CONTRACTS

Final Examination
Spring 1998
Instructor Craig Smith

Time Allotted - Three Hours

An answer should demonstrate your ability to analyze the facts presented by the question, to select the material from the immaterial facts, and to discern the points upon which the case turns. It should show your knowledge and understanding of the pertinent principles and theories of law, their relationship to each other, and their qualifications and limitations. It should evidence your ability to apply the law to the facts given, and to reason logically in a lawyer-like manner to a sound conclusion from the premises adopted. Try to demonstrate your proficiency in using and applying legal principles rather than a mere memory of them.

An answer containing only a statement of your conclusions will receive little credit. State fully the reasons that support them. All points should be thoroughly discussed. Although your answer should be complete, you should not volunteer information or discuss legal doctrines that are not necessary or pertinent to the solution of the problem.

Unless a question expressly asks for California law, it should be answered according to legal theories and principles of general application.

QUESTION 1

Stooge Sporting Goods began to buy merchandise from the Good Sports Corporation in 1995. Two years later, Good Sports entered into an accounts receivable financing agreement with the Toon Town Bank, by which Toon Town acquired a security interest in all of Good Sport's accounts as they might exist from time to time. In June 1997, Toon Town "perfected" its security interest by filing a financing statement with the Secretary of State in the State of Paramount. A few days later, on June 15, Stooge Sporting Goods received a letter from Toon Town which gave notice of the assignment and directed Stooge to make all future payments on its Good Sports account directly to Toon Town.

Earlier in June 1997, Stooge had demanded that Good Sports give it "advertising credits." Although there was a dispute as to whether Stooge was entitled to these credits, officials of the two firms agreed in a conference that Good Sports would give Stooge a credit of $25,000 on this account.

After all of this had transpired, Toon Town brought an action against Stooge for the amount of $266,000, for goods delivered by Good Sports to Stooge (such as goose-down vests and parkas). This amount represented unpaid sums under 189 invoices directed by Good Sports to Stooge. Stooge countered with claims for damages based on defects in some of the goods and on late delivery, and with claims for other credits amounting altogether to $275,000. One of the damage claims concerned delivery of down-filled vests made in June of 1997. Another concerned a delivery of parkas in December of that year. Also, Stooge relied on the earlier agreement that Good Sports would give credit for certain advertising in Stooge catalogs. The defective down goods were all delivered before June 15, 1997. The defective parkas were delivered sometime in December of 1997.

Assume that the goods were in fact defective. Does Stooge have a valid defense with respect to its obligation to pay for the

A. goose-down vests or

B. parkas.

C. Further assume that Stooge was never given credit for the $25,000 advertising credit. May the court deduct this from any amount found to be owed by Stooge?

Discuss fully.

QUESTION 2

Smirgo, Inc., a manufacturer of bakery equipment, specializes in custom made ovens. Bisko, Inc., operates a medium sized bakery in a highly competitive market and sells primarily to restaurants, hotels and other institutional buyers.

On May 15, Bisko's research people informed the president that a new bread had been developed for the institutional trade. It was described as "revolutionary" and "likely to sell like hotcakes." A business decision was then made by the board of directors to purchase two new custom ovens and make a concerted effort to expand the business. At this time Bisko policymakers knew that Carawary Co., a competitor, was working on the development of a similar bread but had no idea what progress had been made.

On June 1, Smirgo and Bisko entered into a written contract for the manufacture and sale of custom made ovens to bake the new bread. The basic design was supplied by Bisko engineers. The agreed price was $30,000, to be paid in full 90 days after Smirgo had delivered both ovens on the promised delivery date, November 1. While Smirgo and Bisko had done business before, this was the first contract for custom made ovens. At the time the contract was signed, the president of Smirgo was informed that the "ovens will be used in a business expansion," "prompt delivery is critical," and "we have a new product coming out." After the contract was signed, Bisko spent, $7,500 in readying its plant for the new ovens.

On November 1, the time agreed for delivery, Smirgo informed Bisko that while the new ovens were completed they would not be delivered unless Bisko paid $30,000 cash. On November 2, Bisko discovered that there were three concerns within a hundred mile radius that would manufacture the custom made ovens at an average price of $29,500. The estimated time for delivery was six months, however, and no business concern had the type of oven needed by Bisko in stock. On November 3, Caraway Co. announced that it was marketing an institutional bread almost identical to that developed by Bisko. The next day, the Bisko sales manager informed the president that unless the ovens were obtained within ten days, Bisko would lose an estimated $20,000 in profits on six long-term contracts already made and an estimated $100,000 in profits on contracts under negotiation but not yet signed. During the past 5 years, Bisko's net profits have averaged $100,000 per year.

On the afternoon of November 4, the president of Bisko comes to you for legal advice. What would you advise Bisko to do? What type of damages, if any, may Bisko be entitled to recover? Discuss fully.

QUESTION 3

Moe, a graduate student, age 25, owned a gold and silver belt which was given to his grandfather when he was welterweight champion of the world. The belt was worth about $500, but had great sentimental value to Moe. On the evening of October 20, Moe, alone in his apartment, took an LSD tablet. Shortly thereafter, he began to hallucinate and, soon, a "voice" told him that he must sell the belt and donate the proceeds to charity. Moe went promptly to Curly's Pawnshop and sold the belt for $475. When the effects of the drug had gone, Moe realized what had happened. Curly, however, refused to return the belt, claiming that he "bought it fair and square."

Moe brought suit to rescind the contract for sale and to recover the belt. At the trial, Plaintiff's expert testified that LSD, like other hallucinogens, can produce a range of mental states, including hallucinations, delusions, and partial amnesia. He also stated that the effect of the drug may range from a loss of time and space perception to panic, paranoid delusions and reactions very similar to schizophrenia.

On cross-examination, it was brought out that Plaintiff had no mental disease or defect and that he had used LSD on previous occasions. Defendant's testimony, corroborated by another witness, was that Plaintiff entered his store, offered to sell the belt for $600 and after about ten minutes of bargaining, agreed to take $475. Defendant testified that Plaintiff acted a "little strange" but that he was lucid and bargained very well.

How should the court rule in this case? Discuss fully.

CONTRACTS
Final Examination
ISSUE SHEET
Spring 1998
Instructor Craig Smith

QUESTION 1

This involves an assignment situation. Contract rights are freely assignable. Any presently existing right may be assigned. No particular form of assignment is necessary to have an effective assignment. All that is required is that the assignment specifically indicate what right is being assigned.

Once the obligor has received notice of the assignment he or she is duty bound to deal with the assignee. If the obligor continues to send payments to the assignor after receiving notification of the assignment, the obligor risks the possibility of having to make double payments.

The assignee stands in the shoes of the assignor. The obligor can assert any defense against the assignee that he or she could have asserted against the assignor. There are exceptions to this rule however. One exception involves claims that could be asserted as either set offs or recoupment. One of the consequences of giving notice of assignment is that it will cut off the right of the obligor to assert certain defenses which could have been asserted against the assignor, against the assignee. Claims or defenses which arise out of the transaction which was the subject of the original assignment (recoupment) can be asserted against the assignee regardless of when they accrued. Claims or defenses which arise out of separate transactions (seperate from the one which gave rise to the original assignment [set offs]) can be asserted only if they accrued prior to notice of assignment being given.

The damage claims for the goose-down vests accrued prior to notice of assignment so they may be asserted against the assignee.

The damage claims for the parkas accrued after notice of assignment however, since this arose out of the transaction which gave rise to the original assignment, the damage claim can be asserted regardless of when it accrued.

The advertising credit claim appears to be a separate transaction from the vests and the parkas. However, it appears that the claim accrued prior to notice being given so it can nevertheless be asserted as a set off.

QUESTION 2

Perhaps what Bisko should do is pay the $30,000 in order to secure delivery of the ovens, and then sue for damages. This was a repudiation, which gave rise to an anticipatory breach. This case has many of the elements of economic coercion. Smirgo is clearly making a demand it has no right to make. Although these ovens are apparently sufficiently unique to justify specific performance as a remedy, as a practical matter, getting such relief from a court may take too long.

If Bisko were to sue for monetary damages, it would, under the measure of expectancy damages, be entitled to be placed in the position it would have been in had the contract been fully performed. However, there are limitations on damages. One of them is foreseeability. Contract damages are limited to those which were reasonably within the contemplation of the parties at the time that the contract was *formed*. (Hadley v. Baxendale) Although, Bisko apprised Smirgo of the losses it would occur, this took place only after Smirgo stated its intention to hold the ovens hostage. Technically, this was not at the time the contract was entered into.

Lost profits can be recovered by an ongoing business to the extent that they can be established with certainty. Damages which are merely speculative, remote or contingent cannot be recovered when they result from breach of contract. Bisko would have to get around this hurdle.

QUESTION 3

The issue here is whether Moe has the legal capacity to enter into a valid contract. Generally, one lacks the capacity to contract when because of mental disease or illness they are either unable to understand the nature and consequences of the transaction or is unable to act rationally in relation to the transaction and the other party has reason to know it. There are certainly facts which suggest that Moe was unable to act rationally with respect to the welterweight belt. Yet on the other hand, he sold it for close to its fair market value and there is really nothing to indicate that Curly should have been aware of any incapacity on the part of Moe. The balance must be struck between mental incapacity and commercial certainty. Here the price was relatively fair and the buyer had no reason to know of the temporary condition.