: \$250,000 upon pouring the foundation, \$250,000 upon completion of framing, \$250,000 upon completion of the house, and the remaining \$250,000 when Jill accepted occupancy and moved into the house. After the contract was duly signed by both parties, Jack went to work. He promptly poured the foundation and was paid the first \$250,000 installment. Framing the house proved to be problematical. Defects in the plans and specifications meant the house had to be reframed three times. When he completed framing the house for the third time Jack asked not only for the second installment but one half (\$125,000) of the third installment. Jill reluctantly agreed to pay this. Jack then proceeded to finish the house. When Jill went to inspect the finished house she determined that Jack had made many mistakes. Although nothing made the house uninhabitable, the quality of the finished workmanship did not meet Jill's taste or fancy. Jill refused to take occupancy or move into the house or to pay the balance owed on the \$1,000,000 total price.

Jack has sued Jill claiming the balance of the purchase price \$375,000 is owed to him. Jill has countersued, seeking the return of the \$625,000 she has already paid to Jack. Who should the court rule in favor of and how much money, if any, should the prevailing party be awarded? Discuss fully.

MODEL ANSWER TO QUESTION 1

What was promised to Jock? He was promised that if he was the first rider to reach Denver and Chicago he would receive \$20,000 in each case and if he was the first rider to reach New York City, he would receive \$100,000. Did these promises constitute offers that could be accepted?

CONTRACT FORMATION – OFFER & ACCEPTANCE

An offer is a manifestation of willingness to enter into a bargain which creates in the offeree the power of acceptance. The promoters of the race communicated their willingness to pay prize money to the first person to reach the respective finishing points. Was the offer accepted? Acceptance is a manifestation of willingness to be bound by the terms of the offer made in the manner required or invited by the offeror. An offer may bargain for a return promise or a return performance. Here, Mello Velo did not merely seek a promise on the part of the offeree to be the first across the line, it only communicated its willingness to pay the prize to the racer who was actually first to cross the line. This is an offer that looks towards formation of a unilateral contract in that the promisee must completely perform the requested act in order to effectively accept.

Unilateral Contract

Jock completely performed two of the three requested acts. Being first to cross the lines in Denver and Chicago. Once Jock completely performed it was too late to withdraw or revoke the offer. Melo Velo purported to withdraw or the revoke the offer to pay the prize money with respect to New York City. The usual rule is that an offer can be revoked or withdrawn any time prior to acceptance. Of course Jock could only accept the offer of the \$100,000 prize by being the first to cross the line in New York City. However, in the case of offers looking towards the formation of a unilateral contract, when the offeree starts to perform in response to the offer, the offeror loses the power to withdraw or revoke and the offeree must be given a reasonable time to complete performance. Hence, a type of “option contract” is formed. (Rest.2d § 87) Jock was on a pace to finish the race at or near the previous record of six days so the offer to pay the reward was irrevocable for that period of time so that Jock’s crossing the line first in New York City entitled him to claim the prize money.

IMPOSSIBILITY & FRUSTRATION OF PURPOSE

Was Mellow Velo legally entitled to cancel the race because of their financial difficulties?

Performance may be excused when due to a supervening circumstance performance has become impracticable or the purpose of the contract has become frustrated. Impossibility or impracticability means that where performance depends upon the continued existence of a person, or thing, the perishing of that person or thing excuses performance. The more modern rule is to recognize the defense of impracticability where due to unforeseen

circumstances performance can only be completed at great or unreasonable cost. (Rest.2d § 261) The mere lack of monetary resources does not satisfy this requirement. The impossibility must lie in the inability of the thing to be done and not in the inability of the promisor to do it. I.e., impossibility must be objective and not subjective. Nor would frustration of purpose appear to excuse Mellow Velo's duty to perform. For frustration to be an excuse it must be total or substantial frustration. The fact that performance will not be as profitable as anticipated or even that the promisor will sustain a loss is not an excuse. Neither impossibility nor frustration will excuse the duty to perform.

DAMAGES FOR BREACH

Certainty

Having concluded that Mellow Velo breached the contract, what is Jock entitled by way of damages? The goal of contract damages is to place the non-breaching party in the position he would have been in had the contract been completely performed. This is known as protecting the expectation interest. Had Jock won the race he would have been entitled to the \$100,000 prize plus the two \$20,000 bonuses for being the first competitor to reach Denver and Chicago. He was in fact first to reach the two intermediate points but would he in fact have won the race? Clearly, that is not certain as the other competitors presumably dropped out when they heard that Mellow Velo withdrew the prize. Whether Jock would have won had the prize not been revoked is speculative. One of the limitations on contract damages is that damages must be established with reasonable certainty. Damages which are merely possible, or contingent cannot be recovered.

Avoidability

Although Jock is entitled to damages for the other party's breach, he cannot recover damages for those losses he could have avoided through his reasonable efforts. Once, he was informed that they would not pay the \$100,000 he should have ceased racing rather than pile up another \$2,500 a day in damages. Therefore he cannot claim his reliance damages of \$2,500 per day for the two days he continued to race after cancellation, because he should have made efforts to mitigate his damages. Jock's damages will be limited to \$40,000.

MODEL ANSWER TO QUESTION 2

Mistake May Curly avoid the lease on the grounds of mistake? The general rule is that a mistake by both parties which goes to the basis of the bargain is grounds for relief (mutual mistake). A mistake by only one of the parties (unilateral mistake) is not grounds for relief unless the nonmistaken party knew or should have known of the mistake or contributed to the creation of the mistake. Here, the facts show that the fact that Moe was mistaken about the proximity of the apartment to Moe's place of work was a misapprehension on the part of Moe and Moe only. There are no facts to indicate that the nonmistaken party Curly, knew or should have known of the mistake. Mistake is not a ground for relief based on these facts.

Duty to Read A party cannot avoid the terms of a contract on the ground that he failed to read it. A party who signs a contract without reading the terms is bound by the terms of the contract notwithstanding the fact that he did not read it. The only exceptions to this rule are when the party is induced to sign by a misrepresentation or in the case of adhesion contracts. Moe might be able to argue that Curly's statement that pets were okay was a statement that was not in accord with the facts and hence, a misrepresentation. However, this argument is not likely to succeed in light of Moe's failure to read.

Assignment Did the sale of the apartment building from Curly to Larry affect Moe's contractual rights? An assignment is a transfer of rights. Contract rights may be freely assigned. When Curly assigned Moe's lease, Moe then became duty bound to deal with Larry. However, Larry, as the assignee, now stands in the shoes of the assignor. Curly. That is, Larry takes the assignment subject to all of the claims or defenses that could have been asserted against Curly. This rule derives from the principle that an assignment cannot enlarge or create greater rights than those held by the original assigning party to the contract.

Parole Evidence Rule Whether Moe will be able to show that there were verbal assurances or promises that were made that conflict with the written terms of the contract depends upon the parole evidence rule. The parole evidence rule states that when the parties have reduced their agreement to final written form which they intend to be the complete embodiment of their agreement, extrinsic evidence of prior or contemporaneous agreements is inadmissible to vary or contradict the terms of the written agreement. Here, there is an integration clause which states that the contract is the complete agreement of the parties and that there are not other agreements. Although an integration clause is not dispositive of the issue of whether a contract was intended by the parties to be their full and complete agreement, it is strong evidence of that fact which a court will give weight to. Ultimately, whether an agreement was integrated is a question of the parties' intent. Assuming, that it was integrated, Moe will be unable to show the existence of a contract term at odds with those incorporated into the contract. The other factor that militates against Moe is the "no oral modification clause." Such clauses which prohibit verbal or oral alterations to a contract are normally given effect and are enforceable. Moe's only hope is to prove that he relied to his detriment on Curly's oral representation that pets are

okay and therefore Larry, who now stands in the shoes of Curly will be estopped or precluded from enforcing the no oral modification clause.

MODEL ANSWER TO QUESTION 3

Jack's right to be paid and Jill's duty to pay depends on whether the promises made by the respective parties were absolute or conditional.

Conditions A condition is an act or event, not certain to occur, the nonoccurrence of which affects a duty of performance. When the happening of an event, triggers or gives rise to a duty that has not yet arisen it is called a condition precedent. When the event discharges a duty that a party is already under it is called a condition subsequent. Jill promised to pay Jack certain sums of money at certain times, but only upon the happening or occurrence of certain conditions. The pouring of the foundation, the completion of the framing, the completion of the house, and Jill's acceptance of his work based upon her satisfaction.

Contract Modification Because framing the house proved more difficult than anticipated, Jack asked for an accelerated payment based upon unforeseen difficulties. Traditionally, modification of a contract had to be supported by additional consideration in order to get around the pre-existing duty rule (doing what one is already legally obligated to do is not consideration). However, the modern trend is to recognize contract modifications that are not supported by new consideration as long as the modification is made in good faith.

A condition that a party be satisfied can either relate to reasonable or objective satisfaction or personal or actual satisfaction. In questions of utility, objective of satisfaction will apply. In cases of subjective satisfaction, usually with respect to matters of taste fancy or judgment, the obligor may insist upon personal satisfaction and may do so as long as their dissatisfaction is in good faith and not a pretext for some other reason for rejecting the other party's performance. Furthermore, a party who hinders or prevents the occurrence of a condition cannot cite the failure of that condition as an excuse not to perform. Jill's unjustifiable failure to accept the house amounts to hindrance or prevention.

Substantial Performance A party that has substantially performed is entitled to the contract price minus deduction for the costs of remedying any defects. So even if the house failed to conform to what Jack originally promised she couldn't use that as an excuse to failing to pay what is due under the contract.