

CONTRACTS  
FINAL EXAMINATION  
Spring 2006  
Santa Barbara/Ventura Colleges of Law  
Instructor: Craig Smith

QUESTION 1

After four years of college and three and one-half years of law school, Moe had racked up quite a bit of debt in loans, \$100,000 to be precise. Soon after graduating, Moe began to receive dunning letters from Scrooge Finance to whom the money was owed. Moe did not dispute the fact that he owed the full \$100,000 but nevertheless, decided to negotiate with Scrooge to see if they would accept a lesser amount as full payment for the loans. Much to Moe's surprise, he was successful. Scrooge agreed that if Moe paid them \$50,000 within 30 days, they would forgive the balance of the remaining \$50,000 that was owed. The very next day Moe sent off a cashier's check to Scrooge for the \$50,000 together with a letter that set forth the understanding that Scrooge was accepting the \$50,000 as full payment and would not pursue him for the balance that was owed. He asked that Scrooge sign the letter and return it to him. Scrooge upon receiving the check promptly cashed it, signed Moe's letter and sent it back as requested. Three months later in exchange for \$15,000, Scrooge Finance transferred to Acme Collections the right to the balance of the \$50,000 that Moe had originally owed. They did not mention to Acme the fact that they had entered into the prior agreement with Moe about forgiving the balance owed.

Acme notified Moe that they had taken over efforts to collect the \$50,000 that had not been paid and that Moe should promptly pay the money to them or they would pursue all available legal remedies against Moe. Moe doesn't pay and predictably Acme sues him. Who should the court rule in favor of and why? Discuss fully.

## QUESTION 2

Bert was a builder of custom made bicycles and was very particular about the materials that he used. In order to insure a reliable supply of the aluminum tubing he used to fabricate the bicycle frames he builds he entered into and signed a formal written contract with Sesame Street Steel and Tubing that provided:

1. Bert would fulfill all of his needs in tubing from Sesame Street and Sesame Street alone.
2. All of the tubing Sesame Street would supply to Bert would be of the "Easton" brand.
3. The price of the tubing would be the wholesale price to Sesame Street on the day it received Bert's order plus a 15% markup.
4. The written contract could only be changed or modified by another written agreement signed by both parties.

Bert placed three orders without a problem. When he placed his fourth order he got a call from the sales manager at Sesame Street, who told him that due to a strike at the Easton plant they were unable to obtain Easton brand tubing, but they could, at the same price, sell him Reynolds brand tubing. Although Reynolds tubing was of the same quality as Easton tubing, Bert had an emotional attachment to Easton. But because he had many bicycle orders to fulfill he reluctantly agreed over the phone to accept the Reynolds tubing. Sesame Street then promptly shipped the tubing. Three days later Bert got a call from his chief competitor, Ernie. Ernie told him that he was going out of the bike building business and wanted to know if Bert would be interested in buying his entire supply of Easton tubing from him. Bert was overjoyed and readily agreed. When the shipment of Reynolds tubing arrived from Sesame Street, Bert opened the box to verify that it was in fact Reynolds tubing and then promptly shipped it back to Sesame Street informing them that he was rejecting it because it did not conform to the description in their written contract.

Sesame Street has sued Bert alleging that in refusing to accept and pay for the tubing Bert has breached their agreement. Discuss fully, who will prevail and why.

### QUESTION 3

Thelma, a wine salesperson, met Louise, a French winemaker, at an event promoting French wines. Thelma entertained Louise and introduced her to California wine merchants. After the event was over Thelma started thinking how she had long wanted to start her own wine distribution business. She contacted Louise and inquired about becoming her exclusive distributor for wines in California. After a short period of negotiation, Thelma and Louise signed a written agreement which contained the following terms.

- Thelma was given the exclusive right to be Louise's distributor of wines in California.
- Either party could terminate the exclusive distributorship agreement at any time if they became dissatisfied with the other party's performance.
- Thelma was to receive a commission of six percent of all of Louise's gross sales of wine in California.

Louise then quit her job as a wine salesperson for Gilbert Vintners, Inc.

During the first six months that Thelma performed her duties she worked very hard and invested her own capital in establishing her distributorship, however, wine sales were very much an "old boy network" and Thelma's performance was falling just below Louise's expectations. At about that same time, Louise was approached by Wino Distributors Inc., a large well-established distributor, who proposed to take over the exclusive distribution of Louise's wines in the California market for a mere two percent commission on gross sales. The offer was one that Louise could not refuse. She promptly terminated her agreement with Thelma and cited her dissatisfaction with Thelma's performance as the reason. The termination was effective immediately.

Thelma is convinced that if she had been given an additional six months to perform she could have exceeded Louise's expectations. Thelma files suit against Louise and claims breach of contract. Fully discuss which party should prevail and why.

MODEL ANSWER TO QUESTION 1

Acme's right to collect the \$50,000 debt from Moe turns on its status as an assignee. An **assignment** is a transfer of rights. Contract rights are ordinarily freely assignable. The exceptions to the free assignability of contract rights are where the assignment would increase materially the burden of the obligor, impair the value of the assignment, or jeopardize the obligor's chance of receiving a return performance. This assignment does not fall into any of these exceptions because Moe's duty to pay the debt is the same regardless of whether he pays the debt to the assignor or to someone to whom the right has been transferred.

Nevertheless, the assignee takes the assignment subject to all of the claims and defenses that can be asserted against it. The obligor (Moe) can assert against the assignee (Acme) any defenses he could have asserted against the assignor (Scrooge). That is why it is sometimes said that the assignee stands in **the shoes of the assignor**. The assignee acquires no greater rights against the obligor than the assignor had. If in fact, Moe had fully settled this debt with Scrooge and Scrooge had released him, the release of the debt could successfully be asserted against Acme as a defense. Scrooge's failure to disclose the fact that they had released Moe from the remainder of the debt was a **breach of the implied warranty of assignment**. Every assignment carries with it an implied promise that the assignor will not do anything to defeat or impair the value of the assignment and knows of no such fact that would do so. The fact that the debt being assigned had been previously compromised would mean that Moe could possibly assert that fact as a defense against the assignee. The assignee was entitled to know this information as it would have an affect on the value of the assignment.

To counter this defense Acme will argue that the settlement agreement between Moe and Scrooge was not supported by **consideration** and hence the promise by Scrooge to waive the balance of the debt was an unenforceable gratuitous promise. Consideration is any act or forbearance which is of benefit to the promisor or detriment to the promisee. It can consist of doing that which one is not obligated to do or refraining from doing that which one is privileged to do. The settlement agreement between Moe and Scrooge was not supported by consideration in that by promising to pay the \$50,000 and be released from the remainder of the debt Moe was only promising to do that which he was already

obliged to do. This is known as the **pre-existing duty rule**. To get around the pre-existing rule, a contract modification needs additional consideration to be enforceable. There is an exception to the rule of additional consideration for contracts for the sale of goods. UCC 2-209 requires no additional consideration to support the modification of a contract provided the modification is made in good faith. However, this is not a contract for the sale of goods and hence 2-209 would not apply. The modern trend is to enforce contract modifications made in good faith that lack additional consideration, but that usually involves the occurrence of some unexpected circumstance (e.g. hitting solid rock while excavating a cellar). Here there was no unexpected circumstance, Moe just doesn't feel like paying the full debt.

Because the modification of the contract was not supported by additional consideration Moe may not assert his settlement with Scrooge as a defense in an action by the assignee to collect the \$50,000.

## MODEL ANSWER TO QUESTION 2

Resolution of this question turns on the issues of requirements contracts, definiteness and getting around the "no oral modification" clause that was contained in the contract.

A **requirements contracts** is one in which one party promises to fulfill all of his needs for a particular product from one source and one source only. To be enforceable a promise must be supported by **consideration**. Consideration is any act or forbearance which is of benefit to the promisor or detriment to the promisee. In a requirements contract the consideration is found in the fact that the promisor is giving up the right to buy the goods in question from any other source. Furthermore, the UCC specifically provides that in a requirements contract "requirements" means such requirements that a party may in good faith need during the term of the contract. And of course, an implied term in every contract is the term of "good faith." Meaning that neither party may do anything to deprive the other party of the fruits of the contract. So, neither party may avoid a requirements contracts on the grounds that it is "illusory" i.e., conditioned on the whim of the promisor.

The contract in question does not quantify price in a dollar amount. At common law a contract had to be definite as to its material terms in order to be enforceable. **A contract which omitted price was too indefinite** and could be voided for being vague. However, where price is determined by a formula set in the contract that relies on external factors, it satisfies the requirement of being definite enough. Here, the contract relies on an external factor, wholesale price at time order is placed, plus a 15% markup.

The contract contained a **no oral modification clause**. This operates like a private statute of frauds and says that an agreement by the parties limiting the right to modify contracts to writings is enforceable. UCC 2-209 specifically recognizes the validity of no oral modification clauses. 2-209 also says that a no oral modification clause can be waived. Waiver of a no oral modification clause results when the parties verbally modify their contract and one of the parties changes their position to their detriment in reliance on the verbal modification. Here, Sesame Street relied on the verbal modification by promptly shipping the Reynolds tubing in

reliance on Bert's agreement to accept Reynolds tubing instead of Easton. Bert may argue that his consent to accept the Reynolds tubing was not supported by additional consideration. At common law, to avoid the preexisting duty rule (i.e., doing that which one was already obligated is not consideration) contract modifications needed additional consideration in order to be enforceable. However, this is a contract for the sale of goods and **UCC 2-209 provides that such contracts can be modified without the necessity of additional consideration** so long as the modification is made in good faith. Here, the strike was a circumstance beyond Sesame Street's control and provides sufficient reason for asking that a modification be assented to to change the brand of tubing.

Inability to obtain the Easton tubing due to the strike might possibly invoke the **defense of impracticability** on the part of Sesame Street. Where a contract contemplates the continued existence of a thing, the perishing of that thing will excuse the duty of performance. Here the contract contemplated the continuing existence of Easton brand tubing hence making it an implied term of the contract. Some courts recognize labor strikes as excusing performance under the impracticability doctrine. Bert would argue that the labor strike does not excuse the duty to perform because where performance contemplates the cooperation of third parties the inability to obtain that cooperation will not excuse the promisor.

Finally, Bert may himself be in breach of the contract. As mentioned before this is a requirements contract and in such a contract the consideration is in foregoing the right to buy the subject goods elsewhere. When Bert agreed to buy the tubing from Ernie he violated this clause of the contract.

### MODEL ANSWER TO QUESTION 3

Resolution of this question depends on whether Louise's right to terminate the contract was absolute or conditional and whether the condition that permitted termination, occurred.

A **condition** is an act or event, not certain to occur, which affects a duty of performance. When the act or event triggers a duty of performance that has not yet arisen, it is called a condition precedent. When the act or event discharges a presently existing duty it is called a condition subsequent. Here, Louise has made a promise to retain Thelma as her distributor of wines, but that promise is not absolute but rather is subject to termination upon the happening of an event, Louise's dissatisfaction with Thelma's performance. Hence the duty to employ is discharged upon the occurrence of a condition subsequent.

The fact that the occurrence or nonoccurrence of a condition is within the control of one of the parties does not make it any less of a condition. Here, the duty to continue to employ Thelma is subject to Louise's satisfaction with her. When a **condition of personal satisfaction** involves matters of **taste fancy or judgment**, the decision of the person whose satisfaction at issue is less likely to be second-guessed as it is deemed to be a **subjective standard**. When the issue relating to satisfaction deals with **commercial fitness or utility**, it is subject to more scrutiny by the courts as to whether a reasonable person in the shoes of the promisor would be **objectively dissatisfied**. In either event, the condition of satisfaction is subject to the **test of good faith**. The **dissatisfaction must be genuine** and not be a pretext for canceling the contract for reasons unrelated to the dissatisfaction. The condition involved here is more in the nature of commercial or business as opposed to artistic and is to be tested by an objective, reasonable person, standard.

Here, the facts show that Louise has mixed motives for terminating the distributorship. She is somewhat displeased by Thelma's performance and she has gotten a better offer. When a person terminates a contract for **reasons which partially relate to the occurrence or the nonoccurrence of a condition** it does not matter that there may be other reasons behind the termination which would not have permitted them to terminate.

The distributorship between the parties had no stated term. It could be terminated by either party upon the happening of a certain event, either party's dissatisfaction with the other's performance. However, in franchise agreements where no term is stated the contract can only be terminated on **reasonable advance notice** and after the franchisee has been given a **reasonable opportunity to recoup their investment**. The facts show that six months may not be a sufficient opportunity for one to establish oneself in the wine distributorship business. Furthermore, the law implies a condition that in exclusive franchise agreements there must be sufficient advance notice of termination to allow the franchisee the opportunity to wind up its affairs. The immediate termination of the agreement did not permit this.

Although Louise was within her rights in terminating the agreement because she was in part, genuinely dissatisfied with Thelma's performance, she breached the contract because she failed to give Thelma enough time to succeed and she definitely did not give Thelma sufficient advance notice of termination.