

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

Paula and Peter have for a long time wanted to spend a weekend at the beautiful Ahwahnee Hotel located in Yosemite National Park. In addition to being located in Yosemite Valley, from an architectural standpoint, the Ahwahnee is one of the finest examples anywhere of the arts and crafts style of building. Although the hotel sits on federal land, it is privately owned and operated and its staff is not government employees.

Because the Ahwahnee is so in demand as a place to stay while in Yosemite, guests must book reservations more than a year in advance. In March of 2010, Paula and Peter made a reservation to spend two nights at the Ahwahnee checking in on Friday April 8, 2011 and checking out on Sunday, April 10, 2011. The Ahwahnee requires all reservations to be accompanied by payment in full. Paula and Peter made their reservations by phone, and paid for their stay with a credit card, the number of which was taken over the phone. Their credit card account was immediately charged for the full price of their stay, which was \$500 per night. A few days later they received from the Ahwahnee a written confirmation of their reservation.

Over a year later, on the morning of April 8, 2011, as Paula and Peter were loading their car and getting ready to make the five hour drive to Yosemite, they heard the announcement over the radio that because of the failure of Congress to pass a budget, the federal government was shutting down and all National Parks were being immediately closed as part of that shutdown. This meant that by the time Paula and Peter drove to the park, the entrance stations to Yosemite would be closed with locked barricades blocking the road. The hotel though was still open for business, as it was a privately owned facility. The hotel is approximately 35 miles from the nearest entrance to the Park.

Heartbroken that they wouldn't be able to stay at the hotel, Paula and Peter decided that making the trip to the Park would be useless as they couldn't get in once they got to the park entrance gate. They called the hotel to explain their predicament and request a refund of the money that they had paid. They were told (1) that while the Ahwahnee was aware of the government shutdown, they were open for business, (2) that getting inside the park was Paula and Peter's problem and (3) the hotel had a policy of not giving refunds unless the reservation was cancelled at least 10 days in advance.

Paula and Peter would like to get their money back. Are they entitled to a refund? Discuss fully.

## QUESTION 2

Moe was hired by Stooze Industries as a software engineer. This was accomplished by means of a duly executed written contract that was signed by both parties. The contract included a clause entitled, "Agreement Not to Compete." It provided that if Moe were to leave his employment with Stooze Industries, he promised not to work for any other company in the computer industry anywhere else in the world for a period of two years. It further provided that if he complied with the provisions of the non-compete agreement he would receive a payment of \$5,000 on the second anniversary of his departure from Stooze Industries.

Six months after signing the contract, Moe left his employment with Stooze Industries so he could embark on a career as a dog trainer. He did this full-time continuously for two years and did not take any other job in the computer industry. On the two-year anniversary of his departure he wrote to Stooze Industries to inform them that he had honored the provisions of the non-compete agreement and requested that he be paid the \$5,000.

Stooze wrote back and acknowledged that Moe had lived up to his part of the bargain. They assured him they would pay him the \$5,000 but couldn't do so immediately because they were having cash flow problems at the time. They promised to pay him the \$5,000, with interest, within 90 days.

Six months later Moe had still not received the \$5,000 payment and was having cash flow problems of his own. Because he needed money badly Moe sold his right to collect the \$5,000 to Curly for the sum of \$2,500. One week after this transaction took place, Curly sent a letter to Stooze Industries informing them that he had purchased Moe's right to collect the \$5,000 and to promptly pay that amount to him. However, between the time Moe sold his right to Curly and Stooze received Curly's letter, Stooze discovered that Moe had failed to pay back a \$5,000 loan that Stooze had made to Moe to assist him in making the down payment on a house. Stooze, believing they no longer owed Moe any money, ignored Curly's letter.

Never having heard back from Stooze, Curly sues them for the \$5,000.

In the lawsuit between Curly and Stooze Industries, who should prevail? Discuss fully.

### QUESTION 3

Bobke, Co. was a manufacturer of athletic apparel. Smith, Co. was a wholesale seller of cotton. On March 31, 2011, Bobke sent Smith a purchase order for 10,000 square yards of cotton, price not to exceed \$.50 per square yard. Delivery to be no later than July 1, 2011. The purchase order was duly signed by Bobke's authorized agent. Smith promptly sent Bobke the following document that stated: "We acknowledge and are happy to fulfill your order of 10,000 square yards of cotton with a delivery date of July 1, 2011. The price at time of entry of your order is \$.50 per square yard." The acknowledgement was duly signed by Smith's authorized agent. On the back side of the document was the following language. "In the event of any dispute with regard to this transaction, both parties agree that neither shall have the right to file a lawsuit in a court of law but instead will submit their dispute to the American Arbitration Association for resolution. If the arbitrator should find in favor of the seller, then the arbitrator's decision shall be final and not appealable. Should the arbitrator find in favor of the buyer, the seller shall have the right to have the arbitrator's decision reviewed for correctness by a court of law."

Because of unusually heavy rains during the month of April there was a shortage of cotton causing the market price of the commodity to rise sharply. Although Smith had enough cotton to fulfill Bobke's order, it had other buyers that were willing to pay \$.90 per square yard for cotton. On June 1, 2011, Smith sent the following letter to Bobke: "Due to shortages of cotton this season we are informing you that we will not deliver the 10,000 square yards of cotton to you on July 1, 2011. We apologize for any inconvenience."

Bobke received this letter and immediately responded with a letter of its own sent to Smith stating: "We are in receipt of your June 1, letter and we strongly suspect we know the real reason for your refusal to deliver the cotton to us as promised. If we do not receive assurance from you that you will deliver the cotton we purchased per our agreement, we will file an action in a court of law to enforce our rights." Smith received Bobke's letter and immediately wrote back on June 5, "See you in arbitration."

On June 1, 2011, the price of cotton on the open market was \$.90 per square yard. By June 15, 2011 the price had risen to \$.95 per square yard and on July 1, 2011 the price was \$1.00 per square yard.

On July 5, 2011, Bobke purchased 10,000 square yards of cotton from another supplier at \$1.00 per square yard. Because Bobke had contracts with its customers that were already in place, it could not pass on the increase in price to its customers. Bobke can prove that its profit on each garment, which would have been \$4.00 per unit had Smith not breached, has been cut in half to only \$2.00 per unit and that it sold 10,000 units from the product it manufactured out of the 10,000 yards.

1. Is the arbitration clause a part of the contract between Bobke and Smith?

2. Assuming that Smith breached the contract, what is Bobke entitled to by way of damages?

Discuss fully.

## ANSWER TO QUESTION 1

The issue is whether Paula and Peter's obligation to pay for the room was excused under the doctrine of **frustration of purpose**, when the Park was closed to the public.

The rule is that a party's duties under a contract may be discharged when due to the occurrence of an unexpected event they are now getting nothing in return for their money.

Here, Paula and Peter should be entitled to get their money back because they were prevented by a supervening change in circumstances the park was closed down and they were unable to reach their hotel room. In this case **something unexpected did occur**, the shutdown of the government and the closing of the park, the park remaining open to visitors was a **basic assumption under which the contract was made**. This was a **total or substantial frustration** in that they could not access the room at all and their purpose in entering into the contract, enjoying the surroundings and environs of the Ahwahnee hotel is being completely denied to them.

This case could also probably be resolved under the rules of **impracticability**. Performance is excused when it becomes impossible or impracticable. In other words, when performance contemplates the continued existence of that thing a constructive condition is that the perishing of that thing will excuse performance. Here, the Ahwahnee hasn't perished and it is open, nevertheless for all practical purposes it is not available to Paula and Peter because the park itself is closed and is unavailable for use. They may even be in violation of the law if they tried to go there.

The **remedy** for when a contract is discharged under the doctrines of either impracticability or frustration is that **the parties are entitled to restitution** of any benefits they conferred on the other party. Here, since Paula and Peter paid the \$1,000 for the room in advance it must be returned to them.

May Paula and Peter avoid the contract on the ground of the Statute of Frauds when it was not evidenced by a writing signed by the party to be charged?

**Contracts not to be completely performed within one year** from the making thereof are within the **Statute of Frauds** and must be evidenced by a writing signed by the party to be charged.

Here, the contract was within the one-year provision of the Statute because although their stay was for only two nights, **the one-year period starts to run from the time the contract is formed**. The facts show, that Paula and Peter booked their room over the phone more than a year in advance. So, from formation through completion of performance would have exceeded a year and thus brought the contract within the one year provision of the Statute. The facts do not show that Paula and Peter, who are trying to avoid the contract, **signed any note or memorandum** which would have satisfied the Statute's writing requirement. Hence, they may avoid the contract on this basis as well.

## ANSWER TO QUESTION 2

The issue is whether Curly can collect from Stooge the full \$5,000 that Moe assigned to him when Moe still owes money to Stooge?

The rule is that while contract rights may be freely assigned and that the assignee of a right may sue the obligor, the obligor may assert against the assignee any defense they could have asserted against the assignor.

An **assignment** is a transfer of a right. When an effective assignment is made, the assignor has no further claim or interest in the right that has been assigned.

Here, when Moe "sold" the right to pursue the \$5,000 he was owed to Curly he transferred something that belonged to him to Curly. Because he got \$2,500 in return it was an assignment for value meaning that it could not be revoked. Curly notified Stooge of the assignment. **Notice of assignment** has two important legal consequences. First, upon receiving notice of assignment the obligor becomes duty bound to deal with the assignee and to no longer deal with the assignor. If the obligor continues to deal with the assignor he does so at his own risk as he or she may have to pay twice. The second important consequence is that **notice of assignment cuts off the obligor's right to set-off defenses** that are unrelated to the right that has been assigned. Defenses that are related to the right that has been assigned may be recouped regardless of when they occur.

Here, Curly may not be able to recover anything from Stooge. Even if the \$5,000 loan is viewed as a separate contract between Moe and his former employer Stooge the fact that he owes money to Stooge could be used by Stooge as a defense had Moe sued Stooge directly for the money he was owed under the non-compete clause. It becomes no less of a defense in spite of the fact that the right has been assigned because the **assignee stands in the shoes of the assignor**, taking the assignment subject to all of the claims and defenses that could have been asserted against it. Had Curly moved promptly to give notice of assignment he may have succeeded in cutting off this defense if he could have convinced the court that the loan was a separate transaction between Moe and Stooge and hence unrelated to the right that was assigned to Curly on the theory that the defense didn't accrue until Stooge discovered it. However, his delay appears to have been costly because Stooge discovered the existence of the outstanding loan before they were given notice of assignment meaning even if unrelated to the assigned right it could still be asserted against them.

This is an example of an old common law rule: "You snooze you lose."

### ANSWER TO QUESTION 3

The issue is whether the arbitration clause was incorporated into the party's agreement, when it was inserted as an additional term to a purported acceptance.

This is a **sale of goods**, cotton which is movable, so therefore will be **governed by the UCC**. At common law, a purported acceptance which varied in any way from the terms of the offer, no matter how trivial or insignificant, it operated as a rejection and counter-offer. This is known as the "**mirror image rule**."

**UCC 2-207 relaxes the mirror image rule**. Now, a definite and seasonable expression of acceptance operates as such notwithstanding the fact that it contains additional or different terms. Here, both parties deal regularly in cotton. Bobke manufactures clothing made out of cotton and Smith is a wholesaler of cotton. Hence, they meet the definition of "merchants" under the UCC. Under 2-207(2) between merchants, additional terms in an acceptance become part of the contract unless the additional term materially alters the contract.

A **material alteration** is one that would come as a surprise and would work a hardship on the party against whom it is to operate. Because Bobke would no doubt be surprised that it suddenly had lost its right to go to court in the event of a dispute, the arbitration clause should not be part of the contract. Furthermore the arbitration clause seems one-sided in favor of Smith. If Smith prevails the decision is final. If Smith loses it gets another bite at the apple. This would meet the definition of **unconscionability** which is equated with lack of meaningful choice coupled with one-sided contract terms. Because it is an unconscionable material alteration, the arbitration clause should not become part of the contract of sale.

The issue is whether Bobke should be entitled to the larger measure of **damages** when it failed to go out in the open market and buy substitute cotton and hence mitigate its losses.

When the seller breaches a contract for the sale of goods the buyer is entitled to damages based upon the difference between the contract price and the market price when the buyer learned of the breach plus any incidental or consequential damages. (UCC 2-713)

Here, the buyer learned of the breach on June 1 when cotton was \$.90 per sq. yd. However, when the seller repudiates, i.e., makes a positive unequivocal statement of an intention not to perform at some time in the future, the buyer does not have to immediately accept the repudiation but may wait a reasonable time to see if the seller will retract the repudiation. However, if the buyer waits too long, he/she may face an argument that they **failed to mitigate their damages**.

Because on June 5, Smith reiterated the fact that it would not honor the contract, Bobke's damages based upon the market price/contract price difference should be capped at the \$.95 per sq. ft. measure and not the \$1.00 per sq.ft. that Bobke ultimately purchased replacement cotton at.

Bobke appears to also have **lost profits** as a result of the breach. Lost profits are consequential damages because they are unique or peculiar to the injured party's situation. To be recoverable, **consequential damages must be foreseeable**, i.e., within contemplation of both parties at the time they entered into the contract. (*Hadley v. Baxendale*.)

Because Bobke was a maker of athletic wear and the circumstances would seem to support Smith's awareness of that fact, Smith should also be liable for the additional \$1.00 per unit in lost profits.