

CONTRACTS FINAL EXAMINATION
Santa Barbara/Ventura Colleges of Law
Instructor: Craig Smith
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QUESTION 1

17-year-old Moe was an aspiring rap artist. One night after playing a show at a club he was approached by Curly, the president of Bad Stooge Records, who had been in the audience and had seen the show. Curly was so impressed with Moe that he offered him a recording contract. Curly told Moe; "If you will agree to record five albums for my record label I'll pay you a million dollars a year as long as I like your music."

Moe replied; "Sounds great, I'd love to" and the two shook hands on it that night. The very next day, Moe went to work recording his first album for Bad Stooge Records. The album sold moderately well but not up to Curly's expectations. Bad publicity regarding rap artists in general had depressed the sales of all artists of the rap genre. Nine months after first agreeing to the arrangement Curly decided that it would simply not be profitable to continue to have Moe under contract. Curly notified Moe that he was canceling the contract.

Moe was furious. He rounded up his "crew" and went to pay Curly a visit. He told Curly that if he didn't keep his word he and his crew would see that Curly's reputation in the record business was ruined, and worse. It worked, Curly reluctantly agreed not to cancel the contract.

Moe then recorded a second album for Bad Stooge that was also moderately successful.

Three months after Moe turned 18 a competing company offered him a record deal. This deal was much more lucrative than the one he had with Bad Stooge Records paying him twice as much money. He agreed to the deal and informed Curly he would no longer be putting out records for him.

This event coincided with a sudden upswing in the sales of Moe's records. Curly realized that Moe was suddenly the hottest rap artist in the country. He decided that he didn't want to let Moe out of his contract.

Curly sues Moe in the local trial court for breaching their agreement.

Discuss fully, who will prevail and why.

QUESTION 2

Bonnie was the owner of a specialty coffee shop located in Ventura, California. She roasted her own beans that she purchased from Sam, a purveyor of wholesale coffee beans, located in Santa Barbara, California. When Bonnie needed beans she would call Sam to place an order. Sam would take the order by phone and then send a written acknowledgment form that listed the quantity of beans ordered and the price of the beans. On the back of the acknowledgment form a number of boilerplate terms were printed including one that stated, "in the event a dispute should arise between buyer and seller with respect to this purchase both parties shall be required to travel to New Delhi, India, where the dispute will be mediated by the Maharishi Mahesh Yogi."

On April 15th, Bonnie placed an order by phone, which Sam accepted. The next day he promptly sent out the usual acknowledgment form and promised to deliver the beans on or before May 15th. One day after doing so, he received a huge order from Gigantic Coffee Chain. He had never done business with them before but was eager to have them as a customer. Because he couldn't fulfill both their order as well as Bonnie's he promptly notified Bonnie, that he would not be delivering her order of coffee beans as he had promised.

Bonnie was furious. She called Sam on the phone and demanded that he deliver the beans on the delivery date at the contract price of \$6.00 per pound. Sam said he was sorry but that he was not going to deliver the beans. Bonnie thought about buying beans elsewhere but decided to wait and see if Sam would change his mind. By May 1st the price of beans had risen to \$7.00 per pound and Bonnie had still not made a substitute purchase. When May 15th came the price of coffee beans was \$7.50 per pound. Sam had still not delivered. Bonnie made a substitute purchase of beans at that price and then sued Sam.

Bonnie sues Sam in a California court of law. Discuss what rights Bonnie's Coffee has against Sam's Beans.

QUESTION 3

Bob and Gail had been dating for nearly 10 years. As the 10th anniversary of their courtship approached, Bob wanted to do something special. He decided he would surprise Gail and buy her the car of her dreams, a brand new Spitfire.

Bob went by himself to the car dealer's and selected a brand new pink Spitfire and directed the dealer to register it in Gail's name and to deliver it to Gail's home with a big red bow tied on top of it. Because Bob's heart was bigger than his bank account, he financed the car. He put \$1000 down and agreed to pay \$399 per month for the next four years. Because he bought the car during a special promotion, he was able to purchase an identical model for half price which he kept for himself and financed under a separate contract.

No sooner than she got the car, problems began to develop with it. The car would mysteriously stall at the most inconvenient of all times. Gail took it back to the dealer several times but they were unable to solve the problem. In the meantime, the car dealer sold the finance contract on Gail's car to a bank. Because the car was obviously a lemon, Bob stopped making payments on the car. He also stopped making payments on the car he kept for himself because it also was experiencing similar problems.

The stress over the problem with the car caused Bob and Gail to break up. Gail returned the car to the dealer and demanded that the price of the car that Bob paid be refunded to her. The bank sued Bob for failing to make the payments on the car. Bob also incurred \$50,000 in psychiatric bills from seeing a therapist who counseled him about the break up.

Gail sued the car dealer over the car that Bob gave to her. Bob sued the car dealer over the car he bought and kept for himself. The bank sued Bob for failing to pay on the contract it had purchased from the car dealer.

In the various lawsuits between the bank, the car dealer and Bob and Gail, discuss who will prevail and why.

MODEL ANSWER TO QUESTION 1

Was an enforceable contract formed? Was Curly's invitation to Moe to join his record label an offer?

An **offer** is a manifestation of willingness to enter into a bargain which creates in the offeree the power of acceptance.

When Curly said, if you'll record for my record label I'll pay you one million dollars a year, he communicated his willingness to enter into a contractual relationship with Moe.

Did Moe accept Curly's offer?

An **acceptance** is a manifestation of willingness to be bound by the terms of the offer made in the manner invited or required by the offer.

Moe's response of "I'd love to" accompanied by shaking hands with Curly could reasonably be taken by Curly as an outward indication by Moe of his willingness to agree to the proposal that he made. A contract was formed.

Defenses to formation.

Since Moe was only 17 years old, did he have the **capacity** to enter into a binding contract?

The contract of a minor other than for the necessities of life is voidable at the option of the minor. Unless the minor was legally obligated to support himself or others, an employment contract would not be a "necessary."

Since Moe was only 17 at the time, he could avoid the contract. However, the power of avoidance is only a "one way street" in that the adult party to the transaction cannot avoid the contract on the ground of the other party's minority.

Validity of oral contract. The general rule is that oral contracts are valid and enforceable. However, certain types of contracts are voidable unless evidenced by some note or memorandum signed by the party to be charged. The contracts that fall into this category are collectively known as the **Statute of Frauds**. Among those contracts are agreements that by their terms are incapable of being completely performed within one year. Although one might normally assume that it would take more than one year to record five albums, the one-year provision is viewed literally. Only if the express terms of the contract preclude the possibility of a complete performance within a year does the contract fall within the writing requirement of the Statute of Frauds. Here, because the possibility of completely performing within one year was left open, the contract didn't need to comply with the writing requirement of the Statute of Frauds in order to be enforceable.

Was Curly free to cancel the contract when sales did not meet his expectations? It depends on whether his promise was absolute or conditional?

A **condition** is an act or event, not certain to occur, the occurrence or nonoccurrence of which affects a duty of performance. His statement, that I'll pay you "as long as I like your music" conditions Curly's duty to perform on his own satisfaction. As long as he exercises the clause in good faith, that is for actual dissatisfaction and not as a pretext for some other reason, he is within his rights in terminating the contract.

Although Curly wanted to cancel the contract, was he dissuaded from doing so by an improper threat?

Coercion or duress can void a contract. **Duress** is the making of an improper threat. An improper threat is a threat that a person has no right to make. **Coercion** results when all of the surrounding circumstances operate to overcome a person's free will. Moe's threat's to "ruin Curly's reputation, or worse" made while Moe was accompanied by his "crew." If Curly can show that the free will of a reasonable person in his shoes would have been overcome by the atmosphere in which Moe threatened to ruin his reputation he may have been able to avoid the contract if he so desired.

Can Moe avoid the contract? As stated before, a minor incurs only voidable contractual duties. Since Moe was a minor when he entered into the contract he can **disaffirm** the contract anytime before reaching majority or within a reasonable time thereafter. Three months after reaching majority may be too late and he may have ratified the contract by his conduct. Moe is probably bound to the contract by his failure to timely disaffirm.

MODEL ANSWER TO QUESTION 2

Was a valid contract formed for the sale of beans? When Bonnie phoned in her order she made an **offer**. That is, a manifestation of willingness to enter into a bargain which creates in the offeree the power of acceptance. Sam's written acknowledgement could be deemed to be an **acceptance**, a manifestation of willingness to be bound by the terms of the offer made in the manner invited or required by the offer. At common law, a purported acceptance which varied in any way from the terms of the offer, no matter how trivial or insignificant, operated as a rejection or counteroffer. This was known as the "**mirror image**" rule.

This harsh rule has been abolished by the Uniform Commercial Code. The contract in question, since it is for the sale of goods, is governed by the UCC. Under **UCC § 2-207**, a definite and seasonable expression of acceptance operates as such even though it may contain additional or different terms. In this case, the acknowledgement would have operated as an acceptance even though the reverse side contained an additional term.

Did the additional terms, the mediation clause, become part of the contract? Under subsection 3 of UCC 2-207, additional terms are treated as merely proposals for addition to the contract. Between merchants, they become part of the contract unless they materially alter it; timely notice of objection is given to the additional term, or the terms of the original offer, limited acceptance to the original terms. Here, both Bonnie and Sam were "merchants" that is, those who deal regularly in goods of the kind or hold themselves out as having special expertise. Since Bonnie was a retailer of beans and Sam was a wholesaler, they presumably dealt regularly in coffee beans.

An additional term is considered to be a material alteration if its presence would result in surprise. It may indeed come as a surprise to Bonnie that she was giving up her right to go to court and was obligating herself to mediate. The additional term would probably be excluded from the contract on that basis alone.

The mediation clause may also be challenged on the basis that it is **unconscionable**. Terms are deemed to be unconscionable if they are unduly harsh or oppressive coupled with lack of meaningful choice. Here a requirement to mediate the case in a far away place, India, a place where neither party to the contract appears to have any connection, would appear to work a hardship on Bonnie. Unconscionability has two facets, substantive and procedural. **Substantive unconscionability** goes to the harshness of the terms in question. **Procedural unconscionability** relates to how did the term in question become incorporated into the contract. Did it find its way into the contract in a manner that was fair and square? Both types of unconscionability must be present but not in equal measure, before a clause will be struck as being unconscionable. Since the mediation clause was snuck in as an additional term it would be procedurally unconscionable as well as substantively unconscionable, and it will not be enforced.

Sam's statement made the day after the contract was performed that he would not deliver the beans was a **repudiation**. A repudiation is a positive, unequivocal statement of an intention not to perform one's contractual duties. Repudiation gives rise to an **anticipatory breach** meaning

that the recipient may treat it as a present breach and sue, or wait a reasonable time to see if the repudiator retracts the repudiation.

When the seller breaches a contract for the sale of goods the buyer's measure of **damages** is the difference between the contract price and the market price at the time the buyer learned of the breach or the difference between the contract price and the price of goods bought in substitution (cover) plus any incidental or consequential damages.

“At the time the buyer learned of the breach” means that the buyer may await a commercially reasonable time before treating the breach as final. This allows the seller an opportunity to retract the repudiation. However, if the buyer waits too long they will be guilty of not **mitigating their damages**. One of the limitations on contract damages is that the injured party may not recover those damages they could have avoided through their reasonable efforts.

Bonnie probably waited too long before she treated the breach as being final and cannot recover the full \$1.00 per pound that was the result in the rise of the market price as she failed to mitigate her damages.

MODEL ANSWER TO QUESTION 3

Does Gail have enforceable contract rights? The answer depends upon whether Gail is a **third party beneficiary** of the contract between Bob and the car dealer. A person, not in privity of contract, may have enforceable contract rights if it was the intention of the original parties to the contract to confer a benefit upon the third person and recognition of a right to performance in the third person would satisfy a debt or obligation owed by the promisee to the third party or the circumstances indicate that the promisee wanted to confer the performance on the third party in the form of a gift and the promisor reasonably understood that intention.

Here, the circumstances indicate that Bob was in a gift giving state of mind in that he wanted to give Gail a car on the occasion of their anniversary and by virtue of his instructions to the dealer to register the car in Gail's name and to deliver it to her with a bow on it should have put the dealer on notice that the dealer's duty of performance was to run to Gail.

Therefore, Gail would have the right to enforce the contract in that she could sue the dealer for breaching the contract and be entitled to the difference in value between what was promised and what was received. However, a third party beneficiary may not rescind the contract. Gail would not have the right to return the car and get her money back.

When the dealer sold the finance contract to the Bank that was an **assignment**. An assignment is a transfer of rights. Contract rights are freely assignable. When Bob stopped paying, the bank had the right, as the assignee, to sue Bob for breach. However, the assignee stands in the shoes of the assignor. That means that the obligor (Bob) can assert against the assignee (Bank) any defenses he could have asserted against the assignor (dealer). The assignee takes the assignment subject to all of the claims and defenses that could have been asserted against the assignor.

The failure of the car to run properly was a failure of consideration and Bob could cite that failure as a valid excuse to pay the bank. Bob's failure to pay on the car that he kept for himself could probably not be asserted against the bank. Assuming the bank gave notice of assignment, that would have cut off the right to "**set off**" claims that did not arise out of the contract being assigned. Claims or defenses that do arise out of the contract that is the subject of the assignment can be "**recouped**" regardless of when they accrue.

Bob's claims for damages, against either the bank or the dealer, would be limited to those damages that are **foreseeable**, in other words, those damages that were in the reasonable contemplation of the parties at the time they entered into the contract. General damages, those that naturally and typically flow as a consequence of the breach, are always foreseeable. Special damages, those which are unique to the injured party's particular situation, are only foreseeable if the breaching party was put on notice of them at the time the contract was formed.

Bob's damages for **emotional distress** would not meet these criteria. Furthermore, emotional distress damages are ordinarily not recoverable for breach of contract unless the contract was of such a nature that emotional distress damages were likely to result in the event of a breach.

