Comparative Contract Law
American and European

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Section 1

INTRODUCTION

1-1. AMERICAN CONTRACT LAW

In the United States, a contract is typically defined as a "promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." *Restatement (Second) of the Law of Contracts* § 1. Accordingly, whenever a plaintiff sues a defendant for breach of contract, the plaintiff claims that the defendant made a promise and did not keep it. The plaintiff then may ask the court to enforce the promise, either by ordering the defendant to do what the defendant promised or more commonly by requiring the defendant to pay the plaintiff money as compensation for the breach.

Courts will not enforce all promises. For example, they will not enforce promises made by children or persons with diminished mental capacity. Similarly, they will not enforce promises induced by certain misrepresentations or fraud. They also will not enforce some promises unless certain formalities have been met.

When sued by a plaintiff for breach of contract, a defendant often presents legal arguments for why the court should not enforce a promise. These arguments are typically called "defenses." Because the plaintiff has only one legal claim (i.e., the defendant did not keep a promise), but the defendant has many potential defenses, much of the study of contract law concerns arguments for why promises are not enforceable.

The United States Constitution divides governmental power between the national federal government and the 50 states. The federal government has exclusive power to regulate certain subjects, like immigration and foreign relations, but shares with the states the power to regulate other subjects. Partly for historical reasons and partly because of limitations in the Constitution, the federal government largely has left the subject of contracts to the states. As a result, most contract law is state law rather than federal law.

Each state in the United States has the power to adopt different legal rules governing contracts. Accordingly, the law of contracts is not uniform in America. For example, contract law in California may differ in some respects

from contract law in New York. Fortunately, differences are few, and most of these differences are not very significant.

For historic reasons, most contract law is not found in statutes or legislation. Instead, at least outside of specialized areas of the law, when courts decide contract cases, they mostly rely on earlier decisions in similar cases. The earlier decisions are called "precedents" and they make up the "common law" of contracts. In addition to relying on prior American decisions, courts in the United States often rely on prominent historical cases from England from the 19th century and before.

Although American courts generally follow earlier decisions, they often confront new issues for which there is no precedent. Accordingly, judges have some power to create new legal rules, and develop new legal doctrines. This power may seem odd because usually elected legislatures create laws in democratic countries. The process, however, is so firmly rooted in the American legal system that it generally is not questioned.

Because contract law is mostly based on cases rather than statutes, American law students learn contracts principally by reading cases. And the skill of reading and understanding cases is very important for practicing American lawyers. For this reason, these materials contain numerous judicial decisions.

"Restatements" of the Law of Contracts

Lawyers and judges often consult treatises and other secondary works for summaries and analyses of common law contract law doctrines. Perhaps the most important secondary sources are the *Restatement of the Law of Contracts* (1932) and *Restatement (Second) of the Law of Contracts* (1982). These treatises were prepared by a nonprofit organization called the American Law Institute ("ALI"), whose members include a diverse group of prominent lawyers, judges, and law professors. They have no legal force. However, because of their distinguished authorship, judges have relied on the *Restatements* as persuasive authority in over 30,000 reported cases. No other secondary source can claim so much influence on the courts. As a result, the *Restatements* offer a good place to start when researching any common law contracts question. *See* Gregory Maggs, *Ipse Dixit: The Restatement (Second) of Contracts and the Modern Development of Contract Law*, 66 Geo. Wash. L. Rev. 508 (1998).

The *Restatement (Second) of the Law of Contracts* contains 385 sections. These sections each state a rule or set of rules and then have comments explaining the rule and giving illustrations. Every section contains a "Reporter's Note." These notes typically list cases that support or, in some instances, contradict the section's rules, comments, and illustrations. As you will see, these materials quote many of *Restatement* provisions when summarizing the typical rules of American contract law.

Uniform Commercial Code (U.C.C.)

Although the common law continues to govern many aspects of contracts, state legislatures have replaced some of its rules by statute. One of the most important legislative enactments is the Uniform Commercial Code (U.C.C.). The U.C.C. is a model statute, drafted in part by the ALI and in part by the Uniform Law Commission (formerly known as the National Conference of Commissioners on Uniform State Laws). The U.C.C. contains rules governing contracts for the sale and lease of goods, negotiable instruments, the check collection process, funds transfers, letters of credit, bulk transfers, documents of title, investment securities, and securities interests in personal property.

Every state legislature and many federal territories have enacted all or part of this model law. As a result, much of the commercial law in the United States, while still a matter of state law, has become codified and uniform throughout the country. Again, as you will see, these materials also refer to the U.C.C. in various places.[1]

Convention on the International Sale of Goods

The United Nations Convention on Contracts for the International Sale of Goods (CISG), 19 I.L.M. 668 (1980), is a multilateral treaty ratified by the United States and most of the countries in Europe. Its purpose is to provide a uniform set of rules for international sales contracts, much like the U.C.C. establishes a uniform set of rules for domestic sales of goods in the United States.

The CISG applies to contracts for the sale of goods between private parties if the parties to the contract have their place of business in two different countries, and both of the countries have ratified CISG. For example, it would govern a contract between an American company and a German company for the sale of automobile parts. The CISG does not apply to contracts for the sale of "goods bought for personal, family, or household use."

The rules in the CISG differ from the general American rules of contract law in several respects. The CISG, for example, contains no statute of frauds or parol evidence rule, it adheres to the mirror image rule for offer and acceptance rather than the special rules now found in the U.C.C., and it makes specific performance a generally available remedy. Because the United States ratified the CISG as a treaty, *see* S. Doc. No. 9, 98th Cong., 1st Sess. 23 (1983), 52 Fed. Reg. 6264 (1987), the CISG has the status of federal law. Both state and federal courts therefore must apply it to cases within its scope.

1. In 2003, the ALI and the Uniform Law Commission published a controversial revision of article 2 on contracts for the sale of goods. No state legislatures have adopted the revised article and passage in the future seems unlikely. So these materials will address the pre-2003 version of article 2.

The CISG is very important. American businesses buy or sell about $1 trillion worth of goods annually companies who have their place of business in countries that have adopted the CISG. But these materials do not address the CISG in depth. Instead, they focus on differences between domestic American and European contract law; as a result of the CISG, in contracts for the international sales of goods, American contract law is unified with European contract law.

Notes

1. Why might it be useful or important to have a "uniform" (i.e., identical) law governing commercial subjects in each of the 50 states in the United States?

2. Can you think of a reason that each state had to enact its own version of the Uniform Commercial Code instead of having the federal government of the United States enact a federal statute that would apply in all states?

3. In addition to facilitating uniformity, what are some advantages of codifying commercial law in a statute rather than leaving it to the common law? Are there any disadvantages?

1-2. EUROPEAN CONTRACT LAW

Europe does not have a single law of contracts. On the contrary, every European nation has its own code or codes which govern contracts. The law in Germany thus may differ from the law in France. In addition, even within one country, different rules may apply to different kinds of contracts. For example, Germany, like the United States, applies different rules to contracts for the sale of goods, to contracts for services, and various other classes of contracts. *See* Basil S. Markesinis, *The German Law of Contract: A Comparative Treatise* 144-146 (2d ed. 2006).

The German Federal Ministry of Justice has posted an English translation of the German Civil Code (Bürgerliches Gesetzbuch or BGB) on the Internet. To see for yourself what the Code looks like, take a few moments to visit this website: http://www.gesetze-im-internet.de/englisch_bgb/index.html. Book 1 of the German Civil Code is the "General Part." As its name suggests, it contains general provisions applicable to many civil law subjects. Some of these general provisions relate to contracts. For example, sections 104-113 address capacity to enter into contracts and sections 145-163 address offer and acceptance, contract interpretation, and conditions. Book 2 of the German Civil Code has specific provisions concerning legal "obligations." It contains some general rules of contract law and it also includes many specific rules governing particular kind of contracts. For example, sections 474-479 address the purchase of consumer goods, section 535-579 concern leases, and

section 611-30 concern service contracts. Other European codes are similar in that they contain both general rules on the subject on contracts and more specific rules pertaining to particular kinds of contracts. For another example, see the English translation of the French Civil Code located here: http://www.legifrance. gouv.fr/html/codes_traduits/code_civil_textA.htm.

Although European countries all have some different rules of contract law and although even within a single nation, the laws applicable to different kinds of contracts may vary, many generalizations about European contract law are still possible. We will look at a number of these generalizations in these materials, and we will then compare them to principles of American contract law.

Various scholars have published books on the subject of European contract law. Two excellent examples are *The Enforceability of Promises in European Contract Law* (James Gordley, ed., 2001) and Raymond Youngs, *English, French and German Comparative Law* (1998). These materials rely heavily on these works.

In addition, scholars and practitioners now have the benefit of a superb two-volume treatise prepared by the Commission on European Contract Law. The treatise is called *Principles of European Contract Law*. The Commission on European Contract Law is an organization whose membership includes prominent European legal scholars and practicing attorneys. The Commission began its work in the 1970s with funding from the European Community and various universities and private enterprises. The Commission published the first version of the treatise in 1995. Subsequent revisions took place in 2000 and 2003. The two current volumes of the treatise are: (1) The Commission on European Contract Law, *Principles of European Contract Law, Parts I & II* (Ole Lando & Hugh Beale, eds. 2000), and (2) The Commission on European Contract Law, *Principles of European Contract Law, Part III* (Ole Lando *et al.*, eds. 2003).

The *Principles of European Contract Law* attempts to restate general principles of European contract law in much the same way the *Restatement (Second) of the Law of Contracts* summarizes the rules of American contract law. In addition to stating rules, the *Principles of European Contract Law*, like the *Restatement (Second) of the Law of Contracts*, also contains comments, illustrations, and notes. These supplementary materials are very important. They typically identify differences that exist among European nations.

Although the *Principles of European Contract Law* is an invaluable research tool, readers must take care not to assume that every rule stated in the *Principles of European Contract Law* accurately reflects the law applicable to every country in Europe. In fact, the introduction warns:

> The Commission has not confined its sources to the national laws of Member States. It has drawn on a wide range of legal materials from both within and outside Europe, including the American *Uniform Commercial Code* and *Restatements* of contract and of restitution. Some of the provisions in the Principles reflect suggestions and ideas which have not yet materialised in the law of any State

Principles of European Contract Law, Parts I & II xxvi (Ole Lando & Hugh Beale, eds. 2000). The "notes" following the rules in the treatise generally identify the European nations that follow the rules and those that do not.

1-3. COMPARING CONTRACT LAWS

Several issues arise in an endeavor to compare contract laws from different countries. One question is what to compare. These materials mostly compare specific rules of contract law. For example, they observe that under American contract law, the party who makes an offer generally can revoke the offer at any time, while an under European contract law, the offeror generally must keep the offer open for a reasonable time.

But readers of these materials should be aware that a comparative study of law could focus on features of contract law other than specific rules. A study, for example, might look to see whether the two legal systems share basic principles, such as freedom of contract or a thorough going insistence on good faith. *See, e.g.*, Nigel G. Foster, *German Law & Legal System* 200-01 (1993). Alternatively, a comparative study might avoid considering specific rules or basic principles and just look at results; in other words, it could focus on the ultimate question of whether particular promises that are enforceable in one legal system would be enforceable in another.

A second question is what to look for when comparing different laws. These materials mostly consider differences between American contract law and European contract laws. Differences are important because they show the non-inevitability of particular rules and thus invite questions about the policies underlying the rules. Differences thus often lead scholars to reconsider points that they previously had taken for granted. But focusing exclusively on differences has a disadvantage. By overlooking similarities, the approach may make legal systems seem more dissimilar than they actually are.

A third question is how to assess the importance of differences between legal systems. Sometimes differences that appear significant when rules are compared directly to each other actually turn out not to matter very much. For instance, to return to the example above, Americans unlike Europeans can revoke offers without having to keep them open for a reasonable time. This difference at first may sound very important. But in reality, most people in

both Europe and the United States in fact do keep offers open for a reasonable time; after all, the purpose of making offers is to obtain acceptance.

A fourth question is how to observe differences between American and European contract law. These materials frequently compare rules stated in the *Principles of European Contract Law* to the rules in the *Restatement (Second) of the Law of Contracts* and the Uniform Commercial Code. But they also look at cases, especially those involving "choice of law" issues. In these choice of law cases, courts frequently determine that a contract is enforceable under one body of law but they would not be enforceable under another. The cases thus pin down and illustrate important differences that actually have arisen and that have had consequences worth litigating over.

1-4. MANDATORY RULES AND DEFAULT RULES

Contract law generally consists of two kinds of rules: mandatory rules and default rules. Mandatory rules are rules that the parties cannot waive or alter by agreement. For example, in both European and American law, the parties must act in good faith during the performance and enforcement of a contract. They cannot dispense with this requirement by consent, disclaimer, or otherwise. In this sense, good faith is a mandatory rule.

By contrast, a default rule is a rule that applies only if the parties decide not to alter the rule. For example, as discussed in Section 7-1 below, American and European contract law contain the default rule that a prevailing plaintiff in a contracts lawsuit is entitled to recover damages measured by the difference between what the plaintiff expected under the contract and what the plaintiff actually received. But the parties have at least some ability to waive this rule. As explained in Section 7-5 below, the parties can agree in advance that the party in breach will have to pay a different measurement of damages.

Although a comparative study of European and American contract law may reveal differences in default rules, these differences may not matter much in practice. If parties have the freedom to alter the rules, then they likely will alter them whenever the rules do not satisfy the needs of a particular transaction. So the rules ultimately applicable to European and American contracts, after modification by the parties, will resemble each other.

Problem

Article 2:205(1) of the *Principles of European Contract Law* provides: "If an acceptance has been dispatched by the offeree the contract is concluded when the acceptance reaches the offeror." Germany, for example, reportedly follows this rule. *See* also Basil S. Markesinis, *The German Law of Contract: A Comparative Treatise* 73 (2d ed. 2006). In contrast, § 63(a) of the *Restatement (Second) of the Law of Contracts* says: "Unless the offer provides other-

wise, . . . an acceptance made in a manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree's possession, without regard to whether it ever reaches the offeror . . . ."

1. How do the rules in Article 2:205(1) and § 63(a) differ from each other?

2. Are Article 2:205(1) and § 63(a) default rules or mandatory rules? How is it possible to tell? Note that Article 2:205(3) says: "If by virtue of the offer, of practices which the parties have established between themselves, or of a usage, the offeree may accept the offer by performing an act without notice to the offeror, the contract is concluded when the performance of the act begins."

3. If both provisions state default rules, how important is the difference between them? Is it possible that in reality, almost all acceptances are effective upon receipt in both the United States and Europe?

4. How should the law set a default rule? In other words, does it matter if the law says that an acceptance is effective on dispatch or effective on receipt, so long as the parties can alter the rule? Consider the following argument:

> The law . . . can reduce the cost of bargaining by establishing default rules that reflect terms most people favor in a given context. For example, although parties may insert a clause liquidating damages in the event of a breach, they do not have to expend this effort. Instead, if they say nothing, the law will supply a term stating that they will receive expectation damages. Default rules of this nature promote efficiency by giving parties to contracts the terms that they want, while sparing them the transaction costs of setting terms.

Gregory E. Maggs, *The Holder in Due Course Doctrine as a Default Rule*, 32 Ga. L. Rev. 783, 804 (1998) (footnotes omitted). If this argument is correct, is the American or European rule preferable? Or does the answer depend on an empirical inquiry?

USINOR INDUSTEEL v. LEECO STEEL PRODUCTS, INC.

United States District Court for the Northen District of Illionis

209 F. Supp.2d 880 (N.D. Ill. 2002)

LINDBERG, Senior District Judge.

Before the Court is Usinor Industeel's ("Usinor") Motion for Replevin.* Usinor seeks to exercise its replevin right . . . to recover possession of the eighteen unpaid shipments of Creusabro 8000 steel (the "Steel Shipments"), valued in excess of one million dollars, that Usinor sold and delivered to Leeco Steel Products, Inc. ("Leeco"). . . .

I. Background

A. Facts

Usinor is a corporation incorporated under the laws of France with its principal place of business in France. Usinor and its parents and sister companies constitute a global leader in steel production, and produce, process and distribute stainless and flat carbon steels serving customers in the automotive, mining, construction, packaging and household appliance industries. One of Usinor's specialty steels is a brand of steel plate, Creusabro 8000, which is an advanced homogeneous, lightweight, anti-abrasive steel plate for applications involving extreme wear and tear.

Leeco is a corporation incorporated under the laws of the State of Illinois with its principal place of business in Illinois. Leeco has operations in Chicago, St. Louis, Pittsburgh, Wisconsin, South Carolina and Tennessee. Leeco is an independent steel center, specializing, securing, processing and delivering sheet and plate grades of steel.

* * *

In early February 2000, Leeco began placing orders with Usinor for the purchase and shipment of certain tonnage of Creusabro 8000. Leeco ordered the steel in order to participate in a proposed new project of Caterpillar relating to large mining vehicles. Leeco intended to sell the steel it had ordered from Usinor to either Caterpillar or Caterpillar suppliers. Caterpillar and its supplier facilities are located in, among other places, Wyoming, Mexico and Peru. Caterpillar and its suppliers intended to fabricate the steel into ultra light truck beds for use at mining facilities throughout the world.

Under Paragraph 7 of the sales agreement between Usinor and Leeco for the Steel Shipments (the "Agreement") Usinor "remain[s] the owner of the goods up to the complete and total payment of all sums due." Also, pursuant to the terms of the Agreement, Leeco was obligated to pay Usinor within 60 days following receipt of the steel. . . .

Usinor states that Leeco's early enthusiasm for the Caterpillar project resulted in extraordinary demands on Usinor to deliver substantial quantities of Creusabro 8000 steel plate. Therefore, beginning in December 2000 and

* Replevin is an action brought to obtain possession of identified personal property. The question in this case is whether Usinor effectively retained title to certain steel and thus has a right to regain possession of it despite the competing claim of LaSalle Bank.—Ed.

continuing until April 20 2001, Usinor produced and exported multiple shipments of the steel, valued at $1,188,817.30, from France to Leeco's designated locations in accordance with Leeco's delivery schedule.

At some time in the year 2000, Caterpillar notified its own suppliers, as well as Leeco and Usinor, that it was halting or considering halting, the fabrication of truck beds in the mining vehicle program. Leeco now has possession of Creusabro 8000 steel that Leeco was unable to sell to Caterpillar, although Usinor asserts it has many alternate uses. Leeco took delivery of the Steel Shipments, and Usinor asserts on information and belief, has used portions of the Steel Shipments in its operations and/or sold portions to others. Leeco has made a partial payment on the total value of only one of the Steel Shipments for the portions that it has used in its operations or sold to others. Leeco has not made a complete and total payment for the Steel Shipments, and has not returned the Steel Shipments, after demand by Usinor to do so. Currently, Leeco still owes Usinor at least $988,817.36 of the total value of the Steel Shipments. Usinor asserts on information and belief that the value of the remaining steel from the Steel Shipment in the possession of Leeco is worth substantially less than the amount of money that Leeco owes Usinor. Instead of making complete and total payment for the Steel Shipments, Usinor asserts that Leeco has instead sought to use its control over the improved steel to force Usinor to provide Leeco a refund on the steel it had purchased, but not used.

Leeco purchased the Steel Shipment using a line of credit (the "Loan") from LaSalle Bank. Usinor asserts that Leeco is in default on the Loan and has been urged by LaSalle Bank to sell the Steel Shipments to pay off any remaining debt owed by Leeco to that lender under the Loan. Usinor asserts on information and belief that Leeco may be facing insolvency through its default on the Loan and would not be able to pay any damages that Usinor might recover from Leeco for breach of the sales agreement.

* * *

First, the Court needs to determine which domestic law applies, that of France or Illinois. Under French law, the seller of goods has an absolute right to contract for title until payment, and therefore the retention of title clause in the Agreement would be determinative. However, under the UCC, Usinor would only have a reservation of a security interest.

* * *

Under UCC Section 2-401(1), Usinor has a reservation of a security interest only. Title retention contracts are construed as creating only security interests under the U.C.C. (*See* UCC Section 2-401(1), "Any retention or reservation by the seller of the title in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these

provisions and to the provisions of the Article on Secured Transactions, title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.") Therefore, under domestic law, Usinor's retention of title in the contract did not effectively retain title in Usinor. Rather, transfer of title was effected upon delivery to Leeco. *See* UCC § 2-401(2) ("[U]nless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest . . .").

* * *

Usinor does not have title in the Steel Shipments, only a reservation of a security interest. Therefore, the remedy of replevin is unavailable to Usinor. *See Hanaman v. Davis,* 20 Ill.App.2d 111, 115, 155 N.E.2d 344 (2d Dist. 1959) (" 'Replevin' is a possessory action and the plaintiff must recover, if at all, on the strength of his own title or his right to immediate possession.")

* * *

Usinor has a security interest in the Steel Shipments, but it is not perfected. A perfected security interest prevails over the retained interest of an unpaid seller who did not perfect a security interest. Therefore, LaSalle's perfected security interest prevails over the retained interest of Usinor in the Steel.

Notes

1. What are the French and American rules with respect to the seller's retention of title to goods?

2. Are these rules default rules or mandatory rules? Is it possible for a rule to be a default rule in one country and a mandatory rule in another country?

Section 2

GRATUITOUS PROMISES

A gratuitous promise is a promise to do something or to give something for nothing in exchange. For example, as a favor, a professor might promise to teach a colleague's seminar on a day when the colleague will be away. Or a parent might promise to convey property to a child when the child reaches the age of 21. American and European contract law treat gratuitous promises very differently.

2-1. AMERICAN CONTRACT LAW

American courts generally will not enforce a promise unless the promise has a legally recognized "basis for enforcement." The two most common bases for enforcement are "consideration" and "reliance." Often gratuitous promises lack either of these bases of enforcement and therefore are not enforceable.

Most courts define consideration for a promise as something—a performance or another promise—given in exchange for the promise as part of a bargain. This definition of consideration is often called the "bargain theory of consideration." Section 71 of the *Restatement (Second) of the Law of Contracts* provides the following detailed definition:

§ 71. *Requirement of Exchange; Types of Exchange*

(1) To constitute consideration, a performance or a return promise must be bargained for.

(2) A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.

(3) The performance may consist of

(a) an act other than a promise, or

(b) a forbearance, or

(c) the creation, modification, or destruction of a legal relation.

(4) The performance or return promise may be given to the promisor or to some other person. It may be given by the promisee or by some other person.

For example, suppose that an employer promises to pay a salary to an employee in exchange for the employee's promise to work for a year. The employee's promise to work is consideration for the employer's promise to pay, and vice versa. Each promise was given in exchange for the other. Similarly, suppose that a passenger purchases an airplane ticket for $1000. In selling the ticket, the airline promises to take the passenger to New York. The consideration for the airline's promise is the payment of $1,000.

By contrast, promises to make gifts or render services for nothing in return lack consideration. These promises are called "gratuitous promises." For example, suppose that out of kindness alone, a person promises to watch a neighbor's house while the neighbor is away. This promise has no consideration. Without some other basis for enforcement, a court would not enforce this promise. Similarly, a court would not enforce a promise to give someone a birthday gift.

Since the mid-1900s, courts in the United States generally have recognized reliance as an alternative basis for enforcing promises. Courts in certain instances may enforce a promise on the grounds that the promise induced the plaintiff to take some action in reliance even if the promise lacks consideration.

The *Restatement (Second) of the Law of Contracts* summarizes the law as follows:

§ 90. *Promise Reasonably Inducing Action or Forbearance*

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

* * *

By tradition, courts call the rule in section 90 the "doctrine of promissory estoppel." The commentary to this section contains the following illustration:

A, knowing that B is going to college, promises B that A will give him $5,000 on completion of his course. B goes to college, and borrows and spends more than $5,000 for college expenses. When he has nearly completed his course, A notifies him of an intention to revoke the promise. A's promise is binding and B is entitled to payment on completion of the course without regard to whether his performance was "bargained for" under § 71.

Restatement (Second) of the Law of Contracts § 90 illus. 1.

Problems

1. A man promises his next door neighbor: "If you come over to my house this evening, I will let you have my antique bicycle that you have always admired." Later, when the neighbor shows up, the man says that he has changed his mind, and will not part with the bicycle. Is the man's promise enforceable on the ground that there was a bargain? Is this an appropriate case for enforcing the promise based on reliance?

2. The owner of a diamond worth more than $2000 agrees to sell it for $200. In the absence of fraud or mistake, is $200 sufficient to constitute "consideration" for the sale of the diamond under *Restatement (Second) of Contracts* § 71?

2-2. EUROPEAN CONTRACT LAW

In contrast to American contract law, gratuitous promises generally are enforceable under European contract law. Consider the following rules from the *Principles of European Contract Law*:

Article 2:101: *Conditions for the Conclusion of a Contract*

(1) A contract is concluded if:
(a) the parties intend to be legally bound, and
(b) they reach a sufficient agreement
without any further requirement.

Article 2:107: *Promises Binding without Acceptance*

A promise which is intended to be legally binding without acceptance is binding.

The commentary provides the following example of an enforceable gratuitous promise:

> When the Gulf War started in 1990 the enterprise X in country Y published a statement in several newspapers in Y promising to establish a fund of 1 million Euros to support the widows and dependent children of soldiers of country Y who were killed in the war. After the war X tried to avoid payment invoking big losses recently made. X will be bound by its promise.

Principles of European Contract Law, Parts I & II 157 (Ole Lando & Hugh Beale, eds. 2000).

The commentary also mentions two important exceptions to the general enforceability of promises under European contract law. First, in some European countries, a promise to make a gift in the future generally is not enforce-

able unless it is made before a notary. *See id.* at 143. This rule, for example, applies in Germany. *See* German Civil Code § 518(1) ("For a contract by which performance is promised as a donation to be valid, notarial recording of the promise is required."); *see also* James Gordley, *The Enforceability of Promises in European Contract Law* 43 & n. 81. Second, some European legal systems, including those of France and Austria, will not enforce a promise absent an evident "cause" for the promise. As a result, a "promise which has no apparent purpose" is not binding. *Principles of European Contract Law, Parts I & II* at 141 (Ole Lando & Hugh Beale, eds. 2000). In some ways, the requirement of cause is similar to the requirement of consideration. The construction of a house can be the cause for a promise to pay the builder. But the two requirements are not identical. A court in France, for example, may find "a duty of conscience" or "motivating generosity" to constitute cause for a promise to make a gift. *See* Raymond Youngs, *English, French, and German Comparative Law* 360-61 (1997). A promise to make a gift that has "no rationale explanation" will lack cause. *Id.*

Notes

1. Many scholars have identified the doctrine of consideration as a major difference between American and European law. The practical consequences of the doctrine, however, may not be large. Professor Ingeborg Schwenzer has written:

> In contrast to Anglo-American law, German law does not require consideration for a contract or offer to be binding. But German law employs different devices to achieve the essential purposes of the Anglo-American doctrine of consideration. These include, for example, form requirements to protect a party from making hasty promises, the devices of illegality (*Verbotswidrigkeit*) and unconscionability, and the ability to declare void an expression of will that was not meant seriously (§ 118 BGB).

Ingeborg Schwenzer, The Law of Contracts 177, in *Introduction to German Law* (Werner F. Ebke & Mathew W. Finkin, eds. 1996).

2. One argument for requiring a basis for enforcement is that enforcing promises through the courts is expensive and burdensome. For this reason, the law arguably should enforce only the kinds of promises for which enforcement is most necessary. Under this theory, courts should enforce promises made as part of bargains because otherwise people and businesses would be reluctant to enter into trades, and the economy would suffer. In contrast, people still might promise to give gifts even if courts did not enforce these promises. What counterargument might be made in support of European contract law, which does not require a basis for enforcement?

3. Another argument for requiring a basis for enforcement is that the requirement may make it more difficult for a person to make fraudulent con-

tract claims. For example, suppose that a criminal is willing to give false testimony in order to obtain money from a rich actress. If the criminal sues the actress, the criminal cannot allege merely that the actress promised to give him $1 million. A promise to give $1 million lacks consideration. Instead, the criminal would have to allege the actress promised to pay him $1 million in exchange for something. The criminal may have great difficulty identifying something that he possibly could have given the actress in exchange for payment of $1 million. Would a requirement of "cause" accomplish a similar purpose? Are there other checks against fraudulent contract claims?

4. Both American law and European law uphold gifts that already have been made. The concern in this section is about promises to make gifts in the future. While American law generally considers these promises unenforceable, European legal systems "recognize that the promisor may have a good reason for deciding to commit himself in advance." *The Enforceability of Promises in European Contract Law* 338 (James Gordley, ed., 2001). What might a good reason be for making such a commitment?

2-3. COMPARISON

MILLS v. WYMAN

Massachusetts Supreme Judicial Court

20 Mass. 207 (1825)

* * *

This was an action of assumpsit[*] brought to recover a compensation for the board, nursing, &c., of Levi Wyman, son of the defendant, from the 5th to the 20th of February, 1821. The plaintiff then lived at Hartford, in Connecticut; the defendant, at Shrewsbury, in this county. Levi Wyman, at the time when the services were rendered, was about 25 years of age, and had long ceased to be a member of his father's family. He was on his return from a voyage at sea, and being suddenly taken sick at Hartford, and being poor and in distress, was relieved by the plaintiff in the manner and to the extent above stated. On the 24th of February, after all the expenses had been incurred, the defendant wrote a letter to the plaintiff, promising to pay him such expenses. There was no consideration for this promise, except what grew out of the relation which subsisted between Levi Wyman and the defendant, and Howe J., before whom the cause was tried in the Court of Common Pleas, thinking this not sufficient to support the action, directed a nonsuit. To this direction the plaintiff filed exceptions.

PARKER C. J.

General rules of law established for the protection and security of honest

* "Assumpsit" was the name of a common law form of action used to enforce promises.—Ed.

and fair-minded men, who may inconsiderately make promises without any equivalent, will sometimes screen men of a different character from engagements which they are bound in foro conscientiae to perform. This is a defect inherent in all human systems of legislation. The rule that a mere verbal promise, without any consideration, cannot be enforced by action, is universal in its application, and cannot be departed from to suit particular cases in which a refusal to perform such a promise may be disgraceful.

The promise declared on in this case appears to have been made without any legal consideration. The kindness and services towards the sick son of the defendant were not bestowed at his request. The son was in no respect under the care of the defendant. He was twenty-five years old, and had long left his father's family. On his return from a foreign country, he fell sick among strangers, and the plaintiff acted the part of the good Samaritan, giving him shelter and comfort until he died. The defendant, his father, on being informed of this event, influenced by a transient feeling of gratitude, promises in writing to pay the plaintiff for the expenses he had incurred. But he has determined to break this promise, and is willing to have his case appear on record as a strong example of particular injustice sometimes necessarily resulting from the operation of general rules.

. . . What a man ought to do, generally he ought to be made to do, whether he promise or refuse. But the law of society has left most of such obligations to the interior forum, as the tribunal of conscience has been aptly called. Is there not a moral obligation upon every son who has become affluent by means of the education and advantages bestowed upon him by his father, to relieve that father from pecuniary embarrassment, to promote his comfort and happiness, and even to share with him his riches, if thereby he will be made happy? And yet such a son may, with impunity, leave such a father in any degree of penury above that which will expose the community in which he dwells, to the danger of being obliged to preserve him from absolute want. Is not a wealthy father under strong moral obligation to advance the interest of an obedient, well disposed son, to furnish him with the means of acquiring and maintaining a becoming rank in life, to rescue him from the horrors of debt incurred by misfortune? Yet the law will uphold him in any degree of parsimony, short of that which would reduce his son to the necessity of seeking public charity.

Without doubt there are great interests of society which justify withholding the coercive arm of the law from these duties of imperfect obligation, as they are called; imperfect, not because they are less binding upon the conscience than those which are called perfect, but because the wisdom of the social law does not impose sanctions upon them.

A deliberate promise, in writing, made freely and without any mistake, one which may lead the party to whom it is made into contracts and expenses,

cannot be broken without a violation of moral duty. But if there was nothing paid or promised for it, the law, perhaps wisely, leaves the execution of it to the conscience of him who makes it. It is only when the party making the promise gains something, or he to whom it is made loses something, that the law gives the promise validity.

* * *

For the foregoing reasons we are all of opinion that the nonsuit directed by the Court of Common Pleas was right, and that judgment be entered thereon for costs for the defendant.

Notes

1. What promise by Wyman (the father and defendant) did Mills (the plaintiff) seek to enforce? Did the court hold that the promise was enforceable? Did Mills give Wyman anything in exchange for the promise? Did Mills rely on Wyman's promise?

2. Was it possible for Wyman to make an enforceable promise to pay Mills?

3. Would Wyman's promise be enforceable under European contract law?

FEINBERG v. PFEIFFER CO.

Court of Appeals, Missouri

322 S.W.2d 163 (1959)

DOERNER, Commissioner.

This is a suit brought in the Circuit Court of the City of St. Louis by plaintiff, a former employee of the defendant corporation, on an alleged contract whereby defendant agreed to pay plaintiff the sum of $200 per month for life upon her retirement. A jury being waived, the case was tried by the court alone. Judgment below was for plaintiff for $5,100, the amount of the pension claimed to be due as of the date of the trial, together with interest thereon, and defendant duly appealed.

The parties are in substantial agreement on the essential facts. Plaintiff began working for the defendant, a manufacturer of pharmaceuticals, in 1910, when she was but 17 years of age. By 1947 she had attained the position of bookkeeper, office manager, and assistant treasurer of the defendant, and owned 70 shares of its stock out of a total of 6,503 shares issued and outstanding. Twenty shares had been given to her by the defendant or its then president, she had purchased 20, and the remaining 30 she had acquired by

a stock split or stock dividend. Over the years she received substantial dividends on the stock she owned, as did all of the other stockholders. Also, in addition to her salary, plaintiff from 1937 to 1949, inclusive, received each year a bonus varying in amount from $300 in the beginning to $2,000 in the later years.

On December 27, 1947, the annual meeting of the defendant's Board of Directors was held at the Company's offices in St. Louis, presided over by Max Lippman, its then president and largest individual stockholder. The other directors present were George L. Marcus, Sidney Harris, Sol Flammer, and Walter Weinstock, who, with Max Lippman, owned 5,007 of the 6,503 shares then issued and outstanding. At that meeting the Board of Directors adopted the following resolution, which, because it is the crux of the case, we quote in full:

"The Chairman thereupon pointed out that the Assistant Treasurer, Mrs. Anna Sacks Feinberg, has given the corporation many years of long and faithful service. Not only has she served the corporation devotedly, but with exceptional ability and skill. The President pointed out that although all of the officers and directors sincerely hoped and desired that Mrs. Feinberg would continue in her present position for as long as she felt able, nevertheless, in view of the length of service which she has contributed provision should be made to afford her retirement privileges and benefits which should become a firm obligation of the corporation to be available to her whenever she should see fit to retire from active duty, however many years in the future such retirement may become effective. It was, accordingly, proposed that Mrs. Feinberg's salary which is presently $350.00 per month, be increased to $400.00 per month, and that Mrs. Feinberg would be given the privilege of retiring from active duty at any time she may elect to see fit so to do upon a retirement pay of $200.00 per month for life, with the distinct understanding that the retirement plan is merely being adopted at the present time in order to afford Mrs. Feinberg security for the future and in the hope that her active services will continue with the corporation for many years to come. After due discussion and consideration, and upon motion duly made and seconded, it was—

"Resolved, that the salary of Anna Sacks Feinberg be increased from $350.00 to $400.00 per month and that she be afforded the privilege of retiring from active duty in the corporation at any time she may elect to see fit so to do upon retirement pay of $200.00 per month, for the remainder of her life."

At the request of Mr. Lippman his sons-in-law, Messrs. Harris and Flammer, called upon the plaintiff at her apartment on the same day to advise her of the passage of the resolution. Plaintiff testified on cross-examination that she had no prior information that such a pension plan was contemplated, that

it came as a surprise to her, and that she would have continued in her employment whether or not such a resolution had been adopted. It is clear from the evidence that there was no contract, oral or written, as to plaintiff's length of employment, and that she was free to quit, and the defendant to discharge her, at any time.

Plaintiff did continue to work for the defendant through June 30, 1949, on which date she retired. In accordance with the foregoing resolution, the defendant began paying her the sum of $200 on the first of each month. Mr. Lippman died on November 18, 1949, and was succeeded as president of the company by his widow. Because of an illness, she retired from that office and was succeeded in October, 1953, by her son-in-law, Sidney M. Harris. Mr. Harris testified that while Mrs. Lippman had been president she signed the monthly pension check paid plaintiff, but fussed about doing so, and considered the payments as gifts. After his election, he stated, a new accounting firm employed by the defendant questioned the validity of the payments to plaintiff on several occasions, and in the Spring of 1956, upon its recommendation, he consulted the Company's then attorney, Mr. Ralph Kalish. Harris testified that both Ernst and Ernst, the accounting firm, and Kalish told him there was no need of giving plaintiff the money. He also stated that he had concurred in the view that the payments to plaintiff were mere gratuities rather than amounts due under a contractual obligation, and that following his discussion with the Company's attorney plaintiff was sent a check for $100 on April 1, 1956. Plaintiff declined to accept the reduced amount, and this action followed. Additional facts will be referred to later in this opinion.

Appellant's first assignment of error relates to the admission in evidence of plaintiff's testimony over its objection, that at the time of trial she was sixty- five and a half years old, and that she was no longer able to engage in gainful employment because of the removal of a cancer and the performance of a colocholecystostomy operation on November 25, 1957. Its complaint is not so much that such evidence was irrelevant and immaterial, as it is that the trial court erroneously made it one basis for its decision in favor of plaintiff. As defendant concedes, the error (if it was error) in the admission of such evidence would not be a ground for reversal, since, this being a jury-waived case, we are constrained by the statutes to review it upon both the law and the evidence, Sec. 510.310 RSMo 1949, V.A.M.S., and to render such judgment as the court below ought to have given. Section 512.160, Minor v. Lillard, Mo., 289 S.W.2d 1; Thumm v. Lohr, Mo.App., 306 S.W.2d 604. We consider only such evidence as is admissible, and need not pass upon questions of error in the admission and exclusion of evidence. Hussey v. Robinson, Mo., 285 S.W.2d 603. However, in fairness to the trial court it should be stated that while he briefly referred to the state of plaintiff's health as of the time of the trial in his amended findings of fact, it is obvious from his amended grounds

for decision and judgment that it was not, as will be seen, the basis for his decision.

Appellant's next complaint is that there was insufficient evidence to support the court's findings that plaintiff would not have quit defendant's employ had she not known and relied upon the promise of defendant to pay her $200 a month for life, and the finding that, from her voluntary retirement until April 1, 1956, plaintiff relied upon the continued receipt of the pension installments. The trial court so found, and, in our opinion, justifiably so. Plaintiff testified, and was corroborated by Harris, defendant's witness, that knowledge of the passage of the resolution was communicated to her on December 27, 1947, the very day it was adopted. She was told at that time by Harris and Flammer, she stated, that she could take the pension as of that day, if she wished. She testified further that she continued to work for another year and a half, through June 30, 1949; that at that time her health was good and she could have continued to work, but that after working for almost forty years she thought she would take a rest. Her testimony continued:

"Q. Now, what was the reason—I'm sorry. Did you then quit the employment of the company after you—after this year and a half? A. Yes.

"Q. What was the reason that you left? A. Well, I thought almost forty years, it was a long time and I thought I would take a little rest.

"Q. Yes. A. And with the pension and what earnings my husband had, we figured we could get along.

"Q. Did you rely upon this pension? A. We certainly did.

"Q. Being paid? A. Very much so. We relied upon it because I was positive that I was going to get it as long as I lived.

"Q. Would you have left the employment of the company at that time had it not been for this pension? A. No.

"Mr. Allen: Just a minute, I object to that as calling for a conclusion and conjecture on the part of this witness.

"The Court: It will be overruled.

"Q. (Mr. Agatstein continuing): Go ahead, now. The question is whether you would have quit the employment of the company at that time had you not relied upon this pension plan? A. No, I wouldn't.

"Q. You would not have. Did you ever seek employment while this pension was being paid to you—A. (interrupting): No.

"Q. Wait a minute, at any time prior—at any other place? A. No, sir.

"Q. Were you able to hold any other employment during that time? A. Yes, I think so.

"Q. Was your health good? A. My health was good."

It is obvious from the foregoing that there was ample evidence to support the findings of fact made by the court below.

We come, then, to the basic issue in the case. While otherwise defined in defendant's third and fourth assignments of error, it is thus succinctly stated in the argument in its brief: "* * * whether plaintiff has proved that she has a right to recover from defendant based upon a legally binding contractual obligation to pay her $200 per month for life."

It is defendant's contention, in essence, that the resolution adopted by its Board of Directors was a mere promise to make a gift, and that no contract resulted either thereby, or when plaintiff retired, because there was no consideration given or paid by the plaintiff. It urges that a promise to make a gift is not binding unless supported by a legal consideration; that the only apparent consideration for the adoption of the foregoing resolution was the "many years of long and faithful service" expressed therein; and that past services are not a valid consideration for a promise. Defendant argues further that there is nothing in the resolution which made its effectiveness conditional upon plaintiff's continued employment, that she was not under contract to work for any length of time but was free to quit whenever she wished, and that she had no contractual right to her position and could have been discharged at any time.

Plaintiff concedes that a promise based upon past services would be without consideration, but contends that there were two other elements which supplied the required element: First, the continuation by plaintiff in the employ of the defendant for the period from December 27, 1947, the date when the resolution was adopted, until the date of her retirement on June 30, 1949. And, second, her change of position, i. e., her retirement, and the abandonment by her of her opportunity to continue in gainful employment, made in reliance on defendant's promise to pay her $200 per month for life.

We must agree with the defendant that the evidence does not support the first of these contentions. There is no language in the resolution predicating plaintiff's right to a pension upon her continued employment. She was not required to work for the defendant for any period of time as a condition to gaining such retirement benefits. She was told that she could quit the day upon which the resolution was adopted, as she herself testified, and it is clear from her own testimony that she made no promise or agreement to continue in the employ of the defendant in return for its promise to pay her a pension. Hence there was lacking that mutuality of obligation which is essential to the validity of a contract. Middleton v. Holecraft, Mo.App., 270 S.W.2d 90; Solace v. T. J. Moss Tie Co., Mo.App., 142 S.W.2d 1079; Aslin v. Stoddard County, 341 Mo. 138, 106 S.W.2d 472; Fuqua v. Lumbermen's Supply Co.,

229 Mo.App. 210, 76 S.W.2d 715; Hudson v. Browning, 264 Mo. 58, 174 S.W. 393; Campbell v. American Handle Co., 117 Mo.App. 19, 94 S.W. 815.

But as to the second of these contentions we must agree with plaintiff. . . .

* * *

Section 90 of the Restatement of the Law of Contracts states that: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." This doctrine has been described as that of "promissory estoppel," as distinguished from that of equitable estoppel or estoppel in pais, the reason for the differentiation being stated as follows:

"It is generally true that one who has led another to act in reasonable reliance on his representations of fact cannot afterwards in litigation between the two deny the truth of the representations, and some courts have sought to apply this principle to the formation of contracts, where, relying on a gratuitous promise, the promisee has suffered detriment. It is to be noticed, however, that such a case does not come within the ordinary definition of estoppel. If there is any representation of an existing fact, it is only that the promisor at the time of making the promise intends to fulfill it. As to such intention there is usually no misrepresentation and if there is, it is not that which has injured the promisee. In other words, he relies on a promise and not on a misstatement of fact; and the term 'promissory' estoppel or something equivalent should be used to make the distinction." Williston on Contracts, Rev. Ed., Sec. 139, Vol. 1.

* * *

Was there such an act on the part of plaintiff, in reliance upon the promise contained in the resolution, as will estop the defendant, and therefore create an enforceable contract under the doctrine of promissory estoppel? We think there was. One of the illustrations cited under Section 90 of the Restatement is: "2. A promises B to pay him an annuity during B's life. B thereupon resigns a profitable employment, as A expected that he might. B receives the annuity for some years, in the meantime becoming disqualified from again obtaining good employment. A's promise is binding." This illustration is objected to by defendant as not being applicable to the case at hand. The reason advanced by it is that in the illustration B became "disqualified" from obtaining other employment before A discontinued the payments, whereas in this case the plaintiff did not discover that she had cancer and thereby became unemployable until after the defendant had discontinued the payments of $200 per month. We think the distinction is immaterial. The only reason for the reference in the illustration to the disqualification of A is in connection

with that part of Section 90 regarding the prevention of injustice. The injustice would occur regardless of when the disability occurred. Would defendant contend that the contract would be enforceable if the plaintiff's illness had been discovered on March 31, 1956, the day before it discontinued the payment of the $200 a month, but not if it occurred on April 2nd, the day after? Furthermore, there are more ways to become disqualified for work, or unemployable, than as the result of illness. At the time she retired plaintiff was 57 years of age. At the time the payments were discontinued she was over 63 years of age. It is a matter of common knowledge that it is virtually impossible for a woman of that age to find satisfactory employment, much less a position comparable to that which plaintiff enjoyed at the time of her retirement.

The fact of the matter is that plaintiff's subsequent illness was not the "action or forbearance" which was induced by the promise contained in the resolution. As the trial court correctly decided, such action on plaintiff's part was her retirement from a lucrative position in reliance upon defendant's promise to pay her an annuity or pension. In a very similar case, Ricketts v. Scothorn, 57 Neb. 51, 77 N.W. 365, 367, 42 L.R.A. 794, the Supreme Court of Nebraska said:

> "* * * According to the undisputed proof, as shown by the record before us, the plaintiff was a working girl, holding a position in which she earned a salary of $10 per week. Her grandfather, desiring to put her in a position of independence, gave her the note accompanying it with the remark that his other grandchildren did not work, and that she would not be obliged to work any longer. In effect, he suggested that she might abandon her employment, and rely in the future upon the bounty which he promised. He doubtless desired that she should give up her occupation, but, whether he did or not, it is entirely certain that he contemplated such action on her part as a reasonable and probable consequence of his gift. Having intentionally influenced the plaintiff to alter her position for the worse on the faith of the note being paid when due, it would be grossly inequitable to permit the maker, or his executor, to resist payment on the ground that the promise was given without consideration."

The Commissioner therefore recommends, for the reasons stated, that the judgment be affirmed.

PER CURIAM.

The foregoing opinion by DOERNER, C., is adopted as the opinion of the court. The judgment is, accordingly, affirmed.

WOLFE, P. J., and ANDERSON and RUDDY, JJ., concur.

Notes

1. What did the Pfeiffer Company promise Mrs. Feinberg?

2. Why wasn't Mrs. Feinberg's past service of over 35 years consideration for the Pfeiffer Company's promise? Why wasn't Mrs. Feinberg's subsequent service for 18 months consideration for the Pfeiffer Company's promise? Did the record of trial support the company's argument?

3. On what grounds did the Pfeiffer Company argue that the promise should not be enforced even on the basis of promissory estoppel?

IN RE ESTATE OF DANZ

Supreme Court of Pennsylvania

444 Pa. 411, 283 A.2d 282 (1971)

BARBIERI, Justice.

This is an appeal from a decree entered by an Auditing Judge of the Orphans' Court Division of the Common Pleas Court of Philadelphia, modifying the schedule of distribution submitted by the executor, appellant herein, in connection with his first and final account. Appellant filed exceptions to the decree which were dismissed by the Court En banc, which confirmed the decree absolutely. It is from that decision that appellant has filed this appeal.

The decedent, Joseph Danz, died on October 13, 1963 leaving a will which was duly probated and on which letters testamentary were granted to appellant. At the audit a claim against the estate was presented by decedent's nephew, Lothar Danz, and his wife, Frieda (nee Wiegand) Danz, appellees. The claim was based upon an alleged gift contract executed by the decedent on October 12, 1963, the day before his death, while he was hospitalized in Darmstadt, Federal Republic of Germany (hereinafter West Germany). The claim was denied by the accountant.

The amount claimed by appellees is $6,564.01 representing the amount withdrawn from decedent's account in a Philadelphia bank and forwarded to the claimants a few days prior to decedent's death. That check, however, did not clear before the bank was notified of decedent's death and, therefore, was not honored. A similar check in the amount of $3,307.20 withdrawn from another Philadelphia bank, again prior to decedent's death, did clear before notice of the decedent's death was received. In connection with this amount the accountants claim a set-off against the claimant's distributive share of the estate. The auditing judge sustained appellees' claim and dismissed the executor's set-off claim.

Appellees-claimants asserted that under West German law they had a valid claim against the estate as the document executed by decedent on October 12, 1963 is a "deed of gift" for which specific performance is available under the

German Civil Code. At the audit, a qualified expert on West German law testified concerning the code provisions dealing with gifts. During his testimony, he translated the pertinent sections of the code as follows: "The so-called paragraph, as well call it, 518 reads: "A contract through which a consideration is promised as a gift equal to donation is only valid in the form of a notarial or court document.'" * * * "A notarial form or the court form * * * the law means that a document has to put down the promise of the gift and that document has been made—not notarized but has been made by a notary public who is a lawyer also in Germany, or has been executed by the court in practice by the clerk of court with the stamp of the court or of the notary * * * Such a gift promise is in German law a contract, Sui generis, a contract of this kind, and as other contracts the paragraph 241 of the German Civil Code is the one according to which such a contract, gift, donation or whatever it is, is to be fulfilled. The obligee is entitled to request—I'm translating now Paragraph 241 of the German Civil Code—"The obligee is entitled to request from the obligor action based on the obligation."

Appellees also presented evidence that the "deed of gift" was validly executed by the decedent while he "was able to conduct his business and declare his will." Thus, the essence of appellees' claim was that the auditing judge should apply West German law under which they had an enforceable claim.

Appellant argues that appellees were prosecuting a claim arising under foreign law, had the burden of proving what that foreign law was pursuant to the Act of May 4, 1939, P.L. 42, § 5, 28 P.S. § 295, and failed to meet that burden. This contention is based on the following allegations: (a) the German law expert never examined the document, but merely testified generally from the German Civil Code relating to gifts; (b) there was no testimony regarding German conflicts of laws rules which may refer the question back to Pennsylvania law (renvoi), under which this gift would be ineffective; and (c) there was no testimony relative to the question of an oral proxy, from Lothar Danz to his wife, to accept the deed of gift, and there was no testimony relating to the written power to retroactively authorize a proxy to accept a gift, from Lothar Danz to his wife, where the death of the decedent intervened before the written acceptance.

The Court En banc in affirming the auditing judge, properly disposed of all of these arguments. First, it agreed that German law was to be applied because that is the place where the contract was made and was to be performed. See e.g., State Bank of Chicago v. King, 244 Pa. 29, 90 A. 453 (1914). The court then found this to be a valid contract under German law and that our courts should grant recognition to that law unless it was contrary to the public policy of Pennsylvania or it manifestly tended to injure the public in some way. See McCurdy's Estate, 303 Pa. 453, 458, 154 A. 707

(1931). The court then found that there could be no injury to the public resulting from a contract whereunder a man gives his property to a close relative.

The Court En banc disposed of the argument that the German law expert did not evaluate the document here for compliance with the Civil Code by holding, quite properly, that the court of the forum (the Pennsylvania court in this case), must construe, as it did here, the foreign statute to determine the validity of the contract. See, R.C.A. v. Rotman, 411 Pa. 630, 192 A.2d 655 (1963); Sexton v. Security Insurance Co. of New Haven, Conn., 13 Pa.Dist. & Co. R.2d 444 (1957).

Appellant's final argument goes to the construction placed upon the "deed of gift" by the court below relating to the amount of the gift. The instrument provided as follows: "I have requested Mr. Karl Schroff of 812 Borbeck Ave., Philadelphia 11, Pa. to withdraw the money from my accounts, deposited in Banking Institutes in Philadelphia, on my behalf and forward the same in my name to Lothar Danz and Frieda * * * Mr. Karl Schroff has forwarded a part of the saving in the amount of $6,000.00 (Dollar) by check per air-mail to Mr. and Mrs. Lothar Danz. Mr. Lothar Danz and Mrs. Frieda, nee Weigand * * * and I have agreed, that this money forwarded to me as well as another remittance in the amount of approx. 1,000.00 Dollar, which Mr. Karl Schroff will forward, shall belong to both of them.'

Frieda Danz accepted this gift on behalf of herself and her husband, Lothar. Lothar Danz, two or three days later, executed a power of attorney authorizing his wife, retroactively, to accept this gift. Thus, she accepted as his agent and he ratified her actions.

The Court En banc held that while the contract did not state any specific amounts to be withdrawn from the Philadelphia bank accounts and sent to appellees, "it is clear that decedent-donor's direction to his attorney-in-fact "to withdraw the money from my accounts" would under the facts and circumstances here present represent a gift of the total amounts involved. Taylor's Estate, 154 Pa. 183, 25 A. 1061 (1893) and Campbell's Estate, 274 Pa. 546, 118 A. 547 (1922)." This finding is amply supported by the facts of this case, especially in light of the fact that the checks for the amounts claimed by appellees were already in the mail at the time of decedent's death.

We conclude that the record in this case supports the findings of the trial court; that there was no abuse of discretion below; and that, under the circumstances, the decree appealed from should be affirmed.

Notes

1. In the United States, many disputes about gratuitous promises arise after the promisor has died. What typically happens is that a person promises

to make a gift, fully intending to keep it, but dies before he or she has the opportunity to perform. Once the person dies, the administrator of his or her estate usually must oppose enforcement of the promise. The administrator generally can dispense money and other things of value only to creditors and heirs who have enforceable claims, and not to the beneficiaries of unenforceable promises.

2. What were the promises in this case? Why did the court think that the promisor had not kept them before he died? In the United States, a check "does not of itself operate as an assignment of fund in the hands of the drawee available for its payment." U.C.C. § 3-408. Instead, a check is merely an order to the drawee to pay money, combined with an implied promise that the drawer will pay the money if the drawee does not. *See id.* § 3-414(b).

Section 3

PROMISES NOT EVIDENCED BY A SIGNED WRITING

3-1. The "Statue of Frauds" in American Contract Law

In the United States, most oral promises are enforceable even if the person making the promise never makes a record of the promise in a signed document. But there are exceptions. All state legislatures have passed statutes that make certain kinds of promises unenforceable unless they are evidenced by a writing signed by the person who made the promise. A law of this type is typically called a "statute of frauds." Legislatures have enacted these laws primarily for evidentiary reasons. They are worried that a plaintiff might allege falsely that a defendant made a promise when in fact the defendant did not. The requirement of a signed writing strives to prevent this kind of fraud.

The following is a sample statute of frauds from New York which lists several types of contracts for which a writing is required.

NEW YORK STATE GENERAL OBLIGATIONS LAW

§ 5-701. Agreements required to be in writing

a. Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

1. By its terms is not to be performed within one year from the making thereof or the performance of which is not to be completed before the end of a lifetime;

2. Is a special promise to answer for the debt, default or miscarriage of another person;

3. Is made in consideration of marriage, except mutual promises to marry;

* * *

5. Is a subsequent or new promise to pay a debt discharged in bankruptcy;

* * *

9. Is a contract to assign or an assignment, with or without consideration to the promisor, of a life or health or accident insurance policy, or a promise, with or without consideration to the promisor, to name a beneficiary of any such policy. This provision shall not apply to a policy of industrial life or health or accident insurance.

10. Is a contract to pay compensation for services rendered in negotiating a loan, or in negotiating the purchase, sale, exchange, renting or leasing of any real estate or interest therein, or of a business opportunity, business, its good will, inventory, fixtures or an interest therein, including a majority of the voting stock interest in a corporation and including the creating of a partnership interest. "Negotiating" includes procuring an introduction to a party to the transaction or assisting in the negotiation or consummation of the transaction. This provision shall apply to a contract implied in fact or in law to pay reasonable compensation but shall not apply to a contract to pay compensation to an auctioneer, an attorney at law, or a duly licensed real estate broker or real estate salesman.

Notes

1. This statute is just one of many New York statutes requiring various kinds of promises to be evidenced by a signed writing. Most states have similar statutes.

2. Why might a legislature believe that certain kinds of promises, as opposed to others, should be evidenced by a signed writing?

3. Can you think of any unintended and unfortunate consequences of preventing the enforcement of contracts not evidenced by a signed writing?

3-2. Requirements of a Writing under European Contract Law

The *Principles of European Contract Law* include the following rule, which generally disavows any requirement of a writing or notarization:

Article 2:101: *Conditions for the Conclusion of a Contract*

* * *

(2) A contract need not be concluded or evidenced in writing nor is it subject to any other requirement as to form. The contract may be proved by any means, including witnesses.

The commentary to this provision identifies important exceptions to this general rule that may exist in individual European countries. For example, some countries require a writing or notarization for contracts for the sale of land, for contracts having a value greater than a certain amount, for guarantees, employment contracts, and many other types of agreements. *See*, e.g., see, e.g., German Civil Code § 492 ("Consumer loan contracts are to be entered into in writing unless a more stringent form is provided for. Entering into the agreement in electronic form is excluded."). But, in general, there are fewer categories of contracts in Europe that require a signed writing for enforcement than in the United States. *See Principles of European Contract Law, Parts I & II* 142-43 (Ole Lando & Hugh Beale, eds. 2000).

GRAY INTERNATIONAL, INC. v. DEGUSSA, AG

United States District Court, Southern District of New York

1989 WL 51717 (S.D.N.Y.)

KEENAN, District Judge.

BACKGROUND

Plaintiff Gray International, Inc. ("Gray International"), a New York corporation, brings this action against defendant Degussa, AG ("Degussa"), a West German corporation, to recover a "finder's fee" for allegedly aiding Degussa in its merger with Metz Metallurgical Corp. ("Metz"), a New Jersey corporation. The relevant facts are substantially undisputed. In 1964, Leon Gray ("Gray"), the president of Gray International, founded that corporation which is primarily engaged in buying and selling precious metals. Gray himself has been involved in the precious metals business for over thirty years in both Europe and the United States. Gray International began to do business with Degussa in 1964. Gray was also involved in business with a small New Jersey corporation, Metz Metallurgical. The complaint alleges that in the mid-1970's Gray and Mr. Werner Knies ("Knies") of Degussa agreed orally that Gray would try to facilitate the merger of Degussa and Metz, for which Degussa would compensate Gray. The first conversation Gray and Knies had concerning Metz took place in Frankfurt, West Germany to Gray's recollection. *See* Deposition of Leon R. Gray of November 29, 1988 at 34 (hereinafter "Gray Dep."). Thereafter, Gray would meet with Knies throughout the 1970's, in Frankfurt six or seven times a year, and in New York at least five times a year. *See* Gray Dep. at 37, 40-45. In the 1980's, Gray travelled less to Europe but continued to see Knies in New York. *See* Gray Dep. at 45-46. Although Gray and Knies typically met socially over lunch or dinner, Metz was almost always discussed and Gray testified that at those meetings, Metz was "always on [his] mind." *See* Gray Dep. at 37, 48.

Gray attempted to persuade Peter Metz, the head of Metz Metallurgical, to sell his company to Degussa. These social meetings took place in New York, on the phone or at Metz' plant in New Jersey. *See* Gray Dep. at 30-31, 48-51. In 1986, Gray met with Knies in Frankfurt and discussed the upcoming merger between Degussa and Metz and Gray understood that he would be compensated after the merger later that year. *See* Gray Dep. at 81-82.

Degussa and Metz eventually merged and Gray International brought this action for a "finder's fee" alleging that Gray was due compensation from Degussa pursuant to an oral agreement. Defendant now brings this motion for summary judgment alleging that under New York General Obligations Law ("G.O.L.") § 5-701, oral finder's fee contracts are unenforceable. Plaintiff opposes arguing that New York's choice of law principles dictate that West German law should apply. For the purpose of this motion, the existence of an oral agreement is undisputed.

Discussion

* * *

Neither party disputes the fact that New York's Statute of Frauds, New York G.O.L. § 5-701(a)(10), bars the enforcement of an oral agreement for a finder's fee. The crucial issue to be decided is whether New York or West German law applies.

It is well-established that New York's choice of law rules require that the law of the jurisdiction with the greatest interest will be applied and that "the facts or contacts which obtain significance in defining State interests are those which relate to the purpose of the particular law in conflict." *Intercontinental Planning, Ltd. v. Daystrom, Inc.,* 24 N.Y.2d 372, 382 (1969); *see Fort Howard Paper Co. v. William D. Witter, Inc.,* 787 F.2d 784, 790 (2d Cir. 1986); *Pallavicini v. International Telephone & Telegraph Corp.,* 41 A.D.2d 66, 69 (1st Dep't 1973). Thus the Court must consider the contacts between the present action and the two competing jurisdictions and the interests of each jurisdiction in resolving this action.

In the present case, neither jurisdiction has significantly greater contacts than the other. Degussa is a West German corporation and many of the meetings between Knies and Gray took place in Frankfurt, including a meeting where Metz was initially discussed. There is no evidence submitted to indicate that Gray travelled to Frankfurt specifically to discuss Metz with Degussa. As Gray testified, he could not remember whether he or Degussa originally brought up the subject of the acquisition of Metz; rather, it just "came up in conversation." *See* Gray Dep. at 32-33, 36. As to contacts with New York, plaintiff is a New York corporation and Gray a New York resident. Gray met with Knies in New York and discussed the Metz acquisition on many occasions. *See* Gray Dep. at 37, 43-46, 48. In trying to persuade

Peter Metz to agree to the acquisition, Gray also met Peter Metz in New York and phoned Metz, presumably from Gray's New York home or office. *See* Gray Aff. at ¶ 23; Gray Dep. at 49. There is no testimony to indicate that Gray travelled to West Germany or that Knies travelled to New York solely for the purpose of discussing Metz. Rather, the majority, if not all of the meetings between Gray and Knies were social meetings in which the potential Metz acquisition was only one topic of conversation. *See* Gray Dep. at 43-48. Thus there is no indication that either jurisdiction has significantly more contacts with this action than the other.

The Court must also balance the interest of each jurisdiction in resolving this action. In examining the legislative history of New York G.O.L. § 5-701, New York courts have found that New York has a "unique concern for the problems associated with oral finder's-fee arrangements." *See Fort Howard Paper,* 787 F.2d at 791. Because New York is generally acknowledged as a "national and international center for the purchase and sale of businesses," New York's statute of frauds is evidence of its interest in protecting its residents and foreign entities who come to New York from "the unfounded claims" of brokers. *Daystrom,* 24 N.Y.2d at 383-84; *see Fort Howard,* 787 F.2d at 790-91; *Pallavicini,* 41 A.D.2d at 69.

As to West German law, plaintiff has submitted the affidavit of Michael A. Schwind, a Professor of Law specializing in the field of comparative law and civil law ("Schwind Aff."). Defendant has submitted the affidavit of Ernest C. Stiefel, a member of the New York and West German Bars, who has been qualified as an expert on German law in federal and state courts ("Stiefel Aff."). Although the two affidavits are submitted in opposition to one another, they are somewhat consistent in their conclusions. The Schwind affidavit indicates that West German law would recognize oral finder's fee contracts as part of an interest in "freedom of form" in contract transactions. *See* Schwind Aff. at ¶¶ 11, 13. The Stiefel affidavit does not dispute this opinion but points out that although West German law does not mandate that finder's fee contracts be written, such contracts must be proven by a clear and unambiguous showing of a relationship between the two parties and an understanding and intention to compensate. *See* Stiefel Aff. at ¶¶ 13- 17. Thus, in addition to a policy of "freedom of form," West German law also seeks to protect a client from unjustified claims of brokers. *Id.* at ¶ 13.

Consequently, although in this case it is unclear whether plaintiff's alleged oral contract would be enforceable under West German law, both West Germany and New York have an interest in discouraging unfounded finder's fee claims by brokers. The application of New York law then would not offend the interests of West Germany. Moreover, neither jurisdiction's contacts with this litigation significantly outweigh the other's contacts. Thus, this Court will defer to New York's strong public policy of protecting residents and foreign entities from unfounded brokers' claims and apply New York law.

Since New York G.O.L. § 5-701(a)(10) bars the enforcement of an oral finder's fee contract and both sides concede that a contract between Gray and Knies, if any, would have been oral, New York law bars the enforcement of that contract.

* * *

Defendant's motion for summary judgment is hereby granted as set forth in the body of this opinion and the complaint is dismissed. This action is to be removed from the active docket of this Court.

Notes

1. As a matter of statutory interpretation, why does this promise fall within the language of § 5-701(a)(10)?

2. As a matter of policy, why does New York require promises of this type to be evidenced by a signed writing? How are they different from other types of promises for which no signed writing is required for enforcement?

MEREX A.G. v. FAIRCHILD WESTON SYSTEMS, INC.

U.S. District Court for the Southern District of New York

810 F. Supp. 1356 (S.D.N.Y. 1993)

LOWE, District Judge.

Plaintiff, Merex A.G. ("Merex"), is an international trading and brokerage company located in what was formerly known as West Germany. Defendant, Fairchild Weston Systems, Inc. ("Fairchild"), is a United States corporation whose principal place of business is Syosset, Long Island, New York. This action is brought under the diversity jurisdiction of the Court. 28 U.S.C. § 1332.

This action grows out of Merex's claim that it is entitled to collect a fee or commission, pursuant to an oral agreement, for introducing Fairchild to the Peoples Republic of China ("PRC") where a business opportunity was consummated between defendant and the PRC.

* * *

Findings of Fact

Plaintiff Merex alleged that in the late Summer of 1982 Robert Neasham ("Neasham"), defendant's European market manager, approached Gerhard Mertins ("G. Mertins"), the president of Merex, at his office in West Germany, and informed him that Fairchild would be interested in selling its system of military aerial surveillance cameras—the LORAP/MTRF Sys-

tem—to the PRC. Fairchild had no contacts with the PRC, and Mertins had an ongoing business relationship with that country.

G. Mertins alleges that at the meetings with Neasham in the late summer of 1982 he informed Neasham that such a deal could be arranged but he required a ten percent commission—an amount later reduced to eight percent. G. Mertins testified that no distributorship was discussed and that he and Neasham agreed he would earn his commission upon any Fairchild sale to the PRC. They shook hands on the deal. G. Mertins believed he had reached an agreement with Fairchild through Neasham. G. Mertins testified:

> I asked him what is your authority? How long have you been with the company? He told me he was a lieutenant colonel in the Navy [sic] . . .
>
> I told him: We are together, the two old soldiers, and we have a good understanding. He [Neasham] said: Naturally, Fairchild is a generous company. And . . . he asked me: What is your request? I said: We are making such deals normal on the base of 10 percent of the sales value . . .
>
> And he agreed. He said: Even if it is going—he promised even more. I said: No, we will make the deal for 10 percent.
>
> He was agreed. . . . [W]e confirmed our agreement with [sic] shake hand.

G. Mertins further testified that his German attorney advised him that such an oral contract was valid and enforceable under German law.

[The parties subsequently negotiated a written distributorship contract (called the "buy/sell proposal" that did not mention any commission. In September 1984, following extensive discussions with Chinese officials which Mertins played a role in arranging, Fairchild sold two systems to the People's Republic of China for a price of $20,300,000. Merex requested that Fairchild pay a commission pursuant to the oral agreement, but Fairchild refused. Merex then sued Fairchild in the United States.]

* * *

II.
Choice of Law
Oral Contract

Merex argued that the oral commission agreement in Germany between G. Mertins and Neasham in August, 1982, is governed by German law and is enforceable in New York courts. He alleged that: the contract negotiations took place in Germany between Neasham and G. Mertins; plaintiff performed in Germany where his business is located; and German law would recognize an oral brokerage contract.

Fairchild argued that: the defendant was located in New York; the goods in question were manufactured and shipped from New York; the key meetings

between the parties took place in New York; and the plaintiff chose New York as the forum for the litigation.

Under this forum's conflict rule, New York courts would apply the "paramount interest" test, Hutner v. Greene, 734 F.2d 896 (2d Cir.1984), in choosing the applicable law of decision in this case. In Intercontinental Planning, Ltd. v. Daystrom, Inc., 24 N.Y.2d 372, 382, 300 N.Y.S.2d 817, 825, 248 N.E.2d 576, 581 (1969), the New York Court of Appeals defined the test:

> [T]he law of the jurisdiction having the greatest interest in the litigation will be applied and the facts or contacts which obtain significance in defining State interests are those which relate to the purpose of the particular law in conflict.

(citing Miller v. Miller, 22 N.Y.2d 12, 15-16, 290 N.Y.S.2d 734, 737, 237 N.E.2d 877, 879 (1968)).

The law in conflict in this case is the law of Germany which would recognize an oral brokerage contract, and the law of New York (General Obligations Law § 5-701(a)(10)—Statute of Frauds) which does not.

The legislative history of the Statute of Frauds reveals that the New York legislature was concerned that courts were clogged with oral brokerage contract cases which all too often degenerated into swearing contests. In order to protect New York courts from what was perceived to be widespread perjury, the legislature required that such contracts, in order to be enforceable in New York courts, be in writing subscribed by the party to be charged. See Intercontinental Planning Ltd. v. Daystrom, 24 N.Y.2d at 382- 83, 300 N.Y.S.2d at 825, 248 N.E.2d at 581; William J. Conlon & Sons, Inc. v. Wanamaker, 583 F.Supp. 212 (E.D.N.Y.1984). New York's policy of protecting its residents from unfounded finder's fee claims is clear whereas Germany's interest in protecting the reasonable expectations of its residents is much less apparent. See Denny v. American Tobacco Co., 308 F.Supp. 219, 223 (N.D. Cal. 1970) (applying similar reasoning to the choice between New York and California law).

The essence of the business relationship which plaintiff alleged in its contract claim was that Merex was to provide Fairchild an entrance into the markets of the PRC and provide the "know-who" and "know-how" in negotiating a business opportunity, i.e., the sale of LORAP camera systems. This relationship is clearly a "business opportunity" under N.Y. General Obligations Law § 5-701(a)(10). Freedman v. Chemical Constr. Corp., 43 N.Y.2d 260, 267, 401 N.Y.S.2d 176, 181, 372 N.E.2d 12, 16 (1977); see also Seven Star Shoe Co. v. Strictly Goodies, Inc., 628 F.Supp. 1237, 1240 (S.D.N.Y. 1986).

Under the rule of Intercontinental Planning, where the parties negotiated key provisions in this jurisdiction, the defendant resided in this state, and the

case was brought here, there are sufficient contacts with New York to give New York a substantial interest in applying its policy. New York Courts would rule that a business broker's claim for commission pursuant to an oral contract would be unenforceable in New York courts. Minichiello v. Royal Business Funds Corp., 18 N.Y.2d 521, 526-27, 277 N.Y.S.2d 268, 271-72, 223 N.E.2d 793, 795-96 (1966), cert. denied, 389 U.S. 820, 88 S.Ct. 41, 19 L.Ed.2d 72 (1967).

* * *

V.
Promissory Estoppel

The plaintiff in the instant case requested the Court to charge the jury under the doctrine of Philo Smith & Co. v. USLIFE Corp., 554 F.2d 34 (2d Cir. 1977), which establishes the possibility of, and requirements for, a claim of promissory estoppel.

In support of its claim of promissory estoppel plaintiff argued that it performed at all times pursuant to the oral commission promise of Neasham to Merex made in Germany in August of 1982. . . .

The Court charged the jury that in order to find for the plaintiff it must be convinced by a preponderance of the credible evidence that:

(1) a clear and unambiguous promise was made to plaintiff;

(2) plaintiff relied on the promise alleged;

(3) the performance of plaintiff was unequivocally referable to the promise alleged; and

(4) plaintiff sustained injury as a result of its reliance.

The Court further charged the jury that loss of profits was an insufficient injury to invoke the doctrine of equitable estoppel.

i. A Clear and Unambiguous Promise

After so many pages of this opinion, it seems rhetorical to state again that the defendant in this case is Fairchild. The contract plaintiff alleged was an asserted oral agreement between G. Mertins on behalf of Merex and Neasham on behalf of Fairchild.

Because the promise here, if any, was made by Neasham, plaintiff must show not only that the promise was clear and unambiguous, but that Neasham had authority to bind Fairchild. . . .

* * *

The only direct evidence in this case as to Neasham's actual authority is Neasham's testimony that he informed G. Mertins that he had no authority to

bind the company, and the testimony of Pighi and Lay that Neasham, as a sales representative, had no authority to make a contract for commissions.

G. Mertins testified he "asked Neasham what was his authority." Neasham replied that Fairchild is a generous company. When G. Mertins informed Neasham that his practice is to receive a ten percent commission, G. Mertins testified that Neasham agreed. "We confirmed our agreement with [sic] shake hand." On the record, this Court holds there is an absence of any proof, much less proof by a preponderance of the evidence, that Neasham had actual authority to bind Fairchild to an oral commission contract. Rodriguez v. Western Union Tel. Co., 285 N.Y. 667, 34 N.E.2d 375 (1941).

[The court also held that Neasham did not have apparent authority and that Fairchild did not ratify Neasham's promise.]

* * *

ii. Plaintiff's Acts Must Have Been in Reliance on the Oral Promise

Plaintiff has failed to meet his burden of proving by a preponderance of credible evidence that he reasonably relied upon the oral promise alleged to have been made by Neasham in Germany. See City of Yonkers v. Otis Elevator Co., 844 F.2d 42, 49 (2d Cir.1988) ("Yonkers officials were aware of the weakness of their position at the time they contracted, rendering reliance unreasonable."); Wurmfeld Assocs., P.C. v. Harlem Interfaith Counseling Servs., 179 A.D.2d 502, 578 N.Y.S.2d 200, 201 ("[P]laintiffs' services could not have been performed in reasonable reliance . . ."), leave to appeal dismissed, 79 N.Y.2d 1027, 584 N.Y.S.2d 439, 594 N.E.2d 933 (1992).

The alleged oral promise contradicts the terms of an admitted, subsequent, written executory agreement. The credible evidence—as opposed to plaintiff's unreliable, unsubstantiated and self-serving testimony—shows that any oral promise was superseded by the parties' later dealings. Indeed, plaintiff did not convincingly establish that the alleged oral agreement was ever discussed with Fairchild after the meeting with Neasham. Reasonable reliance cannot be based upon wishful thinking, yet nothing more is suggested by the credible evidence here; plaintiff may have preferred a percentage commission all along, but it went ahead with a deal structured in a wholly different manner.

* * *

iii. Plaintiff's Performance Must Be Unequivocally Referable to the Promise Alleged.

Plaintiff has alleged reliance on an oral agreement between G. Mertins and Neasham in Germany in August, 1982.

* * *

Where, as in the instant case, plaintiff performs under an alleged oral contract and defendant offers proof of another agreement (the sale/resale proposal) to which plaintiff's acts are equally referable, the finder of fact must be convinced that plaintiff's performance was pursuant to the contract it alleges and not another.

In the instant case, plaintiff did not perform any substantive act until after G. Mertins sent the October 6, 1982 letter to Fairchild accepting the sale/-resale proposal. It cannot on this record be said that the preponderance of evidence demonstrated reliance by plaintiff on the oral agreement. Cunnison v. Richardson Greenshields Sec., 107 A.D.2d 50, 485 N.Y.S.2d 272, 276 (1985) ("If . . . an act is equally consistent with an explanation having a basis in other than the alleged oral agreement, the part performance relied upon will not remove the agreement from the bar of the statute of frauds."); see also American Bartenders School, Inc. v. 105 Madison Co., 59 N.Y.2d 716, 463 N.Y.S.2d 424, 450 N.E.2d 230 (1983) ("[T]he doctrine of part performance is inapplicable, inasmuch as the performance is not 'unequivocally referable' to the alleged oral agreement."); Ripple's of Clearview, Inc. v. Le Havre Assocs., 88 A.D.2d 120, 452 N.Y.S.2d 447, 449, appeal denied, 57 N.Y.2d 609, 456 N.Y.S.2d 1026, 442 N.E.2d 1277 (1982).

* * *

iv. Injury

* * *

In the instant case, there has been no proof of damages other than loss of a fee. This Court charged the jury that such loss was insufficient to invoke the doctrine of promissory estoppel.

* * *

. . . This Court finds that plaintiff has not proven its claim of promissory estoppel by a fair preponderance of the credible evidence and renders a verdict for the defendant on this claim.

Note

Should reliance on a promise suffice to make it enforceable notwithstanding the statute of frauds?

Section 4

OFFER AND ACCEPTANCE

4-1. INTRODUCTION

In American contract law, if the plaintiff alleges that a promise is enforceable on the basis of consideration because there was a bargained for exchange, the plaintiff must prove that a bargain was in fact formed. Bargains typically are formed through a process of offer and acceptance. (There is no need to show an offer an acceptance for promises which are enforceable on the basis of reliance.)

European contract law is similar. In general, contracts are formed through an offer and acceptance which result in an agreement. But as in American law, an agreement is not always necessary for an enforceable promise. Article 2:107 of the *Principles of European Contract Law* says: "A promise which is intended to be legally binding without acceptance is binding."

4-2. WHAT IS AN OFFER

The *Principles of European Contract Law* specify what an "offer" is in article 2:201. This article says:

Article 2:201: *Offer*

(1) A proposal amounts to an offer if:

(a) it is intended to result in a contract if the other party accepts it, and

(b) it contains sufficiently definite terms to form a contract.

(2) An offer may be made to one or more specific persons or to the public.

(3) A proposal to supply goods or services at stated prices made by a professional supplier in a public advertisement or a catalogue, or by a display of goods, is presumed to be an offer to sell or supply at that price until the stock of goods, or the supplier's capacity to supply the service, is exhausted.

Paragraphs (1) and (2) of this article state rules that are very similar to the rules in the *Restatement (Second) of the Law of Contracts*. "An offer," the *Restatement* says, "is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that

bargain is invited and will conclude it." *Id.* § 24. But even if "a manifestation of intention is intended to be understood as an offer, it cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain." *Id.* § 33(1). The offer may "create a power of acceptance in a specified person or in one or more of a specified group of classes of persons." *Id.* § 29(2).

But paragraph (3) expresses a presumption that is contrary to American contract law. The commentary to the *Restatement (Second) of the Law of Contracts* explains:

> Advertisements of goods by display, sign, handbill, newspaper, radio or television are not ordinarily intended or understood as offers to sell. The same is true of catalogues, price lists and circulars, even though the terms of suggested bargains may be stated in some detail. It is of course possible to make an offer by an advertisement directed to the general public (see § 29), but there must ordinarily be some language of commitment or some invitation to take action without further communication.

Id. § 26 cmt. a.

LEFKOWITZ v. GREAT MINNEAPOLIS SURPLUS STORE, INC.

Minnesota Supreme Court
86 N.W.2d 689 (Minn. 1957)

MURPHY, Justice.

This is an appeal from an order of the Municipal Court of Minneapolis denying the motion of the defendant for amended findings of fact, or, in the alternative, for a new trial. The order for judgment awarded the plaintiff the sum of $138.50 as damages for breach of contract.

This case grows out of the alleged refusal of the defendant to sell to the plaintiff a certain fur piece which it had offered for sale in a newspaper advertisement. It appears from the record that on April 6, 1956, the defendant published the following advertisement in a Minneapolis newspaper:

> "Saturday 9 A.M. Sharp 3 Brand New Fur Coats Worth to $100.00
> First Come First Served $1 Each"

On April 13, the defendant again published an advertisement in the same newspaper as follows:

> "Saturday 9 A.M. 2 Brand New Pastel Mink 3-Skin Scarfs
>
> Selling for $89.50
>
> Out they go Saturday. Each ... $1.00

1 Black Lapin Stole Beautiful, worth $139.50 ... $1.00

First Come First Served"

The record supports the findings of the court that on each of the Saturdays following the publication of the above-described ads the plaintiff was the first to present himself at the appropriate counter in the defendant's store and on each occasion demanded the coat and the stole so advertised and indicated his readiness to pay the sale price of $1. On both occasions, the defendant refused to sell the merchandise to the plaintiff, stating on the first occasion that by a "house rule" the offer was intended for women only and sales would not be made to men, and on the second visit that plaintiff knew defendant's house rules.

The trial court properly disallowed plaintiff's claim for the value of the fur coats since the value of these articles was speculative and uncertain. The only evidence of value was the advertisement itself to the effect that the coats were "Worth to $100.00," how much less being speculative especially in view of the price for which they were offered for sale. With reference to the offer of the defendant on April 13, 1956, to sell the "1 Black Lapin Stole * * * worth $139.50 * * *" the trial court held that the value of this article was established and granted judgment in favor of the plaintiff for that amount less the $1 quoted purchase price.

1. The defendant contends that a newspaper advertisement offering items of merchandise for sale at a named price is a "unilateral offer" which may be withdrawn without notice. He relies upon authorities which hold that, where an advertiser publishes in a newspaper that he has a certain quantity or quality of goods which he wants to dispose of at certain prices and on certain terms, such advertisements are not offers which become contracts as soon as any person to whose notice they may come signifies his acceptance by notifying the other that he will take a certain quantity of them. Such advertisements have been construed as an invitation for an offer of sale on the terms stated, which offer, when received, may be accepted or rejected and which therefore does not become a contract of sale until accepted by the seller; and until a contract has been so made, the seller may modify or revoke such prices or terms. Montgomery Ward & Co. v. Johnson, 209 Mass. 89, 95 N.W. 290; Nickel v. Theresa Farmers Co-op. Ass'n, 247 Wis. 412, 20 N.W.2d 117; Lovett v. Frederick Loeser & Co. Inc., 124 Misc. 81, 207 N.Y.S. 753; Schenectady Stove Co. v. Holbrook, 101 N.Y. 45, 4 N.E. 4; Georgian Co. v. Bloom, 27 Ga.App. 468, 108 S.E. 813; Craft v. Elder & Johnson Co., 38 N.E.2d 416, 34 Ohio L.A. 603; Annotation, 157 A.L.R. 746.

The defendant relies principally on Craft v. Elder & Johnston Co. supra. In that case, the court discussed the legal effect of an advertisement offering for sale, as a one-day special, an electric sewing machine at a named price. The view was expressed that the advertisement was (38 N.E.2d 417, 34 Ohio

L.A. 605) "not an offer made to any specific person but was made to the public generally. Thereby it would be properly designated as a unilateral offer and not being supported by any consideration could be withdrawn at will and without notice." It is true that such an offer may be withdrawn before acceptance. Since all offers are by their nature unilateral because they are necessarily made by one party or on one side in the negotiation of a contract, the distinction made in that decision between a unilateral offer and a unilateral contract is not clear. On the facts before us we are concerned with whether the advertisement constituted an offer, and, if so, whether the plaintiff's conduct constituted an acceptance.

There are numerous authorities which hold that a particular advertisement in a newspaper or circular letter relating to a sale of articles may be construed by the court as constituting an offer, acceptance of which would complete a contract. J. E. Pinkham Lumber Co. v. C. W. Griffin & Co., 212 Ala. 341, 102 So. 689; Seymour v. Armstrong & Kassebaum, 62 Kan. 720, 64 P. 612; Payne v. Lautz Bros. & Co., City Ct., 166 N.Y.S. 844, affirmed, 168 N.Y.S. 369, affirmed, 185 App.Div. 904, 171 N.Y.S. 1094; Arnold v. Phillips, 1 Ohio Dec. Reprint 195, 3 West.Law J. 448; Oliver v. Henley, Tex.Civ.App., 21 S.W.2d 576; Annotation, 157 A.L.R. 744, 746.

The test of whether a binding obligation may originate in advertisements addressed to the general public is "whether the facts show that some performance was promised in positive terms in return for something requested." 1 Williston, Contracts (Rev. ed.) § 27.

The authorities above cited emphasize that, where the offer is clear, definite, and explicit, and leaves nothing open for negotiation, it constitutes an offer, acceptance of which will complete the contract. The most recent case on the subject is Johnson v. Capital City Ford Co., La.App., 85 So.2d 75, in which the court pointed out that a newspaper advertisement relating to the purchase and sale of automobiles may constitute an offer, acceptance of which will consummate a contract and create an obligation in the offeror to perform according to the terms of the published offer.

Whether in any individual instance a newspaper advertisement is an offer rather than an invitation to make an offer depends on the legal intention of the parties and the surrounding circumstances. Annotation, 157 A.L.R. 744, 751; 77 C.J.S., Sales, § 25b; 17 C.J.S., Contracts, § 389. We are of the view on the facts before us that the offer by the defendant of the sale of the Lapin fur was clear, definite, and explicit, and left nothing open for negotiation. The plaintiff having successful managed to be the first one to appear at the seller's place of business to be served, as requested by the advertisement, and having offered the stated purchase price of the article, he was entitled to performance on the part of the defendant. We think the trial court was correct in holding

that there was in the conduct of the parties a sufficient mutuality of obligation to constitute a contract of sale.

2. The defendant contends that the offer was modified by a "house rule" to the effect that only women were qualified to receive the bargains advertised. The advertisement contained no such restriction. This objection may be disposed of briefly by stating that, while an advertiser has the right at any time before acceptance to modify his offer, he does not have the right, after acceptance, to impose new or arbitrary conditions not contained in the published offer. Payne v. Lautz Bros. & Co., City Ct., 166 N.Y.S. 844, 848; Mooney v. Daily News Co., 116 Minn. 212, 133 N.W. 573, 37 L.R.A.,N.S., 183.

Affirmed.

Notes

1. Was the advertisement in this case an offer? If so, why?

2. If the advertisement had contained the "house rule" limiting the sale to women, should the court enforce it?

3. How would a tribunal following the *Principles of European Contract Law* write the opinion in this case?

NAIDITCH v. BANQUE DE GESTION PRIVEE-SIB

U.S. District Court for the Northern District of Illinois

1995 WL 548568 (N.D. Ill.)

NORDBERG, District Judge.

Plaintiff Michael Naiditch ("Naiditch") brings the present action alleging breach of contract and breach of an implied contract. According to Naiditch, Defendant Banque De Gestion Privee-SIB ("BGP") has failed to pay him, as previously promised, thirty percent of the net profits from BGP's bond options trading. Naiditch claims that thirty percent of the net profits from bond options trading during the relevant time period amounts to approximately $576,000. . . .

[The court determined that French law would govern the dispute.]

* * *

BGP argues that it is entitled to judgment as a matter of law on Naiditch's breach of contract claim because the alleged oral agreement between [Jean Frignet, the head of BGP's Capital Markets Department] and Naiditch regarding profit based bonus is too indefinite to be enforceable under French law. Naiditch responds that the oral agreement between him and Frignet is not too

indefinite to be enforceable for, if all of the facts and circumstances of the parties relations are considered, the missing terms can be implied, supplied by industry custom or deemed inessential.

Under French law, a profit-based bonus may be recovered only if either (1) a specific agreement between the employer and the employee, (2) a Bargaining Collective Agreement or a Company Collective Agreement, (3) a particular custom or (4) a particular law provides for such recovery. (Dreano's Aff. ¶ 5; Bera's Aff. ¶ 5.) Article L 121-1 of the French Labor Code sets forth that an "employment contract is subject to general law rules, and may be established in the manner the parties deem it convenient to adopt." (Dreano's Aff. ¶ 8; Bera's Aff. ¶ 8.) Thus, French law permits an agreement to be oral, written or part oral and written. Id.

The parties do not dispute that Naiditch signed a written employment agreement, the Contrat de Travail, in Chicago at the French consulate. (BGP's Stmt. ¶ 13; Naiditch's Resp. ¶ 13.) Although some disagreement exists as to whether the Contrat de Travail accurately sets forth Naiditch's terms of employment with BGP, it is uncontested that the Contrat de Travail does not provide for a profit based bonus. (BGP's Stmt. ¶ 16; Naiditch's Resp. ¶ 16.) Accordingly, Naiditch bases his claim for a bonus of thirty percent of net profits of bond options trading solely on his alleged oral agreement with Frignet.

Under French law, the establishment of a valid oral contract requires a finding that the parties have reached an agreement of wills. (Dreano's Aff. ¶ 10 citing Soc. January 7, 1981 Bull.V. No. 2; Bera's Aff. ¶ 5.) An agreement of wills requires an offer and an acceptance of such offer. (Dreano's Aff. ¶ 11; Bera's Aff. ¶ 5.) An offeror is bound by his offer once he communicates all of the essential terms, in a clear and precise manner, to the offeree. (Dreano's Aff. ¶ 12; Bera's Aff. ¶¶ 8, 12 citing J. Ghestin, Traite de Droit Civil, Le Contrat, n 224, L.G.D.J.1980; P. Debelecque, Clauses allegeant les obligations, These Aix 1981.) Where the offer contains all of the essential terms of the contract, mere acceptance of the offer by the offeree is sufficient to constitute an agreement. (Dreano's Aff. ¶ 13 citing Civ. 3rd, June 27, 1973 Sem. Jur. 1973 IV 308; Bera's Aff. ¶ 5.) However, where the offer does not convey all of the essential terms in a clear and precise manner, it does not constitute an offer to contract, but merely an offer to begin negotiations. Id. Under French law, an offer to contract for employment requires a description of the tasks to be performed by the employee, and the precise method of compensation, specifically the form and the amount. (Dreano's Aff. ¶ 14.)

The parties agree that, during his tenure at BGP, Naiditch received $5,000 a month in compensation from TransOptions, and that BGP reimbursed TransOptions for such payments. (BGP's Stmt. ¶ 9; Naiditch's Resp. ¶ 9.) However, Naiditch alleges that in addition to his monthly compensation,

Frignet promised him, prior to the executive committee meeting at Trans-Options on October 20, 1988, that BGP would pay him a bonus equivalent to thirty percent of BGP's net profits from bond options trading. (Third Amended Complaint ¶ 11.) In relation to this alleged promise, Naiditch testified at his deposition that Frignet promised him thirty percent of the profits without reference to (1) whether the percentage applied to bond options trading alone; (2) whether the percentage applied to gross profits or net profits; (3) how net profits would be calculated if the percentage applied to net profits; and (4) the amount of capital which Naiditch would be allowed to trade. (Naiditch Dep. at 33-43.) Additionally, Naiditch testified that his compensation was not discussed in detail at the TransOptions executive committee meeting on October 20, 1988. Id. at 43-47. Naiditch states that he merely asked Frignet whether he would still be getting a raise and thirty percent of the profits and Frignet replied that he would. Id. at 47-52. The minutes of the executive committee meeting reflect no discussion regarding Naiditch's compensation. (Stumpf Aff.Ex. E.) Finally, Naiditch testified that he could recall no further conversations with Frignet, prior to leaving for Paris on or about November 2, 1988, regarding the compensation package he would receive from BGP. Id. at 51.

Based on Naiditch's own deposition testimony, BGP asserts that it is entitled to judgment as a matter of law. According to BGP, Naiditch's own testimony affirms that the alleged oral agreement is too indefinite to be enforced because BGP never communicated the offer in clear and precise terms. The Court agrees with BGP that absent specification of at least some of the terms, whether the percentage applied to gross or net profits and how net profits would be calculated, Frignet's offer of thirty percent was merely an offer to negotiate, and not an offer to contract.

Naiditch responds that the parties' failure to specify the above terms does not require judgment for BGP on his breach of contract claim because all of the missing terms can be implied, supplied by industry standard or custom, or deemed inessential to the contract. First, Naiditch asserts that, as Frignet promised him thirty percent of the profits in the context of offering him a position as the head of options trading for BGP, see Naiditch Dep. at 40, a trier of fact could reasonably assume that Frignet's promise of thirty percent of the profits referred to those profits earned by BGP's option trading group. Moreover, as BGP had not yet initiated its equity and index options trading, see id., Naiditch claims that a reasonable trier of fact could further infer that Frignet's promise referred to thirty percent of bond options trading. However, even if this Court assumes that a trier of fact could reasonably infer from context that Frignet's offer of thirty percent of the profits referred to thirty percent of the profits of the options trading group, which at that time only included profits from bond options trading, the alleged oral agreement still lacks numerous other essential terms which cannot be supplied by context.

Naiditch asserts that custom dictates that "thirty percent of profits" refers to net profits and that accepted cost accounting principles can be relied upon to establish deductible trade related expenses. Naiditch's assertion relies upon Seidman's affidavit and the conclusions therein that in the United States a reference to a share of "profits" would be a reference to net profits and expenses customarily deducted from gross profits include capital charges, transactions fees, lease payments for exchange memberships, other exchange dues and fees, commissions, and office expenses. (Seidman's Aff. ¶¶ 5, 9.) However, as this Court has struck Seidman's affidavit, Naiditch's assertions are without adequate support. Similarly, Naiditch cannot turn to Bera's affidavit for support because to the extent Bera's affidavit relies on Seidman's affidavit, the Court has also struck Bera's affidavit. Finally, Naiditch's statement in his affidavit that it "was and is his understanding that profit-sharing arrangements involving options trading, unless otherwise specified, are for the sharing of net profits," is an assumption or conclusory statement not based on any fact, and thus not worthy of credit on a motion for summary judgment. See Naiditch's Aff. ¶ 3; Shroeder v. Copley Newspaper, 879 F.2d 266, 269 n. 1 (7th Cir. 1989).

Just as Naiditch cannot rely on Seidman's affidavit for the assertion that a share of the "profits" refers to net profits and for the proper calculation of net profits, he cannot rely on Seidman's affidavit to support his contention that an explicit agreement on the amount of capital available to Naiditch for options trading is unnecessary for an enforceable agreement under French law. See Seidman's Aff. ¶¶ 6, 7 stating that when a trader is trading for a large financial institution, the amount of capital available to the trader is seldom an issue and affirming that to obtain and maintain its dealer franchise, BGP would be required, either by regulation or the needs of business, to commit significant capital to debt options trading.

Contrary to Naiditch's contentions, the above analysis indicates that the terms absent from Frignet's promise of thirty percent of the profits cannot be implied, supplied by custom or deemed inessential. Accordingly, without any indication as to whether the percentage promised by Frignet applied to net or gross profits, how net profits would be calculated and the extent of the capital available to Naiditch, this Court concludes that, under French law, Frignet's alleged promise is too indefinite to be enforceable, and is more appropriately characterized as an offer to negotiate.

In addition to its argument that the alleged oral agreement is too indefinite to be enforceable, BGP argues that various admissions made by Naiditch further demonstrate that the parties never defined essential elements of the agreement. Under French law, prior or subsequent inconsistent statements by a party to an alleged oral contract may be considered in determining whether the parties had sufficiently specified the essential terms of the contract. (Bera's Aff. ¶ 15.)

BGP notes that it is uncontested that, on June 3, 1989, Naiditch submitted to BGP a proposal, the purpose of which was "to acknowledge and reaffirm the basic intentions of the bonus agreement made between BGP, Patrice Mignot and Michael Naiditch concerning AMM operations." (Stumpf Aff.Ex. F.) It is also undisputed that the June 3 proposal provided that Naiditch and the AMM team together would receive thirty percent of the net profits from bond options trading. Id. BGP attributes significance to Naiditch's June 3 proposal because, unlike the alleged prior bonus agreement, the June 3 proposal provided that the AMM team, as a whole, would be entitled to thirty percent of the net profits from bond options trading. Moreover, the June 3 proposal provided a definition of net profits even though Naiditch testified at his deposition that he and Frignet had not discussed how thirty percent of the profits would be calculated. Id.; Naiditch's Dep. at 48-52. BGP argues that, as Naiditch's June 3 proposal is substantially different from the terms of the oral agreement which Naiditch allegedly entered into with Frignet, on or about October 20, 1988, it further demonstrates the indefiniteness of the alleged oral agreement between BGP and Naiditch. This Court agrees and attributes significance to the fact that the language of Naiditch's June 3 proposal, which requests a thirty percent profit based bonus for the entire AMM Group, is inconsistent with Naiditch's present claim that Frignet promised Naiditch alone thirty percent of the profits.

In his defense, Naiditch asserts that his affidavit and deposition testimony explains the inconsistency between his June 3 proposal and his present claim. Naiditch's affidavit states that the June 3 proposal represented a tactical decision to limit his demands and accept less than his contractual due. (Naiditch's Aff. ¶ 13.) According to Naiditch, because he could not get Frignet to confirm in writing his agreement to pay him thirty percent of options trading profits, he attempted to get Frignet to commit in writing to pay thirty percent of bond options profits to the bond options group. Id. Notably, Naiditch's affidavit demonstrates how important Naiditch felt it was to get an agreement in writing, and thus suggests that Naiditch himself did not believe that the alleged promise made by Frignet was definite enough to be enforceable.

At his deposition, Naiditch testified that he was "feeling guilty that [he] was going to get thirty percent and that the traders weren't accounted for," and that "[he] knew [he] had thirty percent, and it didn't seem to [him] that [the traders] were going to get compensated by anyone else, at least satisfactorily, and ... he took it upon [his] own shoulders to share [his] money." (Naiditch's Dep. at 72, 78.) No where in his testimony does Naiditch attempt to explain why his June 3 proposal makes no reference to his alleged oral agreement with Frignet. Again, the Court finds that the absence of such an explanation indicates that Naiditch did not have an agreement with Frignet

for a profit based bonus. Consequently, the Court concludes that the June 3 proposal does indeed represent a subsequent inconsistent statement.

Similarly, the Court finds that the alleged agreement with Frignet on which Naiditch bases his claim is contradicted by Naiditch's subsequent pleadings. In his Third Amended Complaint, Naiditch claimed an alleged entitlement to thirty percent of the profits earned by BGP's bond options trading group, see Third Amended Complaint ¶¶ 11, 24. However, in his proposed Fourth Amended Complaint, Naiditch sought thirty percent of both bond options and equity and index options trading profits, see Fourth Amended Complaint ¶¶ 11, 24. Such an inconsistency highlights the fact that no specific agreement ever existed.

* * *

Note

Why does the court conclude that there was no offer in this case? Would the result be the same under American contract law?

4-3. REVOCATION OF OFFERS

Sometimes the party who has made an offer wishes to revoke it and thus prevent the formation of a contract. Is this permissible?

German Law reportedly does not allow the offeror to revoke an offer unless the offer indicates that it is revocable or subject to change. Any other offer will remain in effect until it lapses or is rejected by the offeree. *See* Basil S. Markesinis, *The German Law of Contract: A Comparative Treatise* 64 (2d ed. 2006). But the *Principles of European Contract Law* indicates that offerors in most European legal systems have more power. Article 2:202 says:

Article 2:202: *Revocation of an Offer*

(1) An offer may be revoked if the revocation reaches the offeree before it has dispatched its acceptance or, in cases of acceptance by conduct, before the contract has been concluded under Article 2:205(2) or (3).

(2) An offer made to the public can be revoked by the same means as were used to make the offer.

(3) However, a revocation of an offer is ineffective if:

(a) the offer indicates that it is irrevocable; or

(b) it states a fixed time for its acceptance; or

(c) it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer.

Paragraphs (1) and (2) contain rules similar to the rules applicable in American contract law. But American contract law does not follow the rule contained in paragraph (3). In general, under a American contract law, the offeror can freely revoke an offer at any time until the offeree accepts it. Section 42 of the *Restatement (Second) of the Law of Contract* says: "An offeree's power of acceptance is terminated when the offeree receives from the offeror a manifestation of an intention not to enter into the proposed contract." An important exception is that an offeror cannot revoke an offer if the offeror has made an enforceable promise to keep the offer open. A promise to keep an offer open (traditionally called an "option contract") is enforceable only if it has a basis for enforcement, such as reliance or consideration. *See id.* § 37 cmt. a ("An option contract is a promise which meets the requisites of a contract and limits the promisor's power to revoke an offer.").

DICKINSON v. DODDS

Court of Appeal, Chancery Division
2 Ch. Div 463 (1876)

On Wednesday, the 10th of June, 1874, the defendant John Dodds signed and delivered to the plaintiff, George Dickinson, a memorandum, of which the material part was as follows:

"I hereby agree to sell to Mr. George Dickinson the whole of the dwellinghouses, garden ground, stabling, and outbuildings thereto belonging, situate at Croft, belonging to me, for the sum of £800. As witness my hand this tenth day of June, 1874.

"£800. [Signed] John Dodds."

"P.S. This offer to be left over until Friday, 9 o'clock a.m. J.D. (the twelfth), 12th June, 1874.

[Signed] J. Dodds."

The bill alleged that Dodds understood and intended that the plaintiff should have until Friday, 9 a.m., within which to determine whether he would or would not purchase, and that he should absolutely have until that time the refusal of the property at the price of £800, and that the plaintiff in fact determined to accept the offer on the morning of Thursday, the 11th of June, but did not at once signify his acceptance to Dodds, believing that he had the power to accept it until 9 a.m. on the Friday.

In the afternoon of the Thursday the plaintiff was informed by a Mr. Berry that Dodds had been offering or agreeing to sell the property to Thomas Allan, the other defendant. Thereupon the plaintiff, at about half past seven

in the evening, went to the house of Mrs. Burgess, the mother-in law of Dodds, where he was then staying, and left with her a formal acceptance in writing of the offer to sell the property. According to the evidence of Mrs. Burgess this document never in fact reached Dodds, she having forgotten to give it to him.

On the following (Friday) morning, at about seven o'clock, Berry, who was acting as agent for Dickinson, found Dodds at the Darlington railway station, and handed to him a duplicate of the acceptance by Dickinson, and explained to Dodds its purport. He replied that it was too late, as he had sold the property. A few minutes later Dickinson himself found Dodds entering a railway carriage, and handed him another duplicate of the notice of acceptance, but Dodds declined to receive it, saying: "You are too late. I have sold the property."

It appeared on the day before, Thursday, the 11th of June, Dodds had signed a formal contract for the sale of the property to the defendant Allan for £800, and had received from him a deposit of £40.

The bill in this suit prayed that the defendant Dodds might be decreed specifically to perform the contract of the 10th of June, 1874; that he might be restrained from conveying the property to Allan; that Allan might be restrained from taking any such conveyance; that, if any such conveyance had been or should be made, Allan might be declared a trustee of the property for, and might be directed to convey the property to, the plaintiff; and for damages.

* * *

JAMES, L.J., after referring to the document of the 10th of June, 1874, continued:

The document, though beginning "I hereby agree to sell, was nothing but an offer, and was only intended to be an offer, for the plaintiff himself tells us that he required time to consider whether he would enter into an agreement or not. Unless both parties had then agreed, there was no concluded agreement then made; it was in effect and substance only an offer to sell. The plaintiff, being minded not to complete the bargain at that time, added this memorandum: "This offer to be left over until Friday, 9 o'clock a.m. 12th June, 1874." That shows it was only an offer. There was no consideration given for the undertaking or promise, to whatever extent it may be considered binding, to keep the property unsold until 9 o'clock on Friday morning; but apparently Dickinson was of opinion, and probably Dodds was of the same opinion, that he (Dodds) was bound by that promise, and could not in any way withdraw from it, or retract it, until 9 o'clock on Friday morning, and this probably explains a good deal of what afterwards took place. But it is clear settled law, on one of the clearest principles of law, that this promise,

being a mere nudum pactum, was not binding, and that at any moment before a complete acceptance by Dickinson of the offer, Dodds was as free as Dickinson himself.

Well, that being the state of things, it is said that the only mode in which Dodds could assert that freedom was by actually and distinctly saying to Dickinson, "Now I withdraw my offer." It appears to me that there is neither principle nor authority for the proposition that there must be an express and actual withdrawal of the offer, or what is called a retraction. It must, to constitute a contract, appear that the two minds were at one, at the same moment of time, that is, that there was an offer continuing up to the time of the acceptance. If there was not such a continuing offer, then the acceptance comes to nothing. Of course it may well be that the one man is bound in some way or other to let the other man know that his mind with regard to the offer has been changed; but in this case, beyond all question, the plaintiff knew that Dodds was no longer minded to sell the property to him as plainly and clearly as if Dodds had told him in so many words, "I withdraw the offer." This is evident from the plaintiff's own statements in the bill.

The plaintiff says in effect that, having heard and knowing that Dodds was no longer minded to sell to him and that he was selling or had sold to some one else, thinking that he could not in point of law withdraw his offer, meaning to fix him to it, and endeavoring to bind him: "I went to the house where he was lodging, and saw his mother-in-law, and left with her an acceptance of the offer, knowing all the while that he had entirely changed his mind. I got an agent to watch for him at 7 o'clock the next morning, and I went to the train just before 9 o'clock, in order that I might catch him and give him my notice of acceptance just before 9 o'clock, and when that occurred he told my agent, and he told me, 'You are too late,' and he then threw back the paper." It is to my mind quite clear that before there was any attempt at acceptance by the plaintiff, he was perfectly well aware that Dodds had changed his mind, and that he had in fact agreed to sell the property to Allan. It is impossible, therefore, to say there was ever that existence of the same mind between the two parties which is essential in point of law to the making of an agreement. I am of opinion, therefore, that the plaintiff has failed to prove that there was any binding contract between Dodds and himself.

Notes

1. What offer did Dickinson seek to accept? On what basis did Dodds argue that he had revoked the offer? Why did Dickinson think that Dodds could not revoke the offer, but instead had to keep the offer open?

2. How could Dickinson and Dodds have structured the transaction so that Dodds could not revoke the offer for a specified period?

3. Although the common law in the United States continues to follow the rule in *Dickinson v. Dodds*, the Uniform Commercial Code contains a limited exception that applies to offers to sell goods:

U.C.C. § 2-205. *Firm Offers*

An offer by a merchant to buy or sell goods in a signed writing which by its terms give assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

4. Although European contract law does not require consideration for a promise to keep an offer open, it generally will require the person accepting the offer to act in good faith. For example, if there was an abrupt rise in market prices, a buyer could not unfairly prevent a seller from revoking an offer to sell at a low price. *See The Enforceability of Promises in European Contract Law* 298 (James Gordley, ed., 2001).

4-4. REJECTION AND ACCEPTANCE OF OFFERS

The *Principles of European Contract Law* contain the following basic rules concerning the acceptance and rejection of offers:

Article 2:203: *Rejection*

When a rejection of an offer reaches the offeror, the offer lapses.

Article 2:204: *Acceptance*

(1) Any form of statement or conduct by the offeree is an acceptance if it indicates assent to the offer.

(2) Silence or inactivity does not in itself amount to acceptance.

American contract law generally follows the same rules. According to the *Restatement (Second) of the Law of Contracts*, an "offeree's power of acceptance is terminated by his rejection of the offer, unless the offeror has manifested a contrary intention," *id.* § 38(1), and a rejection "by mail or telegram does not terminate the power of acceptance until received by the offeror," *id.* § 40. Acceptance of an offer is "a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer," including a statement or conduct. *Id.* § 50(1).

Article 2:204(2) says that silence "by itself" does not constitute acceptance. But sometimes silence is accompanied by something more. The commentary to article 2:204 says that "silence will be considered an acceptance if the parties have established a practice between themselves to this effect." *Principles of European Contract Law, Parts I & II* 170 (2000). American

contract law follows the same principle: Silence usually is not acceptance but may be a form of acceptance "[w]here because of previous dealings or otherwise, it is reasonable that the offeree should notify the offeror if he does not intend to accept." *Restatement (Second) of the Law of Contract* § 69(c).

German law reportedly contains an additional important exception to the rule that silence ordinarily does not constitute acceptance. The exception is that "an offeror must respond quickly to a counter-offer . . . or he may be deemed to have accepted it." Raymond Youngs, *English, French, and German Comparative Law* 352 (1997). American contract law does not contain a similar exception.

Problem

Author Nigel Foster describes the following case from Germany: "In BGHZ 21, 319 (*Hamburger Parkplatz Fall)*, a car owner refused to pay for car parking in a new park with an automatic entry barrier, and said that he had no intention of paying or forming a contract." Foster, Nigel G., *German Law & Legal System* 204 (1993). Should a court conclude that a contract was properly formed? Was there an offer? Was there an acceptance?

NORSE PETROLEUM A/S v. LVO INTERNATIONAL, INC.

Delaware Superior Court

389 A.2d 771 (Del. Super. 1978)

O'HARA, Judge.

This matter is before the Court on cross-motions for summary judgment. The central issue is whether the plaintiff, Norse Petroleum A/S ("Norse"), and the defendant LVO International, Inc. ("LVOI"), entered into a binding contractual agreement. An examination of the record reveals the following factual setting:

Norse is a joint stock company organized and existing under the laws of Norway, and is engaged in the exploration and development of petroleum resources. LVOI is a corporate vehicle for investments by farm cooperatives which constitute its shareholders. The cooperatives provide funds and credit to LVOI which, like Norse, is engaged in petroleum development.

Norse and Sante Fe International Corp. ("Sante Fe"), a California corporation, were the sole shareholders of Sante Fe Minerals (U.K.), Inc. ("SFM"), a Delaware corporation. Under their shareholders' agreement, Sante Fe and Norse were to provide for the financing of drilling operations in the United Kingdom sector of the North Sea. The financing was to be done in proportion to their respective ownership interests in SFM: Sante Fe having an eight-ninths interest and Norse, one-ninth.

In the summer of 1975 Norse entered into negotiations with LVOI to obtain financing for Norse's interest in the North Sea petroleum project. During the course of negotiations LVOI was represented largely by its President, Wayne E. Swearingen. In August, 1975, the parties met in Bergen, Norway to discuss the terms of their arrangement. Thereafter, they entered into a letter of intent dated August 20, 1975. The letter contemplated a financial agreement whereby LVOI would receive a call on all production of oil, gas, or other hydrocarbons to which Norse was entitled under its agreement with SFM. In return LVOI was to pay cash and assume certain of Norse's related financial obligations to SFM. Paragraph six of the letter of intent contained certain conditions including approval of the agreement by the Board of Directors of LVOI, to be obtained not later than at a scheduled Board meeting on September 23, 1975. The letter further provided that "any binding agreement on both parties must necessarily be the subject of a mutual satisfactory and definite contract."

After a meeting in Tulsa, Oklahoma, Norse and LVOI continued negotiations into September of 1975. Between September 15 and September 22, the parties negotiated a proposed arrangement by trans-Atlantic telephone and telex communications. Instead of the financial arrangement outlined in the letter of intent, this new arrangement was a proposal to buy outright the Norse position.

The first pertinent telex in the series was dated September 15, 1975. It was sent by Swearingen and confirmed LVOI's offer to purchase Norse's interest. After setting forth the major terms the telex provided:

> OUR BANK HAS GIVEN US A LETTER OF INTENT WITH MANY LOOSE ENDS, BUT TERMS ONLY SLIGHTLY TOUGHER THAN PREVIOUSLY ASSUMED, REFLECTING PERHAPS THE CHANGING MONEY MARKET. I REMAIN CONFIDENT THAT FINANCING WILL BE AVAILABLE ON SCHEDULE.

It also stated:

> INTERIM FINANCING AVAILABLE ONLY IN THE EVENT LVOI BUYS ALL NORSE STOCK IS PROPOSED TO COVER A MAXIMUM DELAY OF SIX MONTHS AND A MAXIMUM AMOUNT OF 3.5 MILLION DOLLARS WHEN AND AS CALLED BY SFM FROM DATE OUR BINDING DEAL IS SIGNED (PERHAPS EARLY IN OCTOBER) UNTIL APPROVAL FOR STOCK TRANSFER AND FINAL CONSUMATION OF SALE.

Norse sent a reply telex dated September 16 seeking to clarify the terms of the proposal. One of the concluding paragraphs of the message provided:

> I UNDERLINE THAT THE PROPOSITION HERE MADE IS ENTIRELY ON BEHALF OF THE TWO OF US AS NEGOTIATORS,

AND HAS NEITHER BEEN INTRODUCED TO NORSE'S BOARD NOR STOCKHOLDERS' COMMITTEE, NOR TO OUR BANK DUE TO THE SHORTAGE OF TIME.

After some further exchanges Swearingen sent a telex dated September 18 on behalf of LVOI, the essence of which appears as follows:

BUT BEFORE ANYTHING ELSE IS DONE YOU MUST UNDERSTAND I CANNOT AND WILL NOT MAKE ANY CONCESSIONS NOT ALREADY MADE. FURTHER, WE UNDERSTAND THAT OUR PROPOSAL MUST NOT BE USED TO TRADE WITH OTHERS. ACCORDINGLY, PLEASE BE ADVISED THAT IT IS SUBJECT TO PROMPT ACCEPTANCE AND MAY BE WITHDRAWN WITHOUT NOTICE.

I MUST HAVE ALL MATTERS OF SUBSTANCE CONFIRMED AND BE ABLE TO PRESENT A FIRM DEAL TO MY BOARD MONDAY EVENING SEPTEMBER 22 IN TYPED DRAFT FORM.

After still further communications, Norse sent the following message as part of a September 22 telex:

REFERENCE IS MADE TO YOUR TELEXES OF SEPTEMBER 15, 17, 18 AND 19, 1975.

NORSE CONFIRMS ITS WILLINGNESS TO ENTER INTO YOUR PROPOSED STOCK TRANSFER DEAL BEING YOUR SECOND ALTERNATIVE AS OUTLINED IN YOUR SEPTEMBER 15 AND 17 TELEXES.

CONSEQUENTLY NORSE ACKNOWLEDGES AND ACCEPTS THE PRINCIPLES OF THIS DEAL AND THEREBY ALL MATTERS OF SUBSTANCE IN ACCORDANCE WITH OUR TELEX CORRESPONDENCE. PLEASE CONFIRM BY TELEX LVOI ACCEPTANCE AFTER YOUR BOARD MEETING IN CHICAGO SEPTEMBER 23.

NORSE WOULD APPRECIATE TO RECEIVE A COPY OF BOB MCGOWAN'S DRAFT AGREEMENT IN ORDER TO BE PREPARED FOR OUR FINAL MEETING IN NEW YORK."

The following day, however, Swearingen informed Norse by telex that LVOI was having difficulty with bank financing. While he expressed hope that the deal would still be completed, he stated that:

. . . I MUST RELEASE YOU TO DEAL WITH OTHERS IF YOU CHOOSE TO.

Allegedly LVOI's bank, the Continental National Bank of Illinois, had altered the loan arrangement which it had proposed to LVOI. The new terms would have exposed LVOI's shareholders to considerably greater financial

risks and so LVOI's Board refused to approve it. Subsequently, in October, 1975, Norse brought suit alleging a breach of contract on the part of LVOI.

Initially, the parties have raised a choice of law issue. Norse alleges that its September 22 telex is an acceptance; therefore, a binding contract was formed in Norway on that date. Norse further argues that since the contract was formed in Norway, the Court must apply Norwegian law.

A contract is considered to exist when the final act necessary for its formation takes place. Filson v. Bell Tel. Labs, Inc., 82 N.J.Super. 185, 197 A.2d 196 (1964); Varas v. Crown Life Insurance Company, 204 Pa.Super. 176, 203 A.2d 505 (1964), cert. denied, 382 U.S. 827, 86 S.Ct. 62, 15 L.Ed.2d 72 (1965); 2 Beale, Conflict of Laws, § 326.1 (1935). Norse's telex of September 22 is purported to be an acceptance. Since an acceptance would have been effective as of the time it was transmitted, Linn v. Employers Reinsurance Corporation, 392 Pa. 58, 139 A.2d 638 (1958); Restatement of Contract (Second), § 64 (Tentative Drafts Nos. 1-7, 1973), Norse's September 22 telex may have created a contract in Norway. As Norse has pointed out, the rule in Delaware is that the law of the place where a contract is formed determines its existence and validity. Wilmington Trust Company v. Pennsylvania Company, Del.Supr., 172 A.2d 63 (1961). Therefore, Norwegian law can properly be applied in this instance.

Norse has submitted two documents purporting to set forth certain principles of Norwegian contract law. One is the affidavit of Kai Kruger, a Professor of Law at the University of Bergen. The other is a sworn certificate setting forth a translation of certain Norwegian statutes. Although LVOI has raised several objections to both documents, the Court need not rule on their admissibility. Having examined the documents, the Court finds that neither sets forth any principles which conflict with the general law of contracts as applied in Delaware, nor which would control the outcome of the case as it presently stands. Therefore, the Court need only cite American law in the deposition of these motions.

In considering the respective motions for summary judgment, the Court must weigh the facts in light most favorable to the non-moving party. Schagrin v. Wilmington Medical Center, Inc., Del.Super., 304 A.2d 61 (1973). In support of its motion LVOI alleges that a contract was never formed due to the failure of two conditions: first, the contract was never reduced to a formal, written document; and second, the contract was never approved by LVOI's Board of Directors. Norse, on the other hand, alleges that while the parties contemplated a formal contract, they did not intend to delay entering into a binding agreement until a written document was signed. Norse further alleges that approval by LVOI's Board was not a condition to the contract, but rather was merely a means of giving comfort to Norse by confirming LVOI's intention to carry out the agreement.

In support of its position Norse has filed the affidavit of Bjarne Reiber, who was Chairman of Norse during the period of negotiations. In his affidavit Reiber alleges that Wayne Swearingen represented to him that he and another LVOI officer, together with an Executive Committee, made LVOI's management decisions. Apparently the statement led Reiber to believe that approval of the contract by LVOI's Board would be perfunctorily granted once the endorsement of the Executive Committee had been obtained. According to a Swearingen telex of September 18 the substance of the proposal had been approved by the committee as of September 17. The Reiber affidavit also asserts that Norse was unaware of the financial structure of LVOI and, therefore, was not apprised of the fact that LVOI would require bank financing to consummate the contract. Accordingly, bank financing was not a condition precedent to the contract and LVOI's refusal to recognize the agreement on that basis was unjustified.

In order to be granted a summary judgment, the moving party must always establish that no genuine issue of material fact exists. State v. Wolcott, Del. Supr., 83 A.2d 759 (1951). Norse alleges that the question of bank financing raises a factual issue. However, the statement that Norse was unaware of LVOI's need for bank financing appears questionable. The language of several of the telexes cited above clearly alludes to the problem of financing. In addition, a September 16 telex from Norse to LVOI which discussed the likelihood of governmental approval of LVOI as a substitute for Norse in the oil drilling project indicates knowledge on the part of Norse. The telex concluded that the required governmental approval would probably be forthcoming,

> ESPECIALLY WHEN LVO CAN BACK UP THEIR APPLICATION WITH A CONFIRMING LETTER FROM CONTINENTAL ILLUNOIS (sic), DECLARING ITS WILLINGNESS TO FINANCE ALL LVO'S OBLIGATIONS AND DUTIES AS 1/9TH SHAREHOLDER OF SFM.

However, even if the question of bank financing does not raise a genuine factual issue, the issue of whether the contract required the approval of LVOI's Board, does. In response to the Reiber affidavit LVOI has filed a counter- affidavit in which Swearingen denies ever representing that he and the Executive Committee made LVOI's management decisions. He contends that nothing short of Board approval could bind LVOI to the agreement. This genuine factual issue, in itself, precludes the Court from granting summary judgment.

* * *

Note

What did each of the parties think would constitute an acceptance in this case? How would this case be analyzed under the *Principles of European Contract Law*?

4-5. TIME WHEN ACCEPTANCE OF AN OFFER IS EFFECTIVE

Sometimes a dispute arises over whether the offeree has accepted an offer before the offeror has revoked the offer or before the offer has lapsed. The *Principles of European Contract Law* specifies the following rules:

Article 2:205: *Time of Conclusion of the Contract*

> (1) If an acceptance has been dispatched by the offeree the contract is concluded when the acceptance reaches the offeror.
>
> (2) In case of acceptance by conduct, the contract is concluded when notice of the conduct reaches the offeror.
>
> (3) If by virtue of the offer, of practices which the parties have established between themselves, or of a usage, the offeree may accept the offer by performing an act without notice to the offeror, the contract is concluded when the performance of the act begins.

The rule in 2:205(1) differs from American contract law. In the United States, the so-called "mailbox rule" says that, unless otherwise indicated, the acceptance of an offer is effective upon its dispatch by the offeree rather than its receipt by the offeror. The *Restatement (Second) of the Law of Contracts* summarizes the rule as follows:

§ 63. *Time When Acceptance Takes Effect*

> Unless the offer provides otherwise,
>
> (a) an acceptance made in a manner and by a medium invited by an offer is operative and completes the manifestation of a mutual assent as soon as put out of the offeree's possession, without regard to whether it ever reach the offeror . . . .

The commentary to § 63 offers this rationale for the rule:

> . . . [An] explanation of the rule that the acceptance takes effect on dispatch is that the offeree needs a dependable basis for his decision whether to accept. In many legal systems such a basis is provided by a general rule that an offer is irrevocable unless it provides otherwise. The common law provides such a basis through the rule that a revocation of an offer is ineffective if received after an acceptance has been properly dispatched.

Id. § 63 cmt. a.

The rule in 2:205(2) also differs from American contract law. According to the *Restatement (Second) of the Law of Contracts* § 54(1): "Where an offer invites an offeree to accept by rendering a performance, no notification is necessary to make such an acceptance effective unless the offer requests such a notification." For example, suppose that the offeror says: "I will pay anyone who finds and returns my lost cell phone a reward of $100." The offeree can accept simply by finding and returning the cell phone without any additional requirement of notice.

Paragraph 2:205(3) expresses a rule that is similar to the rule in American contract law.

Notes

1. Can you think of a reason that the difference between 2:205(2) and § 63(a) has little practical effect in business cases?

2. What policy might justify dispensing of the requirement of notice of acceptance when the offer invites acceptance by rendering a performance?

4-6. LAPSE OF OFFERS

Under both American and European contract law, offers typically have a limited duration. After the passage of time, they lapse, and the offeree no longer can accept them. In the United States, an offer expires "at the time specified in the offer, or, if no time is specified, at the end of a reasonable time." *Restatement (Second) of the Law of Contracts* § 41(1). In Europe, the rules are similar. The *Principles of European Contract Law* contains the following provision:

Article 2:206: *Time Limit for Acceptance*

> (1) In order to be effective, acceptance of an offer must reach the offeror within the time fixed by it.
>
> (2) If no time has been fixed by the offeror acceptance must reach it within a reasonable time.
>
> (3) In the case of an acceptance by an act of performance under art. 2:205(3), that act must be performed within the time for acceptance fixed by the offeror or, if no such time is fixed, within a reasonable time.

The most significant difference between the American and European rules results from the mailbox rule discussed in Section 4-5 above. Consider the following problem.

Problem

On Tuesday, a seller made an offer to the buyer. By its terms, the offer was to expire on Friday at noon. The seller mailed a purported acceptance to the buyer on Friday morning. The acceptance did not reach the offeror until the following Monday morning. Did the offer lapse before the attempted acceptance under American or European law?

4-7. ACCEPTANCES WITH ADDITIONAL OR DIFFERENT TERMS

Sometimes the terms of a purported acceptance do not match the terms of the offer. For example, a buyer engaged in business may offer to purchase goods from a seller using one of the buyer's preprinted order forms. The seller may accept the offer using a preprinted standard form of its own. The preprinted forms of the buyer and the seller very well may contain different or additional terms given that the buyer and the seller drafted them separately. For example, one form may require arbitration of any disputes, while the other may say nothing about arbitration. Or one form may require the seller to pay shipping costs, while the other form requires the buyer to pay the shipping costs.

Because of this common problem, the question arises whether a purported acceptance that does not match the offer is effective. In the United States, the answer traditionally has been no. American contract law generally says that a contract cannot be formed unless the acceptance is the "mirror image" of the offer, meaning that the terms of the offer and acceptance cannot differ in any way. The *Restatement (Second) of Contracts* expresses this rule as follows:

> § 59. *Purported Acceptance Which Adds Qualifications*
>
> A reply to an offer which purports to accept it but is conditional on the offeror's assent to terms additional to or different from those offered is not an acceptance but is a counter-offer.

In making a counter-offer of this kind, or of any kind, the offeree terminates his or her power to accept the original offer, "unless the offeror has manifested a contrary intention or unless the counter-offer manifests a contrary intention of the offeree." *Id.* § 39(b). The problem below provides an example.

Since the 1950s, however, the Uniform Commercial Code has contained a limited exception to this rule for contracts for the sale of goods. The exception says:

> § 2-207. *Additional Terms in Acceptance or Confirmation.*
>
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an accep-

tance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

The *Principles of European Contract Law* includes a very similar rule, Article 2:208, clearly inspired by U.C.C. § 2-207.[1] But the Commission on European Contract Law acknowledges that this rule does not reflect actual laws in most European nations. On the contrary, the commentary says: "Most of [European legal] systems do not have rules corresponding to Article 2:208(2) and (3). Several of them seem to require complete agreement between the parties so that even non-material modifications in the offeree's reply prevent the contract from coming into existence—with the proviso that mere trifles are to be is regarded." *Principles of European Contract Law, Parts I & II* 180 (Ole Lando & Hugh Beale, eds. 2000).

Problem

Owner offers to pay Paver $10,000 to construct a walkway across Owner's property. Paver wrote back: "We accept but will require you to pay 50% in

1. Article 2:208: *Modified Acceptance.*
(1) A reply by the offeree which states or implies additional or different terms which would materially alter the terms of the offer is a rejection and a new offer.
(2) A reply which gives a definite assent to an offer operates as an acceptance even if it states or implies additional or different terms, provided these do not materially alter the terms of the offer. The additional or different terms then become part of the contract.
(3) However, such a reply will be treated as a rejection of the offer if:
(a) the offer expressly limits acceptance to the terms of the offer; or
(b) the offeror objects to the additional or different terms without delay; or
(c) the offeree makes its acceptance conditional upon the offeror's assent to the additional or different terms, and the assent does not reach the offeree within a reasonable time.

advance." Owner responded by saying: "Prepayment is not possible." Paver replied by saying: "We accept the original offer." Is Owner bound to a contract with Paver? Would the answer be different if the contract was for the sale of goods, such as bags of paving material for the walkway?

AFP IMAGING CORPORATION v. PHILIPS MEDIZIN SYSTEME UNTERNEHMENSBEREICH DER PHILIPS GmbH.

United States District Court for the Southern District of New York
1994 WL 652510 (S.D.N.Y.)

McKENNA, District Judge.

Plaintiff, AFP Imaging Corporation ("AFP"), filed this Complaint against Defendant, Philips Medizin Systeme Unternehmensbereich der Philips, GmbH ("PMSH"). . . .

* * *

II. Facts

The record establishes the following facts. PMSH manufactures a mammography machine known as the Mammo-Diagnost BC ("MD-BC"). In May of 1991, PMSH contacted AFP to explore the possibility that AFP would market the device in the United States. (Compl. ¶ 6.) On October 28, 1991, following a course of negotiations, PMSH transmitted a fax to AFP that included some proposed terms of a marketing agreement.[1] (Compl. ¶ 8.)

Anticipating the successful completion of these negotiations, AFP rented space at a trade show of the Radiological Society of North America ("R.S.N.A. show"), to be held from November 29, 1991 to December 6, 1991 in Chicago. (Id.) PMSH delivered an MD-BC unit to AFP shortly before the show began, so AFP could exhibit it under its own logo. (Compl. ¶ 10.)

On November 4, AFP sent PMSH two faxes. The first of these explained that AFP had "made a decision to terminate" its relationship with its previous

1. The October 28 fax included prices that AFP would pay for components of the MD-BC unit and, inter alia, the following language:

Prices include: Transport fob New York
No warranty
No. of pieces: 75-100/year
Philips will provide in first year:
— 4 MD-BC on consignment basis
— Service training (2 persons, 1 week in Hamburg)
— *PMS spare-parts-stock in Shelton*
— *Promotion support*
Details to be discussed.

(Ex. B to Compl. (emphasis supplied).)

3. The November 5 fax to PMSH stated, in relevant part:

Foot switches will be supplied by AFP *once actual agreement commences*.
The following issues are *to be finalized during out meetings at the R.S.N.A.:*
Warranty Agreement
Promotion Support
Spare Parts Consignment Stock
Four Units on Consignment Basis for Use

(Ex. C to Compl. (emphasis supplied).)

supplier of mammography equipment, which "[we] hope is further indication of our good will and interest in building a long term multi-product relationship with Philips." (Ex. B to Compl.) The second fax stated that AFP and PMSH "are in agreement in principle" regarding U.S. distribution, and "specific details of our agreement to be defined by both parties at the R.S.N.A." (Ex. N to Pl.'s Exs. on Mot.)

On November 5, AFP sent PMSH a third fax, whose stated purpose was "to clarify the status of our preliminary agreement." (Ex. C to Compl.) While this fax "acknowledged" the prices listed in the October 28 fax, it also included a list of issues "to be finalized," including the question of a manufacturer's warranty.[3] (Id.) PMSH also sent AFP a fax on November 5, speaking to the possibility of shipping a demonstration unit in time for the R.S.N.A. show and noting that "[i]n case of a positive decision, we'll ship the unit immediately." This fax also stated that spare parts, service support, training, and planning for 1992 were "still open." (Ex. 27 to Laumann Aff.)

AFP contends that PMSH's fax of October 28 was an "offer" for a distributorship agreement, which it "accepted" with its faxes of November 4 and 5. (Compl. ¶ 8.) AFP argues that PMSH breached this contract when, on the second day of the R.S.N.A. show, it requested that AFP remove the MD-BC unit from its booth, because an AFP competitor, a company that already had distribution rights to the MD-BC, objected to the adjacent AFP display. AFP complied with this request, and alleges that PMSH immediately thereafter repudiated its distributorship agreement with AFP. (Compl. ¶ 11.)

PMSH contends that the fax correspondence with AFP was merely preliminary negotiations for a distributorship agreement. PMSH claims that during negotiations at the R.S.N.A. show, it saw press releases indicating that AFP had incurred a "sudden and unexpected decline in revenues" for 1991. (Ex. 15 to Laumann Aff.) This information was contrary to earlier representations of financial stability that AFP had made to PMSH (Def.'s Br. at 9; Rabinovitch Dep. at 246), and caused PMSH to alter its position in the ongoing negotiations.

In a letter dated December 10, 1991, PMSH's mammography program manager, Peter Rauen, notified AFP's President that, given the contrary information regarding AFP financials, "I don't know when I can get the go to continue relevant negotiations." (Ex. 16 to Laumann Aff.) In a communication dated January 24, 1992, PMSH sent AFP a proposal that conditioned a distributorship on AFP providing an irrevocable Letter of Credit to guarantee payment. (Ex. 17 to Laumann Aff.) PMSH alleges that AFP never accepted this or any subsequent proposal, so that the parties never entered into a binding agreement.

In a letter dated February 10, 1992, AFP notified PMSH that the requirement of a Letter of Credit was in contravention of the terms of an existing

agreement. (Ex. 21 to Laumann Aff.) This letter also stated that, pursuant to negotiations, the distributorship was for an initial term of three years, and included warranty parts provided by PMSH, but warranty labor provided by AFP. No price for the MD-BC units was specified under these warranty terms. (Id.)

On February 25, 1992, M.D. Buylines, a trade publication for the medical hardware industry, published a brief article stating that, while AFP sources at the R.S.N.A.show had announced a distributorship arrangement with PMSH, "according to Philips' corporate sources, . . . there was never such an agreement with AFP and the RSNA demo in the AFP booth was all a 'mistake.'" (Ex. D to Compl.) M.D. Buylines urged those who had made commitments to purchase the unit from AFP to cancel their orders immediately. (Id.)

On March 9, 1992, AFP sold the MD-BC display unit to a hospital for $47,550 (Ex. 23 to Laumann Aff.), but subsequently refused to pay a PMSH invoice. (Ex. 24 to Laumann Aff.; Rabinovitch Dep. at 319.) AFP contends that it is entitled to keep the proceeds of the sale as an offset against its damages from PMSH's breach. (Def.'s Reply to Countercl. ¶ 21.)

AFP commenced this action against PMSH on August 14, 1992. Count I of the Complaint alleged breach of the distribution contract for the MD-BC unit. . . .

III. Discussion

A. Choice of Law

* * *

The Court finds it difficult to determine whether New York or Germany has the most significant contacts with the instant action. . . .

This Court need not resolve the choice of law issue, however, since it finds that the same results obtain under New York contract law and German contract law, the parties having shown the latter to the Court's satisfaction. (Schmidt Decl.; Klaus Decl.; Schmidt Reply Decl.)

The provision of German law most relevant to this action is § 154 of the German Civil Code, which requires that "declarations by both parties show agreement on every point on which according to the declaration of even one of them agreement is required." 1 E.J. Cohen, Manual of German Law ¶ 160 (1968) (emphasis added) (Ex. B to Kupka Decl.) Section 154 is not applicable when the parties, "despite leaving terms to be discussed, demonstrate their intention to bind themselves." (Kupka Decl. ¶ 14.) "This intent may be found if the parties begin to perform the contract despite some unresolved contract issues." (Id.)

As discussed in sections III. B. and III. C., the Court has determined, as a matter of law, that the parties neither demonstrated an intention to bind themselves by November 5, 1991, nor commenced performance at any time. The Court therefore concludes that under the stringent standards of German law, no contract was formed. . . .

B. Contractual Intent

PMSH argues that the documents evidencing its alleged contract with AFP are insufficient to satisfy the applicable statute of frauds. This question is considered infra. However, a more fundamental inquiry is whether the parties achieved a "meeting of the minds" that is always a prerequisite to contract formation.

> The peculiar rules of the Statute of Frauds merely require that to be put in writing which may be left to parol in other cases. The fundamental question . . . is whether there was any contract; any actual meeting of minds on all the material elements of the agreement. If a material element of a contemplated contract is left for future negotiations, there is no contract enforcible under the Statute of Frauds or otherwise.

Ansorge v. Kane, 244 N.Y. 395, 398 (1927); see also Kusky v. Berger, 225 N.Y.S.2d 797, 798 (Sup.Ct. 1962) (complaint dismissed where preliminary mortgage agreement had indefinite interest rate, indicating no contract), aff'd, 249 N.Y.S.2d 858 (A.D.2d Dept.1964); Kleinschmidt Div. of SCM Corp. v. Futuronics Corp., 41 N.Y.2d 972, 973 (1977) (no contract under the Uniform Commercial Code where dispute over material terms manifested a lack of contractual intent). Common law principles are employed to determine whether a meeting of the minds has occurred, even where the Uniform Commercial Code ("U.C.C.") otherwise controls. See, e.g., Cyberchron Corp. v. Calldata Sys. Dev., 831 F.Supp. 94, 108 (E.D.N.Y. 1993) (applying New York common law on the issue of intent to be bound in a U.C.C. case).

While the parties must have an agreement, it is not required that every one of its terms be fixed with complete certainty for the contract to have legal efficacy. See Park Inn Hotel, Inc. v. Messing, 224 N.Y.S.2d 179, 184 (Sup.-Ct. 1962); Biothermal Process Corp. v. Cohu & Co., 119 N.Y.S.2d 158, 164 (Sup.Ct.), modified, 126 N.Y.S.2d 1 (A.D. 1st Dept.1953), aff'd, 308 N.Y. 689 (1954). The U.C.C. is particularly forgiving of indefinite terms—provided that the parties intended to contract. See, e.g., Kleinschmidt, 41 N.Y.2d at 973 ("[I]f there be no basic agreement, the code will not imply one.").

The Court has carefully searched the entire record for evidence of contractual intent, going farther than it is allowed to go. Crabtree v. Elizabeth Arden Sales Corp., 305 N.Y. 48, 55-56 (1953) (parol evidence is admissible to connect papers, but not to establish missing terms). The Court concludes, as a matter of law, that the parties never reached the stage in their negotia-

tions where they intended to be bound. A few examples will suffice to demonstrate the lack of contractual intent.

First, Plaintiff argues that the faxes of November 4 and 5 constitute acceptance of an October 28 offer from PMSH. The plain language of these documents indicates the contrary. Phrases such as "indication of our . . . interest in a long term relationship," "clarify the status of our preliminary agreement," "once actual agreement commences," and "issues to be finalized" are hardly suggestive of assent to an offer. Supra n.3. Similarly, the price of the MD-BC unit was merely "acknowledge[d]" in the purported acceptance. Supra p. 4.

In V'Soske v. Barwick, 404 F.2d 495 (2d Cir. 1968), cert. denied, 394 U.S. 921 (1969), the trial court found that correspondence between parties negotiating the sale of a business was "almost a classic case of preliminary negotiations which never ripened into a contract." Id. at 499. The Second Circuit reversed, finding the correspondence established both contractual intent and all material contract terms. V'Soske and its progeny are easily distinguished from the case at bar. In V'Soske, early correspondence between the parties referred to an "offer" and to the deadline for its "accept [ance]." Id. at 497. Subsequent correspondence included such language as "[w]e have reviewed your offer carefully and have come to the conclusion that we are willing to sell our business at the price you propose." Id. Although the parties had disagreed over a contractual provision relating to the purchase price, the Court observed that "the term had a well defined meaning and provides a method of valuation by which the exact amount contemplated can be determined." Id. at 500. While the record in V'Soske clearly established that the parties considered themselves bound, the correspondence in the instant action is devoid of similar language of offer and acceptance.

Second, the purported offer and acceptance disagree on whether a warranty would be provided by PMSH, and if so, what it would cost. The prolonged course of negotiations over the warranty issue demonstrates that the parties considered it material to their agreement. Negotiations occurred as late as December 1, 1991, at the R.S.N.A. show and were never finalized. (Hale Dep. at 87, 115-16, 119, 453-55.) The price of the warranty is not analogous to the unresolved term in V'Soske, which the Second Circuit observed had a "well defined meaning." 404 F.2d at 500. Other unresolved terms include promotion support and spare parts stock. (Rabino vitch Dep. at 108, Hale Dep. at 199.)

Third, AFP has argued that its contract with PMSH included not only the distribution of the MD-BC unit, but also other PMSH products, since "the margins [of the MD-BC] were in themselves not as desirable as we would like." (Rabinovitch Dep. at 185; see Id. at 185, 496; Compl. ¶¶ 15, 16.) If AFP concedes that a commercially viable arrangement required distribution

of additional products, the preliminary state of negotiations for those products, witness the language of the first fax of November 4, supra p. 4, casts doubt on the status of the MD-BC distributorship agreement.

Other issues deserve brief mention. The parties' fax correspondence does not address the issue of terms of payment and AFP concedes that this issue was not resolved in oral negotiations before the R.S.N.A. show. (Hale Dep. at 150.) Subsequent negotiations over the requirement of a Letter of Credit requirement prove that terms of payment was also an unresolved material element of the agreement. Nor does the fax correspondence address the duration of this "multi- year" distributorship, which AFP now contends was three years. (Rabinovich Dep. at 181.) Finally, despite the breakdown of negotiations at the R.S.N.A. show in early December, and PMSH's letter of December 10, 1991, informing AFP that "negotiations" were on hold (Ex. 16 to Laumann Aff.), AFP did not assert any rights under the purported contract until February 10, 1992. (Ex. 21 to Laumann Aff.) This gap of over two months is hard to understand if AFP indeed considered itself contractually bound.

The Court therefore concludes that AFP and PMSH failed to successfully conclude their preliminary negotiations—no distributorship agreement was ever formed. This determination is appropriately made on a motion for summary judgment. Mallad Constr. Corp. v. County Fed. Sav. & Loan Ass'n, 32 N.Y.2d 285, 291 (1973) (where "a question of intention is determinable by written agreements, the question is one of law, appropriately decided ... on a motion for summary judgment."); see also Wards Co. v. Stamford Ridgeway Assocs., 761 F.2d 117, 120 (2d Cir. 1985) (summary judgment appropriate in contract dispute where meaning urged by non-moving party is not "fairly reasonable").

The issue of contractual intent is dispositive of the breach of contract claim, however the Court will address AFP's other arguments.

C. Intent to be Bound in the Absence of a Formal Document

AFP argues that the parties intended to be bound before the signing of a formal document.[8] There are two established rules in this area: first, if the parties intend not to be bound until they have executed a formal document,

8. PMSH counters that "Rabinovitch testified that he expected a final writing evidencing the parties' agreement on material issues" (Def.'s Br. at 27), but its citation to the Rabinovitch Deposition reveals no such statement by AFP's President:

> Q. Did you have any expectations at any point one way or the other whether you'd have these agreements put down in writing at some point?
>
> A. No. I think the only thing that we were waiting for was the confirmation of the items and issues that were pivotal to moving ahead commercially . . . and that came forth in writing and were accepted by us in the documents that we've all shared.

(Rabinovitch Dep. at 175.) Clearly AFP's president was not referring to a final and formal written instrument, but only to the fax correspondence of October 28, November 4 and 5.

they will not be bound until then; and second, the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event. V'Soske, 404 F.2d at 499; Zirman v. Beck, 225 N.Y.S.2d 330, 332 (Sup.Ct. 1962).

In determining whether parties intended to be bound in absence of a document executed by both sides, the Court is to consider whether there was an express reservation of the right not to be bound in the absence of a writing; whether there has been partial performance; whether all terms of the alleged contract have been agreed upon; and whether the agreement at issue is the type of contract that is usually committed to writing. Winston v. Mediafare Entertainment Corp., 777 F.2d 78, 80 (2d Cir.1986).

Here the parties did not expressly reserve the right not to be bound in the absence of a writing, but caselaw suggests that this factor is of greatest importance where the parties have exchanged draft contracts, or other documents that might prematurely indicate the consummation of an agreement. See, e.g., Zucker v. Katz, 836 F.Supp. 137, 144 (S.D.N.Y.1993). No such documents were exchanged by AFP or PMSH by November 5, 1991.

To bolster its argument that the signing of a formal agreement was a mere technicality, Plaintiff points to PMSH's shipment of one MD-BC unit to AFP as "constitut[ing] commencement of performance by both parties and demonstrat[ing] the existence of an enforceable agreement." (Pl.'s Mem. at 27.) While a shipment of goods may constitute an "unmistakable signal" that both parties believed they had a binding agreement, R.G. Group Inc. v. Horn & Hardart Co., 751 F.2d 69, 75-76 (2d Cir.1984), AFP may not characterize delivery of this particular machine as "part performance." AFP concedes that the unit was intended for display at the R.S.N.A. show, and was not the first shipment intended for resale under a distribution contract. (Pl.Mem. at 6.) Furthermore, AFP has previously displayed a mammography unit at a trade show, "to test what kind of reaction we were going to get from the marketplace," even though it had no distribution agreement with the manufacturer of that unit. (Hale Dep. at 307-308.) Plaintiff has therefore demonstrated, by its own prior conduct, that displaying a manufacturer's wares at a trade show may not evidence a contractual relationship.

Looking to the last Winston factor, a multi-year distributorship can only be characterized as "the type of agreement that is usually committed to writing." 777 F.2d at 80. AFP entered into a formal written contract with its previous mammography supplier, as well as with another supplier of medical equipment. (Exs. 28, 29 to Laumann Aff.) These documents are 19 and 7 pages long, respectively, and include detailed warranty provisions. (Id.) AFP also concedes that this is the type of agreement that is "usually" memorialized by a formal contract. (Pl.'s Br. at 31.) Finally, a distributorship is of suffi-

cient complexity that it would be unlikely to be consummated without a written contract. (Kirschner Decl. ¶¶ 2-6; Moakley Decl. at 99); see also Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 262-63 (2d Cir.) (magnitude and complexity of $4 million corporate sale warranted a written agreement), cert. denied, 469 U.S. 828 (1984). Under a Winston analysis it is clear that the parties did not intend to be bound in the absence of a written document.

D. Statute of Frauds

* * *

Since the Court has found that a dispute over several essential terms, including warranty, payment terms, promotional support and the duration of the distributorship demonstrated a lack of intent to be bound, the writings proffered by AFP fail to satisfy the threshold requirement of U.C.C. § 2-201 of "evidencing a contract."*

E. Promissory Estoppel

AFP seeks relief, in part, on the ground that it spent substantial sums acting in reliance on its contract with PMSH. (Compl. ¶¶ 9, 10, 13.) AFP is not entitled to relief under the equitable doctrine of promissory estoppel, because, as the Second Circuit has observed, New York is averse to circumventing the statute of frauds. Philo Smith & Co. v. USLIFE Corp., 554 F.2d 34, 36 (2d Cir.1977); see also Swerdloff v. Mobil Oil Corp., 427 N.Y.S.2d 266 (A.D.2d Dept.), appeal denied, 50 N.Y.2d 913 (1980); Tribune Printing Co. v. 263 Ninth Ave. Realty, 452 N.Y.S.2d 590, 593 (A.D. 1st Dept.), aff'd, 57 N.Y.2d 1038 (1982).

* * *

Note

How many different reasons does the Court give for why no contract was formed? Was there an offer? Was there an acceptance? Did the purported terms of the acceptance match the offer?

4-8. LIABILITY FOR FAILED NEGOTIATIONS

Sometimes two parties negotiate in an effort to form a contract but ultimately do not succeed in completing a bargain. The question then arises whether either party bears liability to the other. Consider the following provision from the *Principles of European Contract Law.*

Article 2:301: *Negotiations Contrary to Good Faith*

*U.C.C. § 2-201(1) requires a promise to buy or sell goods for a price of $500 to be evidenced by a signed writing.—Ed.

(1) A party is free to negotiate and is not liable for failure to reach an agreement.

(2) However, a party who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party.

(3) It is contrary to good faith and fair dealing, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party.

Article 2:301(1) states a general rule common to both European and American law. It reflects the idea that contractual liability is voluntary. If parties cannot find terms upon which they both agree, they do not have to enter into a bargain.

But otherwise European and American contract law diverge. Article 2:301(2) and (3) establish a form of liability known as *culpa in contrahendo* ("fault in contracting"). Under European contract law, a party who acts in bad faith during negotiations may have to pay for harm caused to the other party. This harm may consist of expenses in negotiations and lost opportunities. *See Principles of European Contract Law, Parts I & II* 191 (Ole Lando & Hugh Beale, eds. 2000); German Civil Code § 311(2) ("An obligation with duties . . . [including performance in good faith] comes into existence by the commencement of contract negotiations . . . .").

American contract law generally does not recognize liability for bad faith in failed negotiations. The implied duty of good faith applies only to a contract's "performance and its enforcement." *Restatement (Second) of the Law of Contracts* § 205. The commentary affirms: "This Section, like [the comparable provision in] Uniform Commercial Code § 1-203, does not deal with good faith in the formation of a contract." *Id.* cmt. c. So a party generally need not refrain from entering futile negotiations, or cooperate during negotiations, or continue negotiations.

Problems

1. Consumer visits a car dealer and asks a salesperson to show him various luxury vehicles over the course of the afternoon. The consumer does not intend to buy a car from the dealer, but just enjoys looking at them. The

consumer takes the cars on test drives and occupies all of the salesperson's time. At the end of the day, the consumer leaves without making a purchase. The salesperson and the dealer are annoyed at the waste of time. Does the consumer face liability under American or European contract law?

The commentary to Article 2:301 says: "Shopkeepers and other sellers will generally have to accept that people inspect their goods and ask for prices and other terms without buying. The same applies to lessors and sellers of apartments and houses who invite inspection of the premises." *Principles of European Contract Law, Parts I & II* 189 (Ole Lando & Hugh Beale, eds. 2000). How does this commentary square with the text of article 2:301(2)?

2. How could parties in the United States protect themselves from the consequences of bad faith during negotiations?

RACINE & LARAMIE, LTD., INC. v. CALIFORNIA DEPT. OF PARKS AND RECREATION

California Court of Appeal

11 Cal. App.4th 1026, 14 Cal. Rptr.2d 335 (4th Dis. 1993)

FROEHLICH, Associate Justice.

Racine & Laramie, Ltd., Inc. (Racine) is a concessionaire occupying and operating premises in Old Town San Diego State Historic Park under a contract, which bears many attributes of a long-term lease, with the California Department of Parks and Recreation (Department). The contract was executed in 1974 for a term of 40 years, thus extending until the year 2014. Over a period of several years in the 1980s Racine negotiated with the Department for modifications in the concession contract which would permit expanded operations of the premises. Originally limited to the operation of a tobacco shop and wine tasting facility, the negotiations contemplated operation of a restaurant and the on-premises sale of alcoholic beverages.

When negotiations broke down in 1988, Racine brought suit against the Department. Of the several initial causes of action, only one survived demurrers: a cause of action denominated "Breach of Implied Covenant of Good Faith and Fair Dealing." Tried to a jury, the case was submitted on special verdicts. The jury found that the Department was guilty of "breach [of] the

covenant of good faith and fair dealing in its negotiations of an amendment/new contract to the concession agreement with the plaintiff" and that as a result of such breach Racine had been damaged in the sum of $592,110.

Department appeals the judgment on two grounds: (1) there can be no breach of the covenant of good faith by a refusal to enter into a new contract, and (2) the damage award is speculative and excessive. Since we rule in favor of Department as to its first contention, we do not reach the damage issue.

CONTROLLING FACTS

A very detailed examination of the parties' relationship and negotiations was presented to the jury. Since we are bound to accept the jury's determination of fact, assuming it to be supported by substantial evidence, we have no need of close focus on the history of the case. We therefore review the factual background summarily. Modification of a concession contract such as that here involved requires action by several state entities. The concessionaire deals with employees of the Department: Racine commenced doing this as early as 1980. Any contract which would permit on-premises sale of alcoholic beverages must, however, receive approval by the State Park and Recreation Commission (Commission) (Pub. Resources Code, § 5080.20), which is an entity vested with power to establish general policies to guide the Department. (Pub. Resources Code, §§ 530, 539.)

An "impact study" was presented by the Department to the Commission in 1983 which reflected Racine's efforts to establish a restaurant and on-premises liquor sales. On March 31, 1983, the Commission passed a resolution authorizing the Department to permit the expansion of Racine's concession, provided the concession contract be amended to conform to other contracts which had been negotiated with other Old Town concessionaires and include "such other terms as may be required."

Public Resources Code section 5080.20 requires that concession contracts involving certain floor figures of either investment or estimated gross sales, as included in this proposed contract modification, be submitted for review by the Legislature. On July 19, 1983, the Legislature authorized the renegotiation of the existing contract, directing that the Department "attempt to renegotiate the existing rent for the sale of pipes and tobacco products." Although Racine leans heavily on the actions of the Commission and the Legislature as somehow enhancing subsequent relations between Racine and the Department to a higher status than mere negotiations, it is clear that neither action binds the Department in any way.

The parties thereafter met at various times from 1983 through August 1985 and circulated various drafts of proposed amendments to the concession contract, but achieved no final agreement. After a hiatus of some 32 months, the parties renewed negotiations, resulting in a new written proposal from

Racine, dated June 9, 1988. This proposal was quite different from that contained in the 1983 draft. For instance, instead of a 45 to 70-seat restaurant a 300- seat restaurant was proposed. Also, Racine sought to close the tobacco store operation completely. The Department replied by letter dated August 3, 1988, rejecting the proposal on several grounds. One ground, for instance, was that the Department felt the members of the then constituted Commission would probably not accept full alcoholic sale privileges. Another illustrative difference of approach was that the Department now favored only a "quick food" operation, as opposed to a full-service restaurant.

The instant lawsuit was then filed by Racine, without further negotiations. No negotiations have since taken place, although the Department in subsequent correspondence professed willingness to reopen the negotiations.

Racine's position is that having embarked upon lengthy negotiations over a period of several years, which negotiations resulted in tentative agreement as to some of the prospective changes in the concession contract, the Department was precluded arbitrarily and unilaterally from retreating from such positions. Racine emphasizes the fact that it was in an existing contractual relationship with the Department, and that this relationship explicitly contemplated future negotiations for contract modification. Paragraph 25 of the concession contract provided:

> "Notwithstanding any of the provisions of this contract, the parties may hereafter, by mutual consent, agree to modifications thereof or additions thereto in writing which are not forbidden by law. The State shall have the right to grant reasonable extensions of time to Concessionaire for any purpose or for the performance of any obligation of Concessionaire hereunder."

Once having entered into negotiations for a change in the contract, in accordance with paragraph 25 thereof, Racine takes the position that the bargaining had to be conducted in good faith. The Department's alleged reversal of its position on such matters as the full liquor sales privilege and the full restaurant service is characterized by Racine as arbitrary and capricious, and a violation of the covenant of good faith and fair dealing contained by implication in the concession contract.

We do not know exactly what it was in the facts of the case which led the jury to conclude, in its special verdict, that the Department had exhibited bad faith in its negotiations. We do know, however, that the jury was instructed generally on the law of the implied covenant of good faith and fair dealing, deemed to exist in every contract. We also know that counsel for Racine in argument contended that the sudden and arguably arbitrary reversal of negotiating stance taken by the Department constituted a violation of the covenant. We must assume that the jury so found.

We reverse because we conclude that the Department had no obligation to negotiate new terms of the concession contract, that its commencement and continuance of negotiations over a long period of time had no effect upon this lack of obligation, and that its assumption of an arbitrary stance at some point in the negotiations cannot therefore be a breach of any contract term, including implied contract terms of good faith and fair dealing, even though such conduct might be found by a jury to be unreasonable, unfair, or otherwise bad faith negotiation tactics.

Our conclusion in this regard is based, we believe, on rather simple and unassailable contract law principles. The implied covenant of good faith and fair dealing rests upon the existence of some specific contractual obligation. (Foley v. Interactive Data Corp. (1988) 47 Cal.3d 654, 683-684, 689-690, 254 Cal.Rptr. 211, 765 P.2d 373.) "The covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purpose." (Id. at p. 690, 254 Cal.Rptr. 211, 765 P.2d 373.) As we stated in Love v. Fire Ins. Exchange (1990) 221 Cal.App.3d 1136 at page 1153, 271 Cal.Rptr. 246: "In essence, the covenant is implied as a supplement to the express contractual covenants, to prevent a contracting party from engaging in conduct which (while not technically transgressing the express covenants) frustrates the other party's rights to the benefits of the contract."

There existed no express contractual obligation here to negotiate a modification of the concession contract. The provision closest to a possible obligation is that contained in paragraph 25 of the contract, which falls far short of the imposition of any obligation on either party to even participate in activity leading to a modification of the concession. Similarly, the actions taken by the Commission and by the Legislature imposed upon the Department no obligation to enter into either contract negotiations or a contract amendment, but simply removed statutory conditions precedent to the Department's doing so if it should so elect.

There is no obligation to deal fairly or in good faith absent an existing contract. (Hess v. Transamerica Occidental Life Ins. Co. (1987) 190 Cal. App.3d 941, 235 Cal.Rptr. 715; Beck v. American Health Group Internat., Inc. (1989) 211 Cal.App.3d 1555, 260 Cal.Rptr. 237.) If there exists a contractual relationship between the parties, as was the case here, the implied covenant is limited to assuring compliance with the express terms of the contract, and cannot be extended to create obligations not contemplated in the contract. (Gibson v. Government Employees Ins. Co. (1984) 162 Cal.App.3d 441, 448, 208 Cal.Rptr. 511.)

Racine attempts to avoid these accepted principles of law by asserting that, either in general or as related to this specific case, once a negotiation has been undertaken there is an obligation implied in law to negotiate in good

faith. Racine relies heavily on a scholarly analysis of this concept set forth in Kessler & Fine, "Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study" (1964) 77 Harv.L.Rev. 401. This article reviewed and expanded upon a thesis first propounded in German legal philosophy in 1861, characterized by Kessler & Fine as "the thesis that damages should be recoverable against the party whose blameworthy conduct during negotiations for a contract brought about its invalidity or prevented its perfection." (Ibid.)

The difficulty with Racine's reliance on this thesis is that it has never been accepted in Anglo-American jurisprudence. Indeed, the authors' summation of the concept flatly states that "The common law appears to have no counterpart to the German doctrine of culpa in contrahendo."[3] Racine contends that the doctrine has been accepted by American jurisprudence, citing principally Channel Home Centers, Grace Retail v. Grossman (3rd Cir.1986) 795 F.2d 291. This reliance is, however, misplaced. Channel was a case in which negotiations for a lease led to the execution of a "letter of intent." Adhering to the law we have previously referenced, the Channel court first stated that "It is hornbook law that evidence of preliminary negotiations or an agreement to enter into a binding contract in the future does not alone constitute a contract." (Id. at p. 298.) The court went on, however, to find that the terms of the letter of intent constituted an agreement to negotiate in good faith. "[S]uch an agreement, if otherwise meeting the requisites of a contract, is an enforceable contract." (Id. at p. 299.) Citing and quoting from Thompson v. Liquichimica of America, Inc. (E.D.N.Y.1979) 481 F.Supp. 365, 366, the court explained that " 'Unlike an agreement to agree, which does not constitute a closed proposition, an agreement to use best efforts [or to negotiate in good faith] is a closed proposition, discrete and actionable.' " (Channel, supra, at p. 299.) The court then found, as a matter of fact, that the letter of intent before it was an agreement to negotiate in good faith, and hence a failure to do so was actionable. The case does not stand for the proposition that failure to bargain in good faith is actionable absent an agreement impos-

3. Even were we to find that, somehow, this doctrine either existed or should be declared to exist in the common law, it would not support Racine's claim in this case. The culpa in contrahendo concept is one of repairing the damage done by bad faith negotiations, rather than awarding the damaged party the benefits or profits he would have gained had the negotiations succeeded. (Kessler & Fine, supra, at p. 405.) The evidence in this case disclosed no particular or specific damage incurred by Racine as a result of the flawed negotiations (such as having commenced work on the new restaurant, spent money for a liquor license, or the like). The damage testimony which resulted in the very large verdict reflected estimates of lost profits Racine would have made over the balance of the 40-year lease had the negotiations succeeded—-upon the terms Racine sought, of course.

ing such obligation.[4]

Racine also cites as supportive of its position Justice Traynor's opinion in Drennan v. Star Paving Co. (1958) 51 Cal.2d 409, 333 P.2d 757. Drennan was a case of revocation of a construction bid before acceptance of the bid, but after the owner of the project had altered its position in reliance upon the bid. Finding no contract, but holding the bid nevertheless enforceable, the opinion relies upon traditional concepts of promissory estoppel. Promissory estoppel is described as: " 'A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.' " (Id. at p. 413, 333 P.2d 757, quoting Rest., Contracts, § 90.)

Racine's claim was neither pleaded nor tried as promissory estoppel; moreover, the facts do not fit such theory. At no time was any promise made by the Department, and nothing the Department did resulted (insofar as the evidence adduced at trial indicated) in any action or forbearance of action on the part of Racine.

Finally, Racine attempts to find support for its position in the line of cases dealing with discretionary powers vested in one party to a contract to take action which affects the interests of the other party. Such discretionary powers must be exercised in good faith; in other words, when discretionary powers are vested in one party, an implied term of the contract provides that such powers will not be exercised arbitrarily or in disregard of the purposes of the

4. We find that other cases cited by Racine as standing for the proposition of an existence of an implied duty of good faith bargaining also rest upon a finding by the court of the existence of an express commitment to enter into negotiations, or are otherwise unsupportive of Racine's position. These are: Phoenix Mut. Life Ins. v. Shady Grove Plaza Ltd. (D.Md.1990) 734 F.Supp. 1181 (negotiations to achieve capital contribution to a building project failed, giving rise to a claim of failure to negotiate in good faith; any duty to bargain in good faith would be created by the letter of intent, and the letter of intent in this case created nothing preventing a party from "refusing to budge" or from "bargaining to its own economic advantage." (Id. at p. 1190)); A/S Apothekernes Laboratorium v. I.M.C. Chemical (7th Cir.1989) 873 F.2d 155 (the letter of intent in this case was found to constitute an agreement to bargain in good faith, but the appellate court found that agreement had been fulfilled: "The full extent of a party's duty to negotiate in good faith can only be determined . . . from the terms of the letter of intent itself." (Id. at p. 158)); Thompson v. Liquichimica of America, Inc., supra, 481 F.Supp. 365 (simply held that an agreement to use "best efforts" to conclude an agreement is itself a contract which can be enforced); Reprosystem, B.V. v. SCM Corp. (2nd Cir.1984) 727 F.2d 257 (although parties can agree to bargain in good faith to reach a contract, no such agreement was found in this case); Itek Corporation v. Chicago Aerial Industries, Inc. (Del.1968) 248 A.2d 625 (a detailed letter of intent itself was found to be intended as a final contract, hence enforceable). In short, all these cases stand for the proposition that the commencement of negotiation activities looking to the final achievement of a contractual agreement imposes no obligation of good faith or fair dealing unless there is an underlying agreement of some sort (letter of intent, preliminary agreement to use best efforts to agree, etc.) which provides the contractual commitment to use best efforts.

contract and the interests of the other party. (See, e.g., Cal. Lettuce Growers v. Union Sugar Co. (1955) 45 Cal.2d 474, 484, 289 P.2d 785; Mission Ins. Group, Inc. v. Merco Construction Engineers, Inc. (1983) 147 Cal.App.3d 1059, 195 Cal.Rptr. 781.) These cases are inapposite to our situation. With respect to its concessionaire, at least in terms of modification of the concession contract, the Department had no discretionary powers which could be exercised unilaterally.

To recapitulate: The fact that parties commence negotiations looking to a contract, or to the amendment of an existing contract, does not by itself impose any duty on either party not to be unreasonable or not to break off negotiations, for any reason or for no reason. During the course of negotiations things may be done which do then impose a duty of continued bargaining only in good faith.

For instance, a preexisting agreement may impose an obligation of good faith bargaining with respect to the modification of some term of the agreement. The preexisting agreement which vests a discretionary power of alteration of the terms of the agreement may impliedly require that such be done in good faith. Or, in anticipation of an agreement the parties may, by letter of intent or otherwise, agree that they will bargain in good faith for the purpose of reaching an agreement. Finally, in the course of negotiations it is possible for a party to so mislead another by promises or representations, upon which the second party detrimentally relies, as to bring into play the concept of promissory estoppel.

Absent the existence of such special circumstances or conditions, however, there is no obligation in California to bargain for a new or amended contract in good faith. None of the enumerated special circumstances existed in this case. The fact that bargaining took place over a period of many years and that the parties reached tentative agreement from time to time on some of the points at issue does not detract from this conclusion. There was in this case simply no contractual basis upon which to extract implied conditions of good faith bargaining.

DISPOSITION

The judgment in favor of plaintiff is reversed and the trial court is directed to enter judgment notwithstanding the verdict in favor of Department. Defendant is entitled to costs on appeal.

Notes

1. In footnote 3, the court says: "The culpa in contrahendo concept is one of repairing the damage done by bad faith negotiations, rather than awarding the damaged party the benefits or profits he would have gained had the negotiations succeeded." What does this mean?

2. Would this case come out differently under European contract law?

3. Is there any situation in which there can be liability for failed negotiations?

4. Does the court explain why there is no implied duty of good faith?

Section 5

TERMS OF CONTRACTS

5-1. IMPLIED TERMS

European and American contract law both recognize that a contract does not consist only of the terms expressly agreed upon by the parties. Instead, a contract also may include implied terms. The *Principles of European Contract Law* captures this idea in the following rule:

Article 6:102: *Implied terms*

In addition to the express terms, a contract may contain implied terms which stem from

(a) the intention of the parties,

(b) the nature and purpose of the contract, and

(c) good faith and fair dealing.

An illustration to this rule suggests that if a company hired tax advisers to prepare a tax return, the contract would contain an implied term that the tax advisers would complete their work by the legal deadline for submitting the return. *See Principles of European Contract Law, Parts I & II* 304 (Ole Lando & Hugh Beale, eds., 2000). *See also* German Civil Code § 157 ("Contracts are to be interpreted as required by good faith, taking customary practice into consideration.").

Modern American contract law follows the same general principle with essentially the same results, but it uses slightly different terminology. The *Restatement (Second) of the Law of Contracts* says that contracts consist of "agreed terms" and "terms supplied by law." *Id.* § 5 cmts. a & b. The agreed terms a contract "are those expressed in the language of the parties or implied in fact from other conduct." *Id.* cmt. a. For example, if a customer says hello to a barber and sits in the barber's chair, the customer is agreeing to pay the barber's usual price for a haircut, even if the barber and the customer never expressly discuss the formation of a contract or any of its terms. Terms supplied in law are terms which the law considers important for the contract to include regardless of whether the parties actually have agreed upon them. *See id.* cmt. b. One example is the duty of good faith. Regardless of what the parties intend, "[e]very contract imposes upon each party a duty of good faith

and fair dealing in its performance and enforcement." *Id.* § 205. In addition, terms supplied by law include "essential terms" that parties for some reason have omitted from an enforceable agreement. The *Restatement (Second) of the Law of Contracts* includes the following rule:

> § 204. *Supplying An Omitted Essential Term*
>
> When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court.

Problem

Consider the following illustration from the *Restatement (Second) of the Law of Contracts*:

> A, on passing a market, where he has an account, sees a box of apples marked "25 cts. each." A picks up an apple, holds it up so that a clerk of the establishment sees the act. The clerk nods, and A passes on. A has promised to pay twenty-five cents for the apple.

Restatement (Second) of the Law of Contracts § 4 illus. 2. How would American and European law characterize A's promise to pay 25 cents? Is it an agreed term or a term supplied by law? Is it an implied term or an express term? Does the law supply any essential terms?

WEISS v. LA SUISSE

United States Court of Appeals for the Second Circuit

141 Fed. Appx. 31 (2d Cir. 2005)

[This statement of facts comes from an opinion of the district court in the case:

> In 1989 and 1990, defendant La Suisse Life Insurance Company ("La Suisse"), a Swiss insurance company, acting through various agents, sold a number of life insurance policies to plaintiffs, who are members of the Orthodox and Hasidic Jewish communities resident in Rockland County and New York City. The insureds under the policies, which had a face value of either 50,000 or 100,000 Swiss francs (approximately 32,250 or 64,500 U.S. dollars at the current exchange rate), were all minor children at the time of the purchases. The face amount of the policy was payable to the beneficiary (who was, in most cases, the parent of the insured child) in the event the insured either (1) married or died prior to the end of the contract term, which ran for a term of either fifteen or sixteen years from the date of issue, or (2) survived to the end of the policy term. The economics of the policies were structured so that the annual premiums would

> more than cover the face value of the policy. The insurer in effect took the risk that the child would either marry or die before the termination of the contract.
>
> The Court is advised that these unusual life insurance policies were quite popular in Switzerland, where people tend to marry later in life, if they marry at all,[1] and the risk of having to make an early payout is quite manageable. However, it appears that the defendant sellers violated an insurer's equivalent of the "know your customer" rule when they permitted the policies to be marketed among plaintiffs and their neighbors. Customs among many Orthodox Jews, particularly within the Hasidic community, are quite different than those in Switzerland. Marriage is the norm, and marriage at an early age (i.e., in the late teens and sometimes younger) is the rule, not the exception. As a result, the policies were a good investment for American Orthodox Jews. Papers before the Court indicate that as many as 7,000 policies were purchased in this State, of which at least half were sold by a Mr. Elias Horowitz of Bituswiss S.A. from his office in Monroe, New York. The purchasers apparently anticipated that they would work something like burial insurance, except that in most cases, the proceeds would be used to cover the cost of a wedding instead of a funeral. In fact, it is alleged that the agents who peddled them represented that they had been designed especially for the needs of the Orthodox Jewish community. That sales gambit worked, and the policies sold quite well. As a result, the claims began raining down on Lausanne in fairly short order. Therein lies the genesis of this lawsuit.
>
> In July 1997, the Court of Commerce in Zurich (Handelsgericht) held the same La Suisse policy at issue in this case invalid under Swiss law, on the ground that the policy violated Swiss public policy by pressuring young children to marry as early as possible. See Gutmann v. La Suisse Lebensversicherungs-Gesellschaft, No. U/O/HG950445 (Jul. 2, 1997). Faced with the voiding of their policies, plaintiffs, members of the Hasidic and Orthodox Jewish communities in New York State, commenced this action here in the United States. . . .

69 F. Supp.2d 449, 453-454 (S.D.N.Y. 1999). A jury held that La Suisse had violated the insurance contracts by refusing to pay them. On the issue of damages, La Suisse asked the district court to instruct the jury to subtract from the plaintiffs' recovery the amount of the premiums that plaintiffs would have paid if the insured had not died or married by the end of the contract term. Although the insurance contracts did not provide expressly for this kind of offset, La Suisse argued that it was an implied term. The district court did not provide this instruction.]

1. According to the Swiss Federal Statistical Office, roughly 40 percent of Swiss adults will remain unmarried. See Swiss Federal Statistical Office, Annual Population Statistics (last updated Aug. 12, 1999) <http://www.statistik.admin.ch/stat_ch/ber01/eu0106.htm>.

SUMMARY ORDER

* * *

On cross-appeal, defendants assert that the district court erred when it instructed the jury that it "must look to the terms and conditions of the policy" in order to determine whether La Suisse's offset to benefits for unpaid premiums was permissible, and that if the policy did not provide for offsets, jurors could not "interpolate such a term into the contract." Defendants argue that this instruction "flatly contradicts" their Swiss law expert's opinion that La Suisse's offset was permissible, but as the district court judge noted at trial when defendants objected to the instruction, defendants "cited . . . no Swiss law that suggests that the jury is allowed to interpolate terms where a contract is silent." Having failed to provide the district court with Swiss law permitting offsets to benefits where a contract is silent on this issue, defendants have no basis for impugning the court's jury instructions.

* * *

Notes

1. Would it have been enough for the defendants to prove that Swiss law recognizes implied terms? Or would the defendants have to prove something else as well?

2. At least in other contexts, Swiss law may recognize implied contract terms. For example, Swiss bank account agreements reportedly have been held to contain implied terms requiring the banks to maintain certain kinds of secrecy. *See* John M. Ferguson, *Swiss Bank Account "Secrecy" Today: More Holes than Cheese*, 12 EMORY INT'L L. REV. 1131, 1134 (1998).

ORACLE CORPORATION v. FALOTTI

U.S. District Court fo the Northern District of California

187 F. Supp.2d 1184 (2001)

ALSUP, District Judge.

INTRODUCTION

In this employment case involving both Swiss and California law, this order **GRANTS** plaintiff's motion for partial summary judgment and **DENIES** defendant's cross-motion for partial summary judgment.

STATEMENT

Plaintiff Oracle Corporation seeks a declaratory judgment that it does not owe any unvested stock options to defendant Pier Carlo Falotti, a former high-level executive, who Oracle terminated. Mr. Falotti claims that he is entitled to unvested stock options (or their value) for breach of his employ-

ment contract or Oracle's stock-option plan. Both parties have filed cross-motions for partial summary judgment on the issue of entitlement to stock options, although Mr. Falotti seeks only to establish his right to options vesting no later than September of 2000, three months after Oracle told him he was terminated. Oracle also seeks summary judgment on Mr. Falotti's oral-contract and promissory-estoppel counterclaims under California law.

In 1996, Mr. Falotti was hired as Senior Vice President of EMEA, an unincorporated business division of Oracle Corporation, encompassing Oracle's European, Middle Eastern and African operations. Subsequently, he was promoted to Executive Vice President of EMEA and made a member of Oracle's Executive Committee. At the outset of his employment, he and Oracle entered into the contracts that provide the basis for this dispute: an employment contract governed by Swiss law, and a stock-option agreement controlled by California law.

Oracle notified Mr. Falotti of his termination on May 31, 2000. Subsequently, the committee that administered Oracle's stock-option plan determined that Mr. Falotti was not entitled to any stock options vesting after that date. In this action, Mr. Falotti argues that he was entitled to stock options vesting between June and September of 2000 (or their value) for two main reasons. First, he contends that Oracle's stock-option committee abused its discretion by determining that he was terminated on May 31, 2000, when under Swiss law, he should have been considered to be employed by Oracle until September 30. Second, he maintains that he was entitled to the value of the stock options vesting between June and September of 2000 as damages for the breach of his employment contract.

This order holds that Mr. Falotti is not entitled either to the unvested stock options or to their value. Mr. Falotti agreed up front as to what stock options he would receive upon termination before vesting. That agreement is dispositive to his stock-option claim. As an independent and alternative ground, the various stock-option grants conferred on Oracle's stock-option committee the authority to determine when Mr. Falotti ceased to be a "full-time employee." The record does not show that the committee abused its discretion in ruling against Mr. Falotti. Other points of contention will be discussed below.

* * *

Mr. Falotti's Departure

In January of 2000, Mr. Falotti and Mr. Ellison began discussing various plans to have Sergio Giacoletto assume many or all of Mr. Falotti's duties, with Mr. Falotti assisting or training him (Ellison Dep. 154). According to Mr. Falotti, although compensation was not discussed, the two reached an oral agreement, whereby Oracle guaranteed him full-time employment from

June 1, 2000, through June 1, 2001 (Falotti Dep. 197). According to Mr. Lane, Mr. Falotti's former boss (Lane Dep. 76-77):

> The plan I had developed with Pier Carlo was to work halfway through the new fiscal year [May 31, 2000 to May 31, 2001], or work half time for the whole year, but that we would name Sergio Giacoletto as the new head of EMEA, and that Pier Carlo would be there to mentor him and to do customer activities and things like that. . . . I didn't think we should pay somebody full time at this rate . . . So I told Larry my feelings, that I though he was wrong in this decision, and he said, "Well, that's what we've agreed to." So I called Pier Carlo back and said, "It's a done deal."

Mr. Falotti states that Mr. Ellison subsequently affirmed their agreement in the beginning of April, when he asked Mr. Ellison about it (Falotti Dep. 206- 09).

* * *

. . . According to Mr. Ellison, by January of 2000, he had decided to terminate Mr. Falotti as soon as this could be done without hurting business in Europe (*id.* at 152-54). As of January, however, he had not ruled out the possibility of retaining Mr. Falotti in a different role than Executive Vice President, EMEA, to create a smooth transition in management. In his deposition, Mr. Ellison testified, "I didn't know if we needed Pier Carlo at that point for a year of transition or not. So I was keeping my options open" (*id.* at 154). At some point in time, Oracle's attorneys explained that Mr. Falotti could not be given a consulting job, because he would continue to vest in tens of millions of dollars worth of stock options every year (*id.* at 244-45). Thereafter, Oracle began contemplating Mr. Falotti's termination. Several termination letters were drafted, but none was ever sent.

* * *

[On May 30, 2000], Mr. Falotti visited his doctor, Raymond Hadorn, whom he had not seen for almost three years. The appointment was made by his wife, who had contacted Dr. Hadorn the day before, stating that Mr. Falotti was depressed and needed an appointment quickly. According to Dr. Hadorn, Mr. Falotti slumped in a chair and cried during the visit. Dr. Hadorn diagnosed Mr. Falotti with deep depression, resulting in a total incapacity to work. He gave Mr. Falotti a certificate stating this diagnosis. After leaving the doctor, Mr. Falotti returned to Oracle and worked until 7:30 in the evening. That night, he sent business emails from his home until 10:51 p.m.

Under Swiss law, any attempt to terminate an employee who cannot work due to illness is "null and void." Such incapacity is commonly proven by a medical certificate similar to the one provided by Dr. Hadorn.

Mr. Falotti worked on the morning of May 31, 2000. Later in the day, he returned a phone call from Vance Kearney, Vice President of Human Re-

sources, EMEA. Mr. Kearney told Mr. Falotti that he was being terminated immediately (Kearney Dep. 224). According to Mr. Kearney, Mr. Falotti refused an offer of stock options due to vest in June and July in exchange for his retirement, stating "that's not acceptable, you know, I'll discuss this with Larry" (*ibid.*). Mr. Falotti then called his attorney and subsequently Mr. Ellison. According to Mr. Falotti, Mr. Ellison told him he was being terminated because he was "too expensive for his job" (Falotti Dep. 269). Mr. Ellison refused to honor the prior arrangement to retain Mr. Falotti through the fiscal year of 2001 and would not discuss the matter further, Mr. Falotti states. Mr. Ellison, on the other hand, states that in response to Mr. Ellison's offer of stock options due to vest in June and July (775,000 shares), Mr. Falotti responded that he wanted the stock options due to vest in September (1,350,000 shares) as well as those earlier. According to Mr. Ellison, when he refused the counterproposal, Mr. Falotti said: "You can't terminate me because I'm sick. . . . I've got a headache. . . . You don't work in Switzerland as long as I have without being familiar with Swiss law" (Ellison Dep. 213).

As of May 31, Mr. Falotti was relieved of his duties and performed no active work for Oracle. On May 31, Oracle changed his password and began clearing out his office (Boskin Dep. 154). On June 5, 2000, Mr. Falotti sent Dr. Hadorn's note to Oracle via certified mail. Oracle responded on June 22 with two letters. One stated that Mr. Falotti had been terminated as of May 31. The other read: "In case you persist in alleging that you are sick, you will be invited for a medical examination in due course" (Henschke Decl., Exh. 41). The same day, Mr. Falotti was admitted to La Ligniere hospital. La Ligniere released Mr. Falotti on July 5. Two days later, Mr. Falotti visited Dr. Hadorn, who declared him once again fit to work as of July 10. On July 7, Mr. Falotti's attorney wrote Oracle stating that Mr. Falotti would submit to a medical examination by a mutually-agreeable doctor, but that Mr. Falotti would be on vacation until August 4. No examination was ever performed.

* * *

II. The Stock-Option Agreement

Stock-option contracts are interpreted under the normal rules of contract interpretation, looking to the specific language of the contract, the facts of the case, and the general contract-interpretation principles of the applicable law. *Scribner v. Worldcom, Inc.,* 249 F.3d 902, 907 (9th Cir.2001). Entitlement to stock options, the parties argue, turns on the interpretation of the italicized language from the terms and conditions of the stock-option plan:

> Except as provided below in this Section, this Option shall terminate and may not be exercised if Optionee ceases to be employed by the Company or any Parent or Subsidiary or Affiliate of the Company. *Optionee shall be considered to be employed by the Company for all purposes under this Section 3 if Optionee is an officer, director or full-time employee* of the

> Company or any Parent, Subsidiary or Affiliate of the Company or if the Board determines that the Optionee is rendering substantial services as a part-time employee, consultant, contractor or advisor to the Company or any Parent, Subsidiary or Affiliate of the Company. *The Board shall have discretion to determine whether Optionee has ceased to be employed by the Company and the effective date on which such employment terminated.*

In one of his central contentions, Mr. Falotti argues that he should have been "considered to be employed by the Company for all purposes of" the stock-option agreement because Swiss law prohibited his termination until September 30 Specifically, Mr. Falotti's employment contract was governed by the Swiss Code of Obligations, which applied to all employment contracts in Switzerland. Two provisions of the Swiss Code of Obligations bore on when Mr. Falotti was terminated under Swiss law. First, Article 335c of the Code of Obligations provided:

> The employment relationship may be terminated at the end of a month during the first year of service with a notice period of one month, in the second and up to and including the ninth year of service with a notice period of two months, and thereafter with a notice period of three months.
>
> These periods may be altered by written agreement, standard employment contract or collective employment contract. They shall, however, be reduced to less than one month only by collective employment contract and only for the first year of service.

Second, Article 336c of the Code of Obligations stated in part:

> 1. [T]he employer shall not terminate the employment relationship . . .
>
> b. during the period that the employee is prevented from performing his work fully or partially by no fault of his own due to illness or accident for 30 days in the first year of service, for 90 days as of the second year until and with the fifth year of service, and for 180 days as of the sixth year of service.
>
> 2. Notice given during one of the forbidden periods in paragraph 1 shall be null and void. If the notice is given prior to the beginning of such period, however, and if the notice has not expired prior to such period, the expiration shall be suspended and shall continue only after termination of the forbidden period.

Mr. Falotti argues that because he could not have been terminated when he was ill from May 30 until July 10, his two-month notice period did not begin running until July 10, when he had recovered. Since an employee cannot be terminated until the end of a month under Swiss law, his employment did not end until September 30, he maintains. Oracle, on the other hand, contends that under California law, which expressly governed the

stock-option plan, Mr. Falotti was not a "full-time employee" eligible to vest in stock options after May 31 and that the compensation committee had discretion to determine when Mr. Falotti "ceased to be employed by the company and the effective date on which such employment terminated."

As both sides acknowledge, the stock-option agreement was governed by California law. Under California law, Mr. Falotti was not a full-time employee after May 31, since he was told he was terminated, he was relieved of his duties, his password was changed, his office was cleared out, and he performed no active work at all for Oracle. Mr. Falotti, however, maintains that Oracle breached the implied covenant of good faith and fair dealing because the stock- option committee abused its discretion. "The essence of the covenant of good faith is objectively reasonable conduct." *Badie v. Bank of America,* 67 Cal. App. 4th, 779, 796, 79 Cal.Rptr.2d 273 (1998) (quotation omitted). It was not an abuse of discretion for the compensation committee to apply California law, since the stock-option agreement required it to do so. Nor was the committee required to consider Swiss law. The choice-of-law provision and integration clauses in the stock-option agreement evidence that the plan was intended to be self contained, to be administered under rules familiar to the members of the committee and to apply similarly to all Oracle employees. *See Northrop Corp. v. Triad Int'l Mktg., S.A.,* 811 F.2d 1265, 1270 (9th Cir.1987) ("choice-of-law and choice-of-forum provisions in international commercial contracts are an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction, and should be enforced absent strong reasons to set them aside") (quotation omitted). The committee's decision was in keeping with the stated purpose of the stock-option plan, since Mr. Falotti had made no present or potential contributions to Oracle after May 31, and the purpose of the plan was "to provide an incentive to eligible employees . . . whose present and potential contributions are important to the continued success of the Company" (Cooper Decl., Exh. 6, at 1-2).

Thus, the committee's conclusion as to when Mr. Falotti ceased to be employed for purposes of the stock-option plan is a second and dispositive basis for denying him any stock options. . . .

Note

Did the parties actually agree that Oracle Corporation could not fire Falotti during the period of his illness? Was the prohibition on firing him an implied term or something else? Why might California law and Swiss law differ on this point?

5-2. MODIFICATION OF TERMS

Theologians once debated the paradoxical question of whether God, being omnipotent, can create a stone so large that He cannot lift it. A similar question has arisen about whether parties can create a contract so firm that they cannot later modify it.

In the United States, agreements modifying the terms of a contract generally are permissible. But defendants routinely make four arguments against the enforcement of modifications:

First, defendants sometimes argue that the modification was never made. An agreement to modify a contract generally must satisfy the requirements of offer and acceptance described in Section 3 above. But there is an important exception. A defendant can waive rights under a contract unilaterally. A waiver is simply a voluntary relinquishment of rights. *See Restatement (Second) of the Law of Contracts* § 89 cmt. b. Just as a party can abandon property, a party can abandon contract rights. Sometimes that abandonment of a contract right accomplishes the same result as a modification. For example, a buyer may "abandon" the right to insist that the seller deliver a deed to property on the date originally agreed upon in the contract.

Second, defendants sometimes argue that a promise to modify a contract is not enforceable because it lacks consideration. For example, in *Alaska Packers v. Domenico*, 117 F. 99 (9th Cir. 1902), the case reprinted immediately below, a company agreed to pay workers specific rates for the season. When the workers struck and demanded more money, the company agreed to pay them additional money for the same work. A court subsequently held that the company's promise modifying the original agreement was not enforceable because it lacked consideration. Although this rule remains in effect, many states now follow § 89 of the *Restatement (Second) of the Law of Contracts*, which says: "A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made . . . ."

Third, defendants sometimes argue that the modification was not evidenced by a signed writing and therefore is not enforceable under the statute of frauds. The rule is as follows: "For the purpose of determining whether the Statute of Frauds applies to a contract modifying but not rescinding a prior contract, the second contract is treated as containing the originally agreed terms as modified." *Id.* § 149(1).

Fourth, defendants sometimes argue that the alleged modification is not enforceable because the original contract contained a clause saying that the contract could not be modified. In general, "no modification" clauses are not enforceable. The only substantial exception concerns contracts for the sale of goods. The parties may agree in a written contract that no *oral* modifica-

tions will be enforceable. Uniform Commercial Code § 2-209(3) says: "A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party." But this exception contains an important limitation: the Uniform Commercial Code says that an attempted oral modification that is not enforceable depending on the circumstances "can operate as a waiver." § 2-209(4).

The *Principles of European Contract Law* contains the following rule with respect to "no oral modification clauses":

> Article 2:106: *Written Modification Only*
>
> (1) A clause in a written contract requiring any modification or ending by agreement to be made in writing establishes only a presumption that an agreement to modify or end the contract is not intended to be legally binding unless it is in writing.
>
> (2) A party may by its statements or conduct be precluded from asserting such a clause to the extent that the other party has reasonably relied on them.

Notes

1. Under American contract law, defendants who oppose enforcement of alleged modifications can make the four arguments listed above. Based on Article 2:106 and what we have previously seen, which arguments could these defendants make under European contract law?

2. Why might the parties to a contract want to forbid subsequent oral modifications?

Problems

1. The *Principles of European Contract Law* contains the following illustration:

> A construction contract contains a clause providing that "this contract may only be modified in writing signed by the parties." Subsequently the parties orally agree to some changes in favour of the owner which are performed. When later the contractor invokes another oral modification made in its favour the owner invokes the "no oral modification" clause.

Principles of European Contract Law, Parts I & II 155 (Ole Lando & Hugh Beale, eds. 2000).

In this illustration would the "no oral modification clause" bar enforcement of the oral modification under Article 2:106? What arguments could the parties make under American contract law?

2. Consider the following example, which concerns the typical requirement of a signed writing for contracts that the parties cannot fully perform within one year:

> A and B make a written contract that A will employ B for two years at $500 a month. At the time B begins work, they agree orally to substitute a contract for six months at $600 a month.

Restatement (Second) of Contracts § 149 illus. 1. Was the original contract within the statute of frauds? Was the subsequent modified contract? Would the answer be the same if the subsequent contract was for one and a half years?

ALASKA PACKERS' ASS'N v. DOMENICO

United States Court of Appeals for the Ninth Circuit
117 F. 99 (9th Cir. 1902)

ROSS, Circuit Judge.

* * *

The evidence shows without conflict that on March 26, 1900, at the city and county of San Francisco, the libelants[*] entered into a written contract with the appellants, whereby they agreed to go from San Francisco to Pyramid Harbor, Alaska, and return, on board such vessel as might be designated by the appellant, and to work for the appellant during the fishing season of 1900, at Pyramid Harbor, as sailors and fishermen, agreeing to do "regular ship's duty, both up and down, discharging and loading; and to do any other work whatsoever when requested to do so by the captain or agent of the Alaska Packers' Association." By the terms of this agreement, the appellant was to pay each of the libelants $50 for the season, and two cents for each red salmon in the catching of which he took part.

On the 15th day of April, 1900, 21 of the libelants of the libelants signed shipping articles by which they shipped as seamen on the Two Brothers, a vessel chartered by the appellant for the voyage between San Francisco and Pyramid Harbor, and also bound themselves to perform the same work for the appellant provided for by the previous contract of March 26th; the appellant agreeing to pay them therefor the sum of $60 for the season, and two cents each for each red salmon in the catching of which they should respectively take part. Under these contracts, the libelants sailed on board the Two Brothers for Pyramid Harbor, where the appellants had about $150,000 invested in a salmon cannery. The libelants arrived there early in April of the year mentioned, and began to unload the vessel and fit up the cannery. A few days thereafter, to wit, May 19th, they stopped work in a body, and demanded of

*Federal courts have "admiralty" jurisdiction to hear disputes between seamen and the charterers of vessels. In admiralty cases, the party bringing the complaint is called the "libelant" rather than the "plaintiff."—Ed.

the company's superintendent there in charge $100 for services in operating the vessel to and from Pyramid Harbor, instead of the sums stipulated for in and by the contracts; stating that unless they were paid this additional wage they would stop work entirely, and return to San Francisco. The evidence showed, and the court below found, that it was impossible for the appellant to get other men to take the places of the libelants, the place being remote, the season short and just opening; so that, after endeavoring for several days without success to induce the libelants to proceed with their work in accordance with their contracts, the company's superintendent, on the 22d day of May, so far yielded to their demands as to instruct his clerk to copy the contracts executed in San Francisco, including the words "Alaska Packers' Association" at the end, substituting, for the $50 and $60 payments, respectively, of those contracts, the sum of $100, which document, so prepared, was signed by the libelants before a shipping commissioner whom they had requested to be brought from Northeast Point; the superintendent, however, testifying that he at the time told the libelants that he was without authority to enter into any such contract, or to in any way alter the contracts made between them and the company in San Francisco. Upon the return of the libelants to San Francisco at the close of the fishing season, they demanded pay in accordance with the terms of the alleged contract of May 22d, when the company denied its validity, and refused to pay other than as provided for by the contracts of March 26th and April 5th, respectively. Some of the libelants, at least, consulted counsel, and, after receiving his advice, those of them who had signed the shipping articles before the shipping commissioner at San Francisco went before that officer, and received the amount due them thereunder, executing in consideration thereof a release in full, and the others paid at the office of the company, also receipting in full for their demands.

* * *

The real questions in the case as brought here are questions of law, and, in the view that we take of the case, it will be necessary to consider but one of those. Assuming that the appellant's superintendent at Pyramid Harbor was authorized to make the alleged contract of May 22d, and that he executed it on behalf of the appellant, was it supported by a sufficient consideration? From the foregoing statement of the case, it will have been seen that the libelants agreed in writing, for certain stated compensation, to render their services to the appellant in remote waters where the season for conducting fishing operations is extremely short, and in which enterprise the appellant had a large amount of money invested; and, after having entered upon the discharge of their contract, and at a time when it was impossible for the appellant to secure other men in their places, the libelants, without any valid cause, absolutely refused to continue the services they were under contract to perform unless the appellant would consent to pay them more money. Consent to such a demand, under such circumstances, if given, was, in our opinion, without consideration, for the reason that it was based solely upon

the libelants' agreement to render the exact services, and none other, that they were already under contract to render. The case shows that they willfully and arbitrarily broke that obligation. As a matter of course, they were liable to the appellant in damages, and it is quite probable, as suggested by the court below in its opinion, that they may have been unable to respond in damages. But we are unable to agree with the conclusions there drawn, from these facts, in these words:

> Under such circumstances, it would be strange, indeed, if the law would not permit the defendant to waive the damages caused by the libelants' breach, and enter into the contract sued upon, a contract mutually beneficial to all the parties thereto, in that it gave to the libelants reasonable compensation for their labor, and enabled the defendant to employ to advantage the large capital it had invested in its canning and fishing plant.

Certainly, it cannot be justly held, upon the record in this case, that there was any voluntary waiver on the part of the appellant of the breach of the original contract. The company itself knew nothing of such breach until the expedition returned to San Francisco, and the testimony is uncontradicted that its superintendent at Pyramid Harbor, who, it is claimed, made on its behalf the contract sued on, distinctly informed the libelants that he had no power to alter the original or to make a new contract, and it would, of course, follow that, if he had no power to change the original, he would have no authority to waive any rights thereunder. The circumstances of the present case bring it, we think, directly within the sound and just observations of the supreme court of Minnesota in the case of King v. Railway Co., 61 Minn. 482, 63 N.W. 1105:

> No astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party. Surely it would be a travesty on justice to hold that the party so making the promise for extra pay was estopped from asserting that the promise was without consideration. A party cannot lay the foundation of an estoppel by his own wrong, where the promise is simply a repetition of a subsisting legal promise. There can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. The promise cannot be legally enforced, although the other party has completed his contract in reliance upon it.
>
> * * *

[The court below relied on Lawrence v. Davey, 28 Vt. 264.] . . . In that case there was a contract to deliver coal at specified terms and rates. A portion of it was delivered, and plaintiff then informed the defendant that he

could not deliver at those rates, and, if the latter intended to take advantage of it, he should not deliver any more; and that he should deliver no more unless the defendant would pay for the coal independent of the contract. The defendant agreed to do so, and the coal was delivered. On suit being brought for the price, the court said:

> Although the promise to waive the contract was after some portion of the coal sought to be recovered had been delivered, and so delivered that probably the plaintiff, if the defendant had insisted upon strict performance of the contract, could not have recovered anything for it, yet, nevertheless, the agreement to waive the contract, and the promise, and, above all, the delivery of coal after this agreement to waive the contract, and upon the faith of it, will be a sufficient consideration to bind the defendant to pay for the coal already received.

The doctrine of that case was impliedly overruled by the supreme court of Vermont in the subsequent case of Cobb v. Cowdery, 40 Vt. 25, 94 Am.Dec. 370, where it was held that:

> A promise by a party to do what he is bound in law to do is not an illegal consideration, but is the same as no consideration at all, and is merely void; in other words, it is insufficient, but not illegal. Thus, if the master of a ship promise his crew an addition to their fixed wages in consideration for and as an incitement to, their extraordinary exertions during a storm, or in any other emergency of the voyage, this promise is nudum pactum; the voluntary performance of an act which it was before legally incumbent on the party to perform being in law an insufficient consideration; and so it would be in any other case where the only consideration for the promise of one party was the promise of the other party to do, or his actual doing, something which he was previously bound in law to do. Chit. Cont. (10th Am.Ed.) 51; Smith, Cont. 87; 3 Kent, Com.. 185.
>
> * * *

It results from the views above expressed that the judgment must be reversed, and the cause remanded, with directions to the court below to enter judgment for the respondent, with costs. It is so ordered.

Notes

1. Could Alaska Packers have refused to keep its subsequent promise on any grounds other than that the promise lacked consideration?

2. Why did the court conclude that Alaska Packers had not waived its rights under the first contract? Under what circumstances could the court have found a valid waiver?

3. Would this case have come out the same way under the *European Principles of Contract Law*? One source suggests that, even though European legal systems do not require consideration, they might say that the promise to pay more money in this case is not enforceable because it was induced by "economic duress." *See The Enforceability of Promises in European Contract Law* 219, 236-38 (James Gordley, ed., 2001).

Problem

A homeowner hires an excavating company to dig a cellar for his house. They agree on a set price. After the excavating company commences the work, it discovers substantial quantities of rock under the earth. This rock will make the excavation far more difficult. The homeowner initially agrees to pay the excavating company 9 times the previously agreed upon price. But when the work is done, the homeowner refuses to pay more than originally agreed. How should the case come out under European and American contract law? How is the case different from the *Alaska Packers* case? *See Watkins & Sons v. Carey*, 21 A.2d 591 (N.H. 1941) (requiring the a homeowner on similar facts to pay the agreed upon increase on grounds that the increase was agreed upon and was reasonable based on changed circumstances).

In Re EXPRESS ONE INTERNATIONAL INC.

United States Bankruptcy Court for the Eastern District of Texas

243 B.R. 290 (Bankr. E.D. Tex. 1999)

DONALD R. SHARP, Chief Judge.

Now before the Court is the Second Amended Objection to Proof of Claim No. 823 filed By GIE Balkans ("GIE"). . . .

* * *

Express One International, Inc. ("Debtor"), filed for relief under Chapter 11 of the U.S. Bankruptcy Code. At the time of this hearing, Express One was operating as a reorganized Debtor having had their plan of reorganization confirmed earlier. The plan of reorganization provided that certain claims' objections would be litigated later and provisions were made in the plan for funds to be set-aside for payment of those claims. The instant controversy is the last major claim remaining in the case and has been one of the more contentious ones. This contested matter arises from the Debtor's objection to the unsecured proof of claim filed by GIE in the amount of $1,090,323.58 alleged

to be due under that certain Aircraft Operating Lease (the "Lease") entered into by and between the Debtor and GIE pre-petition. Under the terms of the Lease, the Debtor leased a DC-10 aircraft from GIE for an initial deposit and a monthly fee of $240,000 (U.S.) for the purpose of ferrying international tourists. . . . The matter is made somewhat complicated by the fact that GIE is a French company and the Lease, prepared by GIE, provides that it is to be interpreted under French law. The parties have had considerable disagreement over provisions of French law as they apply to the resolution of this dispute. Obviously, Express One was not able to perform under the Lease or there would not be a dispute to adjudicate.

Express One contends that it entered into the 37 month Lease in the belief that there was a substantial market to ferry European tourists from Europe to the United States, primarily Florida, and that the business had the possibility of being a lucrative one for the airline. This was a new and speculative venture for Express One since it was the first wide-bodied jet they operated. The Lease was negotiated during the summer and fall of 1993 and ultimately resulted in the completed agreement on or about October 13, 1993, with the first rental payment being due on December 10, 1993. Express One apparently paid the first rental payment without a problem but immediately experienced problems when the second payment became due. The expected lucrative charter contracts did not materialize, in part, because of an unfortunate attack on some European tourists in Miami which had a very chilling effect on the tourist business. Additionally, the Republic Airlines bankruptcy caused large losses to Express One and further, added to their cash flow problems. The Lease was ultimately terminated by mutual agreement of the parties in September of 1994 and the aircraft was returned to GIE. It is what happened in the interim that forms the basis of the dispute between these parties.

At the outset, the parties argued strenuously concerning procedural and evidentiary matters in the conduct of this trial. The parties agree that the contract requires French law to be applied to the resolution of any disputes and further agree that it is proper to apply French law. The evidentiary dispute centers around whether or not French law allows oral testimony concerning the terms of the agreement between the parties or whether the parol evidence rule (or the French equivalent thereof) prohibits any such testimony. GIE takes the position that the Lease is complete in itself and contains a provision that it cannot be altered except by written instrument and therefore, it is entitled to enforce the terms of the Lease as written. GIE further argues that it is clear that although French substantive law applies to the resolution of this dispute, the law of the forum, the State of Texas, supplies the procedural law for the conduct of the hearing. Thus, they argue it follows from that position that the Parol Evidence Rule as understood in Texas would prohibit the introduction of any oral testimony concerning the terms of a written agreement. The real controversy between the parties is whether the Parol Evidence Rule is a rule of substantive law or a procedural rule. If

substantive law, then it is to be construed in accordance with French law and if procedural law, it is to be construed in accordance with Texas law. In addressing this issue, the Texas Supreme Court opined in *Hubacek v. Ennis State Bank,* 159 Tex. 166, 317 S.W.2d 30 (1958) that the Parol Evidence Rule is not a rule of evidence at all, but a rule of substantive law. *See* also *Brannon v. Gulf States Energy Corp.,* 562 S.W.2d 219 (1977) and the discussion in *McCormick* and *Ray,* Tex. L.Evid.2d. Ed., § 1601. Additionally, the Fifth Circuit, applying Texas Choice of Law Rules to determine a choice of law issue, has also held Parol Evidence Rule to be a rule of substantive law rather than procedural law. *Long Island Trust Company v. Dicker,* 659 F.2d 641, n. 14 (5th Cir.1981) This Court must look to French law in this instance to determine the extent to which oral testimony can be used in the resolution of this dispute.

Contracts in France are classified as either commercial or civil. French law regards every rental of movables (movables in French Civil Law correspond to personal property in common law) and all obligations between traders, dealers and bankers to be acts of commerce. As such, these acts are controlled by the Commercial Code. The Commercial Code is a body of specialized law to deal with commercial contracts while the Civil Code is broader in application and codifies broad general concepts of the law. It is therefore necessary to characterize the aircraft lease to determine which body of law applies. There are two separate and distinct grounds to consider this a commercial transaction. First, it is a lease of an aircraft which is a movable under French law and it is a transaction between a corporation (Express One) and a French economic interest group which is a commercial enterprise under French law. It would seem that there can be no question but that the lease in question in this controversy is a commercial transaction on both of these grounds and is therefore controlled by the French Commercial Code. Article 109 of the Commercial Code of France is the important provision of French law pointed to by both Henry Dahl and Mr. Mondolino in the evidence presented by them. That Article of the French Commercial Code embodies the French freedom of evidence principle which provides that "with respect to merchants, acts of commerce may be proved by all means unless it is otherwise provided by law." This Court has no doubt that under French law evidence of oral agreements and evidence of the subsequent conduct of the parties in carrying into effect their agreement is admissible to prove whether or not there was an amendment to the contract and the terms of that amendment.

There are two separate and distinct issues in this case. First is the question of the right of return which Express One argues was an oral agreement entered into at the time of the conception of the contract and was simply not included in the contract because of mistake or because of a belief that it was not needed under French law. The Court is convinced that the question of the right of return is really immaterial to the resolution of this dispute. It is clear

that the officials at Express One felt that they had the right to terminate the Lease and return the aircraft upon proper notice at any time. It is clear that they conducted themselves in the belief that this was their right. Second is the question of whether there was a subsequent agreement reached between the parties dealing with one aspect of their business relationship. The first issue (that of the right of return) is very troubling in light of Article 1134 of the French Civil Code which provides that the terms of a contract "constitutes the law of the parties." None of the evidence as to French law presented by Henry Dahl or Mr. Mondolino clearly addresses the interplay between that section of the French Civil Code and Article 109 of the French Commercial Code. Henry Dahl implies that the French Commercial Code would take precedence because of the commercial nature of the transaction and perhaps that is the case. This Court is troubled with any attempt to say that the written agreement is not the agreement between the parties but that some oral statement or understanding is an integral part of the agreement from its inception and is now enforceable in contravention of the clear words of the written contract. As stated earlier, this Court finds that issue to be immaterial to the resolution of this dispute. The second issue, which is material, deals with what the parties did subsequent to the entry into the contract which governs the relationship between them. That is the issue of whether or not the parties met on January 19, 1994, and orally modified their relationship and if so, the terms of that subsequent agreement. GIE argues that paragraph 20.9 of the Lease provides that the Lease can only be varied by a written agreement and paragraph 20.4 of the Lease declares that GIE's rights against Express One are not capable of being waved or varied except by an express waiver or variation in writing. These two paragraphs of the Lease are obviously paragraphs placed in the Lease for the protection of GIE. It is axiomatic that any party not under a legal disability can wave any provision placed in any legal document for that parties' benefit. It is also axiomatic that parties can wave rights by express language or by their actions. Were we faced with a situation where Express One argues that the contract was amended and there is no evidence of an amendment except Express One's assertion, we may have a far different result. However, there is no question but that GIE has acknowledged by both their words and their actions that there was an amendment to the contract and that there has been an amendment to the contract and that those amendments were not in compliance with paragraph 20.9 or paragraph 20.4. Therefore, GIE cannot deny the existence of the amendments and does not deny that certain agreements modifying the business relationship were made between the parties on January 19, 1994, at the meeting in Paris. This issue is not controlled by Article 1134 of the French Civil Code upholding the sanctity of written contracts nor the Parol Evidence Rule under Texas law. It is not an attempt to argue that there is some unwritten provision not contained within the contract from its inception which should now be taken into consideration. It is a recognition of all parties rights to contract freely be-

tween themselves.[3] It is clear that these parties made a new agreement but now disagree over the terms of that agreement. Unfortunately, they did not reduce that agreement to writing (maybe through oversight or deliberate design) and this controversy has ensued. Neither the Texas Parol Evidence Rule or any provision of French law prohibits the parties from presenting all evidence of that agreement that they have to the Court so that the matter can be resolved after a full evidentiary hearing.

What is important to this controversy is what happened and what the parties did after the lease was signed and in carrying out the terms of the business relationship between them. GIE's argument that the contract cannot be modified except by written agreement and therefore must be enforced in accordance with its terms must fail. GIE itself admits that the contract was amended and in fact is not attempting to enforce the contract as written but is attempting to enforce the contract as they say it was subsequently modified. There is no denying that the contract was terminated far before the 37 month term specified in the written agreement by the mutual agreement of the parties. There are some documents in the form of letters and communication between the parties dealing with the termination but no formal written amendment of the contract which terminates it. The parties entered into negotiations and tentatively agreed to terminate the contract in July of 1994 when Express One got an opportunity to ferry some troops to Malaysia and pursuant to agreement, delayed the termination through the month of August and into September. The record in this case demonstrates clearly that the parties cooperated and talked to each other concerning the method of returning the plane and keeping it insured until it could be properly returned and reinsured by GIE. It is disingenuous for GIE to now argue that the contract was not modified and must be enforced in accordance with its terms. In fact, GIE seeks no rental payment for any period of time beyond the agreed upon termination which clearly indicates that they agreed with the termination and agree

3. Insofar as French law is applicable to this agreement, it is clearly controlled by Article 109 of the French Commercial Code. The freedom of evidence rule would certainly apply between these commercial entities to allow all evidence concerning the nature of the agreement made between them on January 19, 1994, to be introduced into evidence. If one were to look to common law to resolve this problem, a comparable principle exists. An oral modification agreement may effectively modify any written contract if the new contract is not within the Statute of Frauds *Howard O. Hunter, Modern Law of Contracts.* Rev.Ed.1998. Oral modification of a contract may be found despite the existence of a "no oral modification" clause 4 *Williston on Contracts,* § 591 (3rd Ed.1961) or 6 *Williston on Contracts,* § 1828 p. 5179 (Rev. Ed.); *6 Corbin on Contracts* § 591 (1962) *See* also *Wagner v. Graziano Construction Company, Inc.,* 390 Pa. 445, 136 A.2d 82 (1957) and *Universal Builders v. Moon Motor Lodge,* 430 Pa. 550, 244 A.2d 10 (1968) As the Pennsylvania Supreme Court stated in the *Wagner* case at page 83, "The most iron clad written contract can always be cut into by the acetylene torch of parol modification supported by adequate proof . . . even where the contract specifically states that no non written modification will be recognized, the parties may yet alter their agreement by parol negotiation. The hand that pens a writing may not gag the mouths of assenting parties . . . ." *See* also *In re Franks,* 95 B.R. 346 (Bkrtcy. E.D.Pa. 1989).

that no funds are due for any period past September 24 when the aircraft was returned to them. Thus, this Court finds the issue of "right of return" immaterial. It has already been done.

The real controversy in this case deals with the six month period from January to June of 1994. Express One's position is that when it realized the tourist business would not support the Lease, it immediately requested a meeting with officials of GIE and that meeting was conducted on January 19, 1994. There is no dispute that certain agreements were made at that meeting to govern the conduct of the parties over the following six months. The controversy is that the parties take differing views of what occurred at that meeting. Express One contends that it proposed to maintain the aircraft and pay for it on an hourly basis determined by the number of hours it was actually used in each month. An arrangement commonly referred to in the industry as "power by the hour." Express One's version of the agreement is that, from the period of January through June, it would maintain the aircraft and pay a fixed fee per hour along with the appropriate maintenance charges through June and then return to the regular schedule of payments if business improved during the summer tourist season. That meeting was attended by James Wikert and Chris Chorley for Express One while GIE was represented by Pierre Casau and a representative from Finnair. The only parties to the meeting who testified at trial were James Wikert, Chris Chorley and Pierre Casau. Both Mr. Wikert and Mr. Chorley supported their position that the agreement was a substitution of the power by the hour fees based on the total hours flown during a monthly period for the $240,000.00 per month in rent.

GIE's position, or at least one of its positions, is that the six month period in which power by the hour fees were being paid was a short forbearance in which the difference between the power by the hour payment and the $240,000.00 payment would not be collected but would all remain due and be paid at a later time. These funds constitute the entirety of the proof of claim filed by GIE to which Express One has objected. Express One's counterclaim seeks the return of the $240,000.00 deposit which they paid at the inception of the Lease and which was applied to the unpaid difference between the power by the hour calculation and the $240,000.00 per month regular payment called for in the Lease for the months of January and February 1994. All sums associated with the return of the aircraft and the maintenance have been paid and no further claim is made for those amounts.

This Court is convinced that it does not need to delve deeply into French law nor be sidetracked by the arguments made that the French civil law contains such unusual provisions that some different result would obtain by the application of those legal principles. . . . Just as the common law does not abide a party taking inconsistent legal positions, the civil law provides the same. That simple principle is fatal to GIE's position in this case. As stated earlier, GIE cannot deny that there was a modification to the contract. In fact,

they do not deny that there was a modification and the exhibits and testimony of Pierre Casau clearly demonstrates that the parties met on January 19, 1994, in Paris, France and made an agreement to conduct their business differently than that provided in the written Lease signed some three months earlier. Now that they are in a dispute concerning the terms of that agreement, they cannot simply declare that the agreement did not take place and that they are entitled to enforce a portion of their earlier written agreement. The question to be determined is what are the terms of the agreement reached by the parties on January 19, 1994, at the Paris meeting.

This Court believes that Express One has demonstrated clearly that its version of the agreement is the agreement reached by the parties. . . .

* * *

Note

What legal rules does the court identify regarding (1) whether contracts can be modified; (2) what kinds of evidence may be considered in determining whether a contract has been modified; and (3) the effect of admissions by the parties on the question of whether modifications occurred?

Section 6

INCORRECT INFORMATION OR MISTAKEN ASSUMPTIONS

6-1. AMERICAN AND EUROPEAN PRINCIPLES

Sometimes a party is induced to make a promise based on incorrect information or a mistaken assumption. For example, the buyer of a used car may believe that the car was never involved in any accident when in fact the car was previously damaged and repaired. The person's incorrect belief about the car may stem from something that the seller told the buyer. Or the person may have looked at the car, seen no evident damage, and simply assumed that no accident had ever occurred.

Upon learning the true facts, a party who has entered a contract based on incorrect information or a faulty assumption may wish not to keep the contract and to rescind actions already taken in fulfilling it. American and European contract law both have rules that permit avoidance and rescission in certain circumstances.

In the United States, a party generally does not have to keep and may rescind a promise if the promise was induced by a fraudulent or a material misrepresentation. *See Restatement (Second) of the Law of Contracts* § 164(1). A misrepresentation is any assertion that is not in accordance with the facts. *See id.* § 159. A misrepresentation is fraudulent if "the maker intends his assertion to induce a party to manifest his assent and the maker . . . knows or believes that the assertion is not in accord with the facts." *Id.* § 162(1). A misrepresentation is material "if it would be likely to induce a reasonable person to manifest his assent." *Id.* § 162(2). A misrepresentation "induces" a person to enter a contract if the misrepresentation "substantially contributes to his decision to manifest his assent." *Id.* § 167.

Contract law in the United States also allows a party to avoid some promises that are induced by a mistake. A mistake is "a belief that is not in accord with the facts." *Id.* § 151. All American jurisdictions agree that a "mutual mistake"—that is, a mistake shared by both parties—may make a promise voidable. Section 152(1) of the *Restatement (Second) of the Law of Contracts* says:

> Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake . . . .

The traditional rule in the United States was that a mistake made by just one part—a "unilateral mistake"—was insufficient to make the contract unenforceable. About half of American jurisdictions, however, have now modified this rule and permit a party to avoid a contract based on a unilateral mistake if the mistake would make enforcement of the contract "unconscionable" or if "the other party had reason to know of the mistake or his fault caused the mistake." *Id.* § 153(a) & (b). *See* Gregory E. Maggs, *Ipse Dixit: The Restatement (Second) of Contracts and the Modern Development of Contract Law*, 66 Geo. Wash. L. Rev. 508, 525-27 (1998). But apart from these rules, a party engaged in contract negotiations is permitted to engage in "bare non-disclosure." In other words, the mere fact that one party did not reveal facts to the other party does not permit the other party to void the contract.

The *Principles of European Contract Law* includes the following rules regarding promises induced by misrepresentation, non-disclosure, and mistake:

> Article 4:103: *Fundamental Mistake as to Facts or Law*
>
> (1) A party may avoid a contract for mistake of fact or law existing when the contract was concluded if:
>
> (a) (i) the mistake was caused by information given by the other party; or (ii) the other party knew or ought to have known of the mistake and it was contrary to good faith and fair dealing to leave the mistaken party in error; or (iii) the other party made the same mistake, and
>
> (b) the other party knew or ought to have known that the mistaken party, had it known the truth, would not have entered the contract or would have done so only on fundamentally different terms.
>
> (2) However a party may not avoid the contract if:
>
> (a) in the circumstances its mistake was inexcusable, or
>
> (b) the risk of the mistake was assumed, or in the circumstances should be borne, by it.
>
> Article 4:106: *Incorrect Information*
>
> A party who has concluded a contract relying on incorrect information given it by the other party may recover damages in accordance with Article 4:117(2) and (3) even if the information does not give rise to a funda-

mental mistake under Article 4:103, unless the party who gave the information had reason to believe that the information was correct.

Article 4:107: *Fraud*

(1) A party may avoid a contract when it has been led to conclude it by the other party's fraudulent representation, whether by words or conduct, or fraudulent non-disclosure of any information which in accordance with good faith and fair dealing it should have disclosed.

(2) A party's representation or non-disclosure is fraudulent if it was intended to deceive.

(3) In determining whether good faith and fair dealing required that a party disclose particular information, regard should be had to all the circumstances, including:

(a) whether the party had special expertise;

(b) the cost to it of acquiring the relevant information;

(c) whether the other party could reasonably acquire the information for itself; and

(d) the apparent importance of the information to the other party.

One important formal difference between these European rules and the American rules is that the European rules generally do not make promises voidable on grounds that they were induced by a material but not fraudulent misrepresentation. But European contract law compensates for this difference by making it easier for the parties to avoid contracts based on unilateral mistakes. The commentary to *Principles of European Contract Law* says: "Thus if a seller of land has (without fraud) given the buyer incorrect information about it, on the continent the case is likely to be dealt with via mistake (e.g. in FRENCH law, *The Villa Jacqueline* case, Civ. 23.11.1931, DP 1932.1.129, n. Josserand); in the common law the mistaken party would be permitted to avoid the contract on the ground of misrepresentation." *Principles of European Contract Law, Parts I & II* 235 (Ole Lando & Hugh Beale, eds. 2000).

Another possible difference concerns misrepresentations and mistakes of "law" as opposed to "fact." For example, suppose that a seller of a used car incorrectly tells the buyer (1) that the car has new tires and (2) that the law does not require the car to pass a pollution emissions test. The former statement is one of fact, while the latter is one of law. A minority of American jurisdictions apparently do not allow recission based on misrepresentations or mistakes of law as opposed to fact. But *Restatement (Second) of the Law of Contracts* rejects this position. Its commentary says: "A party's erroneous belief with respect to the law, as found in statute, regulation, judicial decision, or elsewhere, or with respect to the legal consequences of his acts, may

. . . come within these rules." Article 4:103 also draws no distinction between mistakes of fact and mistakes of law. The drafters of the article assert that in most European legal systems, "the fact that a party's mistake is as to the legal position, rather than as to the facts, is irrelevant if the other conditions for relief are fulfilled." *Principles of European Contract Law, Parts I & II* 240 (Ole Lando & Hugh Beale 2000).

Problem

Buyer contracted to buy a farm from Seller. After making the contract, but before completing the purchase, buyer discovered that the farm had severe water drainage problems. These problems will prevent the growing of crops and remedying the problems would cost a great deal of money. Buyer now wants to cancel the contract. Consider whether Buyer would have the right to avoid the contract given each of the following versions of facts.

Version #1: Seller knew that the farm had drainage problems, but told Buyer that it did not. In reliance, Buyer assumed that there was no drainage problem.

Version #2: Seller mistakenly believed that the farm had no drainage problems and told Buyer that it did not. In reliance, Buyer assumed that there was no drainage problem.

Version #3: Seller knew that the farm had drainage problems, but did not tell Buyer about them. In reliance, Buyer assumed that there was no drainage problem.

Version #4: Seller and Buyer each mistakenly assumed that there were no drainage problems.

How would each version of the problem be analyzed under the rules in the *Restatement (Second) of the Law of Contracts* and under the *Principles of European Contract Law*?

SWINTON v. WHITINSVILLE SAVINGS BANK

Supreme Judicial Court of Massachusetts
42 N.E.2d 808 (1942)

QUA, Justice.

The declaration alleges that on or about September 12, 1938, the defendant sold the plaintiff a house in Newton to be occupied by the plaintiff and his family as a dwelling; that at the time of the sale the house "was infested with termites, an insect that is most dangerous and destructive to buildings"; that the defendant knew the house was so infested; that the plaintiff could not readily observe this condition upon inspection; that "knowing the internal destruction that these insects were creating in said house," the defendant

falsely and fraudulently concealed from the plaintiff its true condition; that the plaintiff at the time of his purchase had no knowledge of the termites, exercised due care thereafter, and learned of them about August 30, 1940; and that, because of the destruction that was being done and the dangerous condition that was being created by the termites, the plaintiff was put to great expense for repairs and for the installation of termite control in order to prevent the loss and destruction of said house.

There is no allegation of any false statement or representation, or of the uttering of a half truth which may be tantamount to a falsehood. There is no intimation that the defendant by any means prevented the plaintiff from acquiring information as to the condition of the house. There is nothing to show any fiduciary relation between the parties, or that the plaintiff stood in a position of confidence toward or dependence upon the defendant. So far as appears the parties made a business deal at arm's length. The charge is concealment and nothing more; and it is concealment in the simple sense of mere failure to reveal, with nothing to show any peculiar duty to speak. The characterization of the concealment as false and fraudulent of course adds nothing in the absence of further allegations of fact. Province Securities Corp. v. Maryland Casualty Co., 269 Mass. 75, 92, 168 S.E. 252.

If this defendant is liable on this declaration every seller is liable who fails to disclose any nonapparent defect known to him in the subject of the sale which materially reduces its value and which the buyer fails to discover. Similarly it would seem that every buyer would be liable who fails to disclose any nonapparent virtue known to him in the subject of the purchase which materially enhances its value and of which the seller is ignorant. See Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659. The law has not yet, we believe, reached the point of imposing upon the frailties of human nature a standard so idealistic as this. That the particular case here stated by the plaintiff possesses a certain appeal to the moral sense is scarcely to be denied. Probably the reason is to be found in the facts that the infestation of buildings by termites has not been common in Massachusetts and constitutes a concealed risk against which buyers are off their guard. But the law cannot provide special rules for termites and can hardly attempt to determine liability according to the varying probabilities of the existence and discovery of different possible defects in the subjects of trade. The rule of nonliability for bare nondisclosure has been stated and followed by this court in Matthews v. Bliss, 22 Pick. 48, 52, 53; Potts v. Chapin, 133 Mass. 276; Van Houten v. Morse, 162 Mass. 414, 38 N.E. 705, 26 L.R.A. 430, 44 Am.St.Rep. 373; Phinney v. Friedman, 224 Mass. 531, 533, 113 N.E. 285; Windram Mfg. Co. v. Boston Blacking Co., 239 Mass. 123, 126, 131 N.E. 454, 17 A.L.R. 669; Wellington v. Rugg, 243 Mass. 30, 35, 36, 136 N.E. 831, and Brockton Olympia Realty Co. v. Lee, 266 Mass. 550, 561, 165 N.E. 873. It is adopted in the American Law Institute's Restatement of Torts, § 551. See Williston on Contracts, Rev.Ed., §§ 1497, 1498, 1499.

The order sustaining the demurrer is affirmed, and judgment is to be entered for the defendant. Keljikian v. Star Brewing Co., 303 Mass. 53, 55- 63, 20 N.E.2d 465.

So ordered.

Notes

1. Many states in the United States now have enacted statutes that require the sellers of houses to disclose the presence of termites.

2. Did the bank deceive Swinton by telling him something false or by hiding the termite damage? Why did the court say that the bank did not have to disclose the presence of termites? What advice would you give Swinton in buying a house?

3. How would the *Swinton* case come out under the *Principles of European Contract Law*? See Article 4:103(1)(a)(ii) quoted above.

4. What policy arguments does the court give in support of the rule that it applies? Can you think of any economic reason that one party should not have to disclose information to another?

Problem

The commentary to the *Principles of European Contract Law* provides this illustration:

> A sells her house to B without revealing to B that A knows there is extensive rot under the floor of one room. She does not mention it because she assumes B will be aware of the risk of it from the fact that there are damp marks on the wall and will have the floor checked. B does not appreciate the risk and buys the house without having the floor checked.

Principles of European Contract Law, Part I & II 232 (2000). May B avoid the contract under European contract law or American contract law?

SHERWOOD v. WALKER

Michigan Supreme Court

33 N.W. 919 (1887)

MORSE, J.

[The defendant, Walker, agreed to sell cow named "Rose 2d of Aberlone" to the plaintiff, Sherwood. At the time of the sale, both parties thought that

the cow was infertile. But before delivering the cow to Sherwood, Walker discovered that she was in fact pregnant. Because a fertile cow is more valuable than an infertile cow, Walker refused to convey the animal. Walker sued to obtain possession.]

* * *

It appears from the record that both parties supposed this cow was barren and would not breed, and she was sold by the pound for an insignificant sum as compared with her real value if a breeder. She was evidently sold and purchased on the relation of her value for beef, unless the plaintiff had learned of her true condition, and concealed such knowledge from the defendants. Before the plaintiff secured the possession of the animal, the defendants learned that she was with calf, and therefore of great value, and undertook to rescind the sale by refusing to deliver her. The question arises whether they had a right to do so. The circuit judge ruled that this fact did not avoid the sale and it made no difference whether she was barren or not. I am of the opinion that the court erred in this holding. I know that this is a close question, and the dividing line between the adjudicated cases is not easily discerned. But it must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact, such as the subject-matter of the sale, the price, or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual. 1 Benj. Sales, §§ 605, 606; Leake, Cont. 339; Story, Sales, (4th Ed.) §§ 377, 148. See, also, Cutts v. Guild, 57 N.Y. 229; Harvey v. Harris, 112 Mass. 32; Gardner v. Lane, 9 Allen, 492, 12 Allen, 44; Huthmacher v. Harris' Adm'rs, 38 Pa.St. 491; Byers v. Chapin, 28 Ohio St. 300; Gibson v. Pelkie, 37 Mich. 380, and cases cited; Allen v. Hammond, 11 Pet. 63-71.

If there is a difference or misapprehension as to the substance of the thing bargained for; if the thing actually delivered or received is different in substance from the thing bargained for, and intended to be sold,—then there is no contract; but if it be only a difference in some quality or accident, even though the mistake may have been the actuating motive to the purchaser or seller, or both of them, yet the contract remains binding. "The difficulty in every case is to determine whether the mistake or misapprehension is as to the substance of the whole contract, going, as it were, to the root of the matter, or only to some point, even though a material point, an error as to which does not affect the substance of the whole consideration." Kennedy v. Panama, etc., Mail Co., L.R. 2 Q.B. 580, 587. It has been held, in accordance with the principles above stated, that where a horse is bought under the belief that he is sound, and both vendor and vendee honestly believe him to be sound, the purchaser must stand by his bargain, and pay the full price, unless there was a warranty.

It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least $750; if barren, she was worth not over $80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use as a cow. It is true she is now the identical animal that they thought her to be when the contract was made; there is no mistake as to the identity of the creature. Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale, but the mistake affected the character of the animal for all time, and for its present and ultimate use. She was not in fact the animal, or the kind of animal, the defendants intended to sell or the plaintiff to buy. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one. The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor.

The judgment of the court below must be reversed, and a new trial granted, with costs of this court to defendants.

CAMPBELL, C.J., and CHAMPLIN, J., concurred.

Notes

1. What was the mistaken assumption upon which the parties made the contract in this case? How is this case different from *Swinton v. Whitinsville Savings Bank*?

2. Why should a promise induced by a mutual mistake (i.e., a mistake of both parties) be voidable, but a contract induced by a unilateral mistake (i.e., a mistake of one party) not be voidable?

3. How would this case come out under the *Principles of European Contract Law*?

4. Would it be more appropriate to put the risk of mistake on one party rather than the other in this case?

Problems

1. The commentary to the *Principles of European Contract Law* provides this illustration:

> An Englishwoman who owns a cottage in France agrees to rent it for one month to a Danish friend, although the Englishwoman does not normally rent the cottage. The lease is to start five days later. The Dane books non-refundable air tickets to fly to France. It is then discovered that the cottage had been totally destroyed by fire the night before the contract was agreed.

Principles of European Contract Law, Part I & II 232 (Ole Lando & Hugh Beale, eds. 2000). Does the Dane have to pay rent to the Englishwoman? Can the Dane hold the Englishwoman liable for breach of contract? Is the Dane entitled to compensation for the wasted air tickets?

2. The commentary to Article 4:106 explains that the article "applies only to incorrect information given by the other party to the contract." *Principles of European Contract Law, Parts I & II* 249 (Ole Lando & Hugh Beale, eds.). The article generally does not apply when a party has been misled by information provided by a third party. *See id.* But the article does apply if the "the third party was acting as the agent of the other party or the other party knew that the incorrect information had been given . . . or the other party to the contract passed on the information in a way that showed it was adopting it." *Id.* The commentary contains this illustration:

> G leased a machine from H, relying on a statement made by J, a friend who has a similar machine, that its fuel consumption was 5 litres per hour. In fact, the fuel consumption was much higher.

Id. May G recover damages from H? How do the facts of this illustration differ from the facts of *Lony v. E.I. Dupont De Nemours and Co.*, which follows?

LONY v. E.I. DuPONT de NEMOURS & CO., INC.

United States District Court for the District of Delaware
821 F. Supp. 956 (D. Del. 1993)

FARNAN, District Judge.

I. INTRODUCTION

Plaintiff, Adolf Lony ("Lony") brought this action against Defendant, E.I. DuPont de Nemours ("DuPont") asserting nine grounds for relief, all based on alleged misrepresentations. By way of Order dated May 19, 1993, the Court granted Lony's Motion to Amend the Complaint thereby permitting two of the stated causes of action to be removed. DuPont has moved for summary judgment as to several of the Counts and partial summary judgment as to others. For the reasons discussed, DuPont's Motion will be granted in part and denied in part.

II. BACKGROUND

The Court assumes familiarity with the factual background of the dispute between Lony and DuPont as this case has been appealed twice to the Court of Appeals for the Third Circuit. . . .*

* * *

* In *Lony v. E.I. DuPont de Nemours & Co.*, 886 F.2d 628, 629-30 (3d Cir. 1989), the court recounted these facts:

Appellant Adolf Lony ("Lony") is a sole proprietorship with its principal place of business in the Federal Republic of Germany ("Germany"). It prints and processes cellophane and plastic films into wrappers for food and other products.

In 1985, Lony purchased some DuPont cellophane from Transparent Paper Ltd. ("Transparent"), a Swiss distributor of cellophane for DuPont and other manufacturers. At that time, Lony's largest client was Haribo GmbH. & Co. KG ("Haribo"), a West German candy producer with its principal place of business in Germany, which manufactures, among other products, the children's candy "Gummibaerchen" or Gummy Bears. Lony claims that it used the DuPont cellophane it purchased through Transparent to make wrappers for Haribo candy.

Lony claims that in August of 1985, Haribo asked Lony whether the cellophane packaging provided by Lony for its candy contained diethylene glycol ("DEG"), and specified that the cellophane used for Haribo candy must be free of DEG. The concern was apparently prompted by a widely publicized scandal at that time over the presence of DEG in some European foods and wines. Lony claims that it asked Transparent whether or not the DuPont cellophane was free of DEG, and that Transparent forwarded the question to DuPont and forwarded DuPont"s reply to Lony. In October 1985, William Percival, of the Regulatory Affairs Group of DuPont's Polymer Products Department in Wilmington, wrote to Transparent:

> In response to your question to W. Pierce, I am informing you that there is no diethylene glycol in any type of DuPont Company Cellophane Film handled by your Company.
>
> * * *

Lony alleges that in December 1985 and January 1986, following DuPont's assurances, Lony shipped candy wrappers made with DuPont cellophane to Haribo; in May 1986, Haribo tested the candy wrappers it had received from Lony, found they contained DEG, severed its business relationship with Lony, and drove Lony to the brink of bankruptcy. . . . [Citations to the record omitted.]—Ed.

** Section 823 provides: "(1) A person who, wilfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom. (2) The same obligation is placed upon a person who violates a statute intended for the protection of others. . . ."—Ed.

2. Count III-Negligent Misrepresentation

The parties agree that Count III is governed by West German Law. DuPont contends that under § 823 of the West German Civil Code economic recovery is not possible unless the plaintiff can meet one of the two criteria set out in subsections 1 and 2 of section 823.** According to DuPont, Lony fails to fulfill any of the delineated areas of injury provided by § 823(1) and therefore that section cannot be the basis for recovery. DuPont argues that subsection 2 provides for economic recovery only if the injury was the "consequence of a violation of a protecting statute, or the requirements of the specific provisions of Sections 824, 826, 839." Docket Item ("D.I.") 150, p. 23 *citing* Judgment of March 20, 1919, RGZ 95, 173.

Lony argues that their claim is premised on a violation of section 826 of the German Civil Code and therefore recovery is warranted. According to Lony, two things must be shown under § 826: (1) behavior contrary to public policy; and (2) willful causation of damages.* With respect to the willful causation of damages, Lony argues that conditional willfulness is sufficient and they are able to meet this standard.

DuPont counters that if Lony seeks relief based on a showing of a violation of § 826, Lony is barred because of the determination of the Court of Appeals for the Third Circuit that Delaware law controls intentional misrepresentations, while German law governs negligent acts. According to DuPont, because § 826 requires a showing of intent with respect to damages, even though conditional willfulness is sufficient, Lony cannot pursue this cause of action under West German law.

The Court concludes that summary judgment is appropriate with respect to Count III. The Court of Appeals made clear that all claims involving any alleged intentional conduct are governed by Delaware law. It does not matter what element of a relied upon statute the intent relates, Lony is bound by the earlier decision of the Third Circuit with respect to what law will control. Because a showing of intentional conduct is a necessary element under § 826,[3] summary judgment must be granted.

3. Count VI-Breach of Contract

Lony claims that existence of a tacit information contract, which is recognized under West German Law, can be established in this case. DuPont contends that such a claim is not available to Lony because Lony's theory is nothing more than an attempt to disguise a breach of warranty claim. According-

* Section 826 provides: "A person who wilfully causes damage to another in a manner contrary to public policy must compensate the other for the damage."—Ed.

3. The Court recognizes that the level of intent is somewhat diminished by the plaintiff needing only to show conditional willfulness, however, this still requires a showing of some level of intent and certainly more than negligence.

ing to DuPont, none of the cases cited by Lony involve a manufacturer and distributor relationship and, at a minimum, Lony must show privity for this theory to be available for recovery.

Lony contends that as opposed to § 826 where some intent must be shown, recovery based on a tacit information contract is possible on a showing of mere negligence. According to Lony, even if the information is not provided directly to the injured party, as long as the provider of the information knows the information is destined for a third party, recovery is available.

The Court concludes that the tacit information contract theory of recovery is unavailable to Lony under the facts of this case. There are two factual distinctions between the cases where such a recovery has been permitted and the present case. First, all of the cases where recovery was permitted, the relationship of the parties was based on the communication of information, not on the sale of goods where the communication of information was incidental to that sale. Second, all of the cases cited were used to hold the person, who had acted as a conduit in the communication of the information, liable for carelessly or negligently permitting the information to be communicated. None of the cases held the source of the allegedly erroneous information liable.

In the instant case, the parties' relationship was not based on the communication of information, but rather on the sale of goods. The communication was not the type where liability has been found to attach under German Law.

* * *

Notes

1. Why might Lony have sought to recover under the tort law theories in§ 823 and § 826 instead of merely seeking to rescind the contract?

2. Suppose that the misrepresentation about the presence of DEG in the wrappers was not fraudulent (i.e., it was the result of an innocent mistake) and that Lony merely had wanted to rescind an agreement to purchase the wrappers from Transparent Paper Ltd. Would American or European contract law permit the rescission?

MINEBEA CO., LTD. v. PAPST

United States District Court for the District of Columbia

355 F. Supp.2d 518 (D.D.C. 2005)

[Minebea Co. entered into a patent license with Georg Papst. Later, Minebea Co. claimed that Papst had misrepresented the scope of the patent rights that Minebea Co. would acquire under the license. Papst argued in defense that Minebea Co. was never actually deceived. To support this position, Papst

sought to discover what advice Minebea Co. had received from its legal counsel. Minebea Co. resisted disclosure of this information based on the attorney-client evidentiary privilege, which generally shields conversations between attorneys and their clients from discovery. But Papst argued in response that Minebea Co. had waived the attorney-client privilege by placing at issue its understanding of rights granted under the patent license.]

PAUL L. FRIEDMAN, District Judge.

* * *

The larger question involved in Minebea's objections is whether Minebea, through its pleading and other actions has placed "at issue" its communications with its attorneys regarding the issues identified by the Special Master. Minebea maintains that no "at issue" waiver occurred and that, even if the Court concludes that it did, the scope of the waiver as recommended by the Special Master should be rejected as overly broad. *See* Minebea Objections at 12.

* * *

New York law provides that in a fraud action, "liability is determined by whether the plaintiff justifiably relied upon the defendant's misrepresentations and suffered a loss that reasonably might have been anticipated to result from the reliance." *Gordon & Co. v. Ross,* 84 F.3d 542, 545 (2d Cir.1996). In denying Papst's [earlier] motion to dismiss Minebea's fraud count, this Court held:

> It is true that when a plaintiff has the means of knowing, by the exercise of ordinary intelligence, the truth, he is barred as a matter of law from asserting justifiable reliance . . . . However, whether plaintiffs could have discovered the truth about a matter through the 'exercise of ordinary intelligence' is a question of fact.

Minebea Co. v. Papst, 13 F.Supp.2d 35, 43 (D.D.C.1998). The Special Master concluded that, because both the scope of a patent and rights under a license are questions of law, Minebea's assertion that it "justifiably relied" on Papst's information necessarily puts at issue any advice its own attorneys gave it on that subject.[3]

On December 30, 2004, Minebea filed a notice with the Court indicating that the parties now agree that German, rather than New York, law governs Minebea's fraud claims. *See* Notice of Agreement on Applicability of Foreign Law to Fraud Claims ("Notice") at 1. Because fraud under German law, according to the declaration submitted by Minebea, lacks the "reasonable" or "justifiable" reliance element, Minebea now maintains that this may affect the Court's ruling on the question of at issue waiver. . . .

3. The Special Master indicated that his recommendation would be the same regardless of whether the standard was "reasonable" reliance or "justifiable" reliance under New York law. *See* R & R 6 at 30.

On January 26, 2005, the Special Master issued a letter ruling indicating that even assuming he or this Court were to accept the new "agreement" with respect to German law, his conclusions . . . would not change. He noted that the parties agree that German law requires "actual" reliance and found that even if "actual" reliance is required rather than "reasonable" or "justifiable" reliance, the conclusions contained in Report and Recommendation No. 6 remain the same. *See* Letter Ruling at 6-7. The Court agrees. Even if the Court had accepted the stipulation that German law applies, and even if Minebea's expert is correct that one element of fraud under German law is "error on the part of the injured party," the parties appear to agree that some form of reliance—"actual" rather than "justifiable" or "reasonable"—still is required. What Minebea knew or understood is certainly vital to a finding that Minebea either "actually relied" or "justifiably relied." Furthermore, Minebea has repeatedly alleged that it "reasonably relied" on misrepresentations by Papst, and it has not withdrawn these allegations. Minebea's Objections to the Special Master's Letter Ruling of January 26, 2005 are rejected.

Note

Do the rules from the *Restatement (Second) of Contracts* and the *Principles of European Contract Law* quoted at the start of this section permit rescission on the grounds of a misrepresentation only if the person seeking rescission reasonably has relied on the misrepresentation?

NESSI v. SUDOVEST GROUP, INC.

Minnesota Court of Appeals

2005 WL 832199, 57 UCC Rep. Serv.2d 417 (Minn. App. 2005)

[In May 1992, Sergio Nessi made a loan to Antonio Percassi. In July 1995, Percassi entered into a contract in which he promised to repay this loan. Pursuant to the July 1995 contract, Percassi subsequently paid Nessi 900 million lire. But later, when Nessi sued Percassi over an unrelated debt, Percassi filed a counterclaim seeking rescission of the July 1995 contract and restitution of the 900 million lire payment on grounds of unilateral mistake. Percassi assigned his rights in the matter to Sudovest Group, Inc.]

STONEBURNER, Judge.

. . . [T]he district court applied Italian law to the finding it had made in the initial trial on the counterclaim that Percassi entered into the July 1995 contract with Sergio Nessi in the mistaken belief that he was required to

repay a May 1992 loan from Sergio Nessi to Percassi, because Percassi had forgotten about a "scrittura privata" that excused repayment unless specific conditions were met.[1] The district court found that under Italian law, Percassi's mistake was both "essential" to the July 1995 contract and "recognizable" within the meaning of the Italian Civil Code, that Nessi knew in October 1994 and July 1995 that the scrittura privata excused Percassi from repaying the May 1992 loan unless specified conditions were met, and that Nessi knew on those dates that the conditions had not been met. The court also found that a reasonable person in Nessi's position would have known in July 1995 that Percassi was mistaken about his obligation to repay the May 1992 loan when the parties entered into the July 1995 contract.

Based on these findings, the district court concluded that Sudovest, as the assignee of Percassi's rights, was entitled to rescind the July 1995 contract and recover from Nessi 900 million lire that Percassi mistakenly paid under the July 1995 contract.

* * *

Italian law allows for rescission of a contract based on a unilateral mistake that is "essential" and "recognizable" by the other party. Italian Civil Code § 1428. A mistake is essential when it relates to the object of an agreement. Id. Nessi argues that the condition of repayment contained in the scrittura privata remained a condition at the time of the July 1995 agreement "and, accordingly, had not become an object of any contract." The district court rejected Nessi's proffered definition of "object" as only the tangible material that changes hands in a contract.

From our review of the record, we conclude that there is sufficient evidence in Sudovest's expert's affidavits and deposition testimony to support the district court's finding that Percassi's mistaken belief that he was unconditionally obligated to repay the May 1992 loan was essential to the July 1995 contract.[2] Because the evidence supports this finding, it is not clearly erroneous.

* * *

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1. Under the scrittura privata, Percassi did not have to repay Nessi 900 million lire if proof was not supplied by a specified date that Percassi had been paid a like amount by specified companies.

2. Sudovest's expert discussed at length a treatise by V. Pietrobon, "L'Errore nella dottrina del negozio giuridico" which is cited as the only authority in annotations to Art. 1429 of the Italian Civil Code found in Commentario Breve al Codice Civile, recognized by both parties as a detailed collection of authorities and case law on the Italian Civil Code. The expert explains that "[a] mistake on the object of the contract consists, therefore . . . of a mistake on the conflict of interest that the parties intend to regulate with the contract . . . [T]he mistake on the object consists, in substance, of an incorrect understanding that has caused a person to believe in the existence of a conflict of interest that in fact did not have any reason to exist."

Notes

1. What was the mistake in this case? Was it a mistake of law or a mistake of fact? Was it a mutual mistake or a unilateral mistake?

2. Would American law permit rescission of the contract under these circumstances?

Section 7

REMEDIES

7-1. EXPECTATION DAMAGES

The *Principles of European Contract Law* specifies that, if the defendant breaches the contract, the defendant should have to pay the plaintiff a sum of money calculated to put the plaintiff in the same position that the plaintiff would have been in if the defendant had not breached the contract:

> Article 9:502: *General Measure of Damages*
>
> The general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which it would have been if the contract had been duly performed. Such damages cover the loss which the aggrieved party has suffered and the gain of which it has been deprived.

The commentary to this provision says that all European "legal systems seem to agree that [this is] the general measure of damages." *Principles of European Contract Law Parts I & II* 440 (Ole Lando & Hugh Beale, eds. 2000). *See, e.g.,* German Civil Code § 249(1) ("A person who is liable in damages must restore the position that would exist if the circumstance obliging him to pay damages had not occurred.").

American contract law uses the same general measure of damages, which it calls "expectation damages." Section 347 of the *Restatement (Second) of the Law of Contracts* explains the method of calculating expectation damages as follows:

> § 347. *Measure of Damages in General*
>
> Subject to the limitations in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by
>
> (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus
>
> (b) any other loss, including incidental or consequential loss, caused by the breach, less
>
> (c) any cost or other loss that he has avoided by not having to perform.

Problems

1. Suppose a publisher agrees to publish a book that an author has written, promising to pay him $10,000. The publisher then decides not to publish the book. The author cannot find another publisher. What would the author's expectation damages include? Would the result be the same if the author had not yet finished writing the book?

2. Suppose a farmer hires a laborer to work on his farm, promising to pay the laborer $10,000 for the season. Immediately before the season starts, however, the farmer has a change of mind and decides not to employ the laborer. The laborer spends $500 searching for another position, and ends up taking comparable employment at another farm for a salary of $7000. What expectation damages may the laborer recover?

3. A builder promises to build a cabin for a lawyer for $100,000, expecting costs of $80,000. After the builder starts the work, the lawyer repudiates the contract. It would cost the builder $60,000 to finish the work. What may the builder recover from the lawyer?

4. A construction company agrees to pave a business's parking lot for $10,000. The business repudiates the contract and the construction company subsequently makes a contract to pave a similar parking lot for $10,000. The construction company could have done both jobs simultaneously. What are the construction company's damages?

Notes

1. Why does the law award the plaintiff enough money to put the plaintiff in the same position the plaintiff would have been in if the defendant had kept the promise? Why doesn't the law just compensate the plaintiff for any costs that the plaintiff has incurred in reliance on the promise?

2. Why might a defendant decide to break a contract if the defendant must pay expectation damages to the plaintiff, and thus put the plaintiff in the same position the plaintiff would have been in anyway? Consider the following hypothetical. A manufacturer contracts to sell a product to a wholesaler for $1000. The wholesaler values the product at $1500 because the wholesaler can resell it for that much. The manufacturer then receives an offer to sell the product directly to a retailer for $1600. The manufacturer has two choices: it may keep the contract with the wholesaler or break the contract and sell to the retailer. If the wholesaler can collect expectation damages from the manufacturer if the manufacturer breaches, does it theoretically matter to the wholesaler what choice the manufacturer makes? Does the choice matter to the manufacturer?

ZAPATA HERMANOS SUCESORES, S.A. v. HEARTHSIDE BAKING COMPANY, INC.

United States Court of Appeals for the Seventh Circuit

313 F.3d 385 (7th Cir. 2002)

POSNER, Circuit Judge.

Zapata, a Mexican corporation that supplied Lenell, a U.S. wholesale baker of cookies, with cookie tins, sued Lenell for breach of contract and won. The district judge ordered Lenell to pay Zapata $550,000 in attorneys' fees. From that order, which the judge based both on a provision of the Convention on Contracts for the International Sale of Goods, Jan. 1, 1988, 15 U.S.C.App., and on the inherent authority of the courts to punish the conduct of litigation in bad faith, Lenell appeals.

The Convention, of which both the U.S. and Mexico are signatories, provides, as its name indicates, remedies for breach of international contracts for the sale of goods. Zapata brought suit under the Convention for money due under 110 invoices, amounting to some $900,000 (we round liberally), and also sought prejudgment interest plus attorneys' fees, which it contended are "losses" within the meaning of the Convention and are therefore an automatic entitlement of a plaintiff who prevails in a suit under the Convention. At the close of the evidence in a one-week trial, the judge granted judgment as a matter of law for Zapata on 93 of the 110 invoices, totaling $850,000. Zapata's claim for money due under the remaining invoices was submitted to the jury, which found in favor of Lenell. Lenell had filed several counterclaims; the judge dismissed some of them and the jury ruled for Zapata on the others. The jury also awarded Zapata $350,000 in prejudgment interest with respect to the 93 invoices as to which Zapata had prevailed, and the judge then tacked on the attorneys' fees—the entire attorneys' fees that Zapata had incurred during the litigation.

Article 74 of the Convention provides that "damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach," provided the consequence was foreseeable at the time the contract was made. Article 7(2) provides that "questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law [i.e., conflicts of law rules]." There is no suggestion in the background of the Convention or the cases under it that "loss" was intended to include attorneys' fees, but no suggestion to the contrary either. Nevertheless it seems apparent that "loss" does not include attorneys' fees incurred in the litigation of a suit for breach of contract, though certain prelitigation legal expenditures, for example expenditures designed to mitigate the plaintiff's damages, would probably be covered as "incidental" damages. Sorenson v.

Fio Rito, 90 Ill. App.3d 368, 45 Ill.Dec. 714, 413 N.E.2d 47, 50- 52 (1980); cf. Tull v. Gundersons, Inc., 709 P.2d 940, 946 (Colo.1985); Restatement (Second) of Contracts § 347, comment c (1981).

The Convention is about contracts, not about procedure. The principles for determining when a losing party must reimburse the winner for the latter's expense of litigation are usually not a part of a substantive body of law, such as contract law, but a part of procedural law. For example, the "American rule," that the winner must bear his own litigation expenses, and the "English rule" (followed in most other countries as well), that he is entitled to reimbursement, are rules of general applicability. They are not field-specific. There are, it is true, numerous exceptions to the principle that provisions regarding attorneys' fees are part of general procedure law. For example, federal antidiscrimination, antitrust, copyright, pension, and securities laws all contain field-specific provisions modifying the American rule (as do many other field-specific statutes). An international convention on contract law could do the same. But not only is the question of attorneys' fees not "expressly settled" in the Convention, it is not even mentioned. And there are no "principles" that can be drawn out of the provisions of the Convention for determining whether "loss" includes attorneys' fees; so by the terms of the Convention itself the matter must be left to domestic law (i.e., the law picked out by "the rules of private international law," which means the rules governing choice of law in international legal disputes).

U.S. contract law is different from, say, French contract law, and the general U.S. rule on attorneys' fee shifting (the "American rule") is different from the French rule (loser pays). But no one would say that French contract law differs from U.S. because the winner of a contract suit in France is entitled to be reimbursed by the loser, and in the U.S. not. That's an important difference but not a contract-law difference. It is a difference resulting from differing procedural rules of general applicability.

The interpretation of "loss" for which Zapata contends would produce anomalies; this is another reason to reject the interpretation. On Zapata's view the prevailing plaintiff in a suit under the Convention would (though presumably subject to the general contract duty to mitigate damages, to which we referred earlier) get his attorneys' fees reimbursed more or less automatically (the reason for the "more or less" qualification will become evident in a moment). But what if the defendant won? Could he invoke the domestic law, if as is likely other than in the United States that law entitled either side that wins to reimbursement of his fees by the loser? Well, if so, could a winning plaintiff waive his right to attorneys' fees under the Convention in favor of domestic law, which might be more or less generous than Article 74, since Article 74 requires that any loss must, to be recoverable, be foreseeable, which beyond some level attorneys' fees, though reasonable ex post, might not be? And how likely is it that the United States would have signed the

Convention had it thought that in doing so it was abandoning the hallowed American rule? To the vast majority of the signatories of the Convention, being nations in which loser pays is the rule anyway, the question whether "loss" includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all.

For these reasons, we conclude that "loss" in Article 74 does not include attorneys' fees, and we move on to the question of a district court's inherent authority to punish a litigant or the litigant's lawyers for litigating in bad faith. The district judge made clear that he was basing his award of attorneys' fees to Zapata in part on his indignation at Lenell's having failed to pay money conceded to be owed to Zapata. Although the precise amount was in dispute, Lenell concedes that it owed Zapata at least half of the $1.2 million that Zapata obtained in damages (not counting the attorneys' fees) and pre-judgment interest. Lenell had no excuse for not paying that amount, and this upset the judge.

Firms should pay their debts when they have no legal defense to them. Pacta sunt servanda, as the saying goes ("contracts are to be obeyed"). In the civil law (that is, the legal regime of Continental Europe), this principle is taken very seriously, as illustrated by the fact that the civil law grants specific performance in breach of contract cases as a matter of course. But under the common law (including the common law of Illinois, which is the law that choice of law principles make applicable to any issues in this case not covered in express terms by the Convention), a breach of contract is not considered wrongful activity in the sense that a tort or a crime is wrongful. When we delve for reasons, we encounter Holmes's argument that practically speaking the duty created by a contract is just to perform or pay damages, for only if damages are inadequate relief in the particular circumstances of the case will specific performance be ordered. In other words, and subject to the qualification just mentioned, the entire practical effect of signing a contract is that by doing so one obtains an option to break it. The damages one must pay for breaking the contract are simply the price if the option is exercised. See Oliver Wendell Holmes, Jr., The Common Law 300-02 (1881); Holmes, "The Path of the Law," 10 Harv. L.Rev. 457, 462 (1897).

Why such lenity? Perhaps because breach of contract is a form of strict liability. Many breaches are involuntary and so inapt occasions for punishment. Even deliberate breaches are not necessarily culpable, as they may enable an improvement in efficiency—suppose Lenell had a contract to take a certain quantity of tins from Zapata and found that it could buy them for half the price from someone else. Some breaches of contract, it is true, are not only deliberate but culpable, and maybe this was one—Lenell offers no excuse for failing to pay for tins that it had taken delivery of and presumably resold with its cookies in them. Refusing to pay the contract price after the other party has performed is not the kind of option that the performing party

would willingly have granted when the contract was negotiated. The option of which Holmes spoke was the option not to perform because performance was impossible or because some more valuable use of the resources required for performance arose after the contract was signed. Zapata argues, moreover, perhaps correctly (we need not decide), that Lenell refused to pay in an effort to extract a favorable modification of the terms of the parties' dealings, which would be a form of duress if Zapata somehow lacked an effective legal remedy. Professional Service Network, Inc. v. American Alliance Holding Co., 238 F.3d 897, 900-01 (7th Cir.2001); Alaska Packers' Ass'n v. Domenico, 117 F. 99, 100-04 (9th Cir.1902). But Zapata did not charge duress, and probably couldn't, since it had a good remedy—this suit.

It is true that nowadays common law courts will sometimes award punitive damages for breach of contract in bad faith. But outside the field of insurance, where refusals in bad faith to indemnify or defend have long been punishable by awards of punitive damages to the insured, the plaintiff must show that the breach of contract involved tortious misconduct, such as duress or fraud or abuse of fiduciary duty. See, e.g., Miller Brewing Co. v. Best Beers of Bloomington, Inc., 608 N.E.2d 975, 982-83 (Ind.1993); Story v. City of Bozeman, 242 Mont. 436, 791 P.2d 767, 776 (1990); E. Allan Farnsworth, Contracts § 12.8, pp. 788-89 (3d ed.1999). This is the rule in Illinois, Morrow v. L.A. Goldschmidt Associates, Inc., 112 Ill.2d 87, 96 Ill.Dec. 939, 492 N.E.2d 181, 183-86 (1986), and Zapata has not tried to come within it. For that matter, it did not ask for punitive damages, and the judge had no authority to award attorneys' fees in lieu of such damages. He could not have awarded punitive damages if Zapata had asked for them but had been unable to prove tortious misconduct by Lenell, and even more clearly he could not award them when they had not been requested.

The decision whether punitive damages shall be a sanction for a breach of contract is an issue of substantive law, and under the Erie doctrine a federal court is not authorized to apply a different substantive law of contracts in a diversity case from the law that a state court would apply were the case being litigated in a state court instead. And obviously that rule must not be circumvented by renaming punitive damages "attorneys' fees." United States ex rel. Treat Bros. Co. v. Fidelity & Deposit Co. of Maryland, 986 F.2d 1110, 1119-20 (7th Cir.1993); see also Chambers v. NASCO, Inc., 501 U.S. 32, 52-55, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991); Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc., 976 F.2d 541, 548- 50 (9th Cir.1992). It is true that this is not a diversity case, but the Erie doctrine applies to any case in which state law supplies the rule of decision, see, e.g., O'Melveny & Myers v. FDIC, 512 U.S. 79, 83-85, 87-88, 114 S.Ct. 2048, 129 L.Ed.2d 67 (1994), here by incorporation in the Convention.

The inherent authority of federal courts to punish misconduct before them is not a grant of authority to do good, rectify shortcomings of the common

law (as by using an award of attorneys' fees to make up for an absence that the judge may deem regrettable of punitive damages for certain breaches of contract), or undermine the American rule on the award of attorneys' fees to the prevailing party in the absence of statute. Morganroth & Morganroth v. DeLorean, 213 F.3d 1301, 1318 (10th Cir.2000); Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc., supra, 976 F.2d at 548-50 (9th Cir.1992); Shimman v. International Union of Operating Engineers, Local 18, 744 F.2d 1226, 1232-33 and n. 9 (6th Cir.1984) (en banc). These cases and others we could cite make clear that it is a residual authority, to be exercised sparingly, to punish misconduct (1) occurring in the litigation itself, not in the events giving rise to the litigation (for then the punishment would be a product of substantive law—designed, for example, to deter breaches of contract), and (2) not adequately dealt with by other rules, most pertinently here Rules 11 and 37 of the Federal Rules of Civil Procedure, which Lenell has not been accused of violating.

One issue remains for discussion. Although we have treated the appeal so far as if the only issues concerned attorneys' fees, Lenell also argues that the jury verdict should be set aside because the judge by his comments in open court signaled to the jury his scorn for Lenell's case. There were only a couple of such comments (many more, however, at sidebars outside the jury's hearing), and we do not think they could have changed the outcome. But we also think that judges should be very cautious about making comments in the hearing of a jury about the quality of a party's case or lawyers. For if he signals to the jury his opinion as to how the case should be decided, he undermines the jury's authority. Collins v. Kibort, 143 F.3d 331, 336 (7th Cir. 1998); Nationwide Mutual Fire Ins. Co. v. Ford Motor Co., 174 F.3d 801, 805, 808 (6th Cir.1999); see also Ross v. Black & Decker, Inc., 977 F.2d 1178, 1187 (7th Cir.1992).

From what we have just reported about the judge's statements during the trial and from the tone of a number of other statements that he made in the course of this litigation, we think it best that the further proceedings that we are ordering be conducted before a different judge, in accordance with 7th Cir. R. 36.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

Note

If expectation damages do not include attorney's fees, do they actually put a plaintiff in the same position that the plaintiff would have been in had the defendant not breached the contract?

7-2. PROOF OF EXPECTATION DAMAGES

The *Principles of European Contract Law* includes a rule that facilitates the proof of expectation damages. It allows the plaintiff to prove the value of the defendant's promised performance simply by showing what it actually cost the plaintiff to procure a substitute performance.

Article 9:506: Substitute Transaction

Where the aggrieved party has terminated the contract and has made a substitute transaction within a reasonable time and in a reasonable manner, it may recover the difference between the contract price and the price of the substitute transaction as well as damages for any further loss so far as these are recoverable under this Section.

In the United States, the Uniform Commercial Code establishes the same rule for contracts for the sale of goods. But the common law of contracts does not follow this rule. *See* U.C.C. §§ 2-706(1); 2-712. Under the common law, the plaintiff's loss in value usually is determined by the prevailing market price. A substitute transaction provides some evidence of the market price, but it is not conclusive. *See* Richard E. Speidel *et al.*, *Sales and Secured Transactions: Teaching Materials* 704 (5th ed. 1993).

Problem

Homeowner hired Painter to paint the exterior of his house for $5000. When Painter repudiated the contract, Homeowner hired someone else to do the work for $5500. Painter introduced evidence suggesting the market price of the work was actually about $5300. What could Homeowner recover from Painter under the American common law of contracts? What could Homeowner recover from Painter under Article 9:506? What are the benefits and detriments of each rule?

7-3. LIMITATIONS ON EXPECTATION DAMAGES

Although American and European contract law generally allow the plaintiff to recover expectation damages, they both impose some limitations on this recovery. The *Principles of European Contract Law*, for example, contains the following two provisions:

Article 9:503: *Foreseeability*

The non-performing party is liable only for loss which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of its non-performance, unless the non-performance was intentional or grossly negligent.

Article 9:505: *Reduction of Loss*

(1) The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party could have reduced the loss by taking reasonable steps.

(2) The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the loss.

American contract law similarly provides that the plaintiff may not recover damages "for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made," *Restatement (Second) of the Law of Contracts* § 351, or damages that the plaintiff "could have avoided without undue risk, burden or humiliation," *id.* § 350.

Note

German law reportedly does not follow the rule in Article 9:503. "Liability for harm caused by breach of contract," in Germany, "is based on causation rather than foreseeability." Raymond Youngs, *English, French, and German Comparative Law* 441 (1997). But this does not mean that a defendant necessarily must pay for all harmed caused. German law requires the reduction of an award of damages if the plaintiff was at fault. "A failure to inform the other party about the possibility that an unusually high loss might result from breach of contract might" require a reduction. *Id.* 441-42. What should parties in Germany do at the time of contracting if they do not want their damage recoveries to be limited? Does this advice apply to parties in other countries also?

ROCKINGHAM COUNTY v. LUTEN BRIDGE CO.

U.S. Court of Appeals for the Fourth Circuit

35 F.2d 301 (4th Cir. 1929)

PARKER, Circuit Judge.

This was an action at law instituted in the court below by the Luten Bridge Company, as plaintiff, to recover of Rockingham county, North Carolina, an amount alleged to be due under a contract for the construction of a bridge. The county admits the execution and breach of the contract, but contends that notice of cancellation was given the bridge company before the erection of the bridge was commenced, and that it is liable only for the damages which the company would have sustained, if it had abandoned construction at that time.

* * *

The facts out of which the case arises, as shown by the affidavits and offers of proof appearing in the record, are as follows: On January 7, 1924, the board of commissioners of Rockingham county voted to award to plaintiff

a contract for the construction of the bridge in controversy. [On March 3, 1924, the county passed a resolution effectively repudiated the contract.]

. . . At the time of the passage of the first resolution, very little work toward the construction of the bridge had been done, it being estimated that the total cost of labor done and material on the ground was around $ 1,900; but, notwithstanding the repudiation of the contract by the county, the bridge company continued with the work of construction.

* * *

[The court first discussed two unrelated questions.]

Coming, then, to the third question—i. e., as to the measure of plaintiff's recovery—we do not think that, after the county had given notice, while the contract was still executory, that it did not desire the bridge built and would not pay for it, plaintiff could proceed to build it and recover the contract price. It is true that the county had no right to rescind the contract, and the notice given plaintiff amounted to a breach on its part; but, after plaintiff had received notice of the breach, it was its duty to do nothing to increase the damages flowing therefrom. If A enters into a binding contract to build a house for B, B, of course, has no right to rescind the contract without A's consent. But if, before the house is built, he decides that he does not want it, and notifies A to that effect, A has no right to proceed with the building and thus pile up damages. His remedy is to treat the contract as broken when he receives the notice, and sue for the recovery of such damages, as he may have sustained from the breach, including any profit which he would have realized upon performance, as well as any other losses which may have resulted to him. In the case at bar, the county decided not to build the road of which the bridge was to be a part, and did not build it. The bridge, built in the midst of the forest, is of no value to the county because of this change of circumstances. When, therefore, the county gave notice to the plaintiff that it would not proceed with the project, plaintiff should have desisted from further work. It had no right thus to pile up damages by proceeding with the erection of a useless bridge.

The contrary view was expressed by Lord Cockburn in Frost v. Knight, L. R. 7 Ex. 111, but, as pointed out by Prof. Williston (Williston on Contracts, vol. 3, p. 2347), it is not in harmony with the decisions in this country. The American rule and the reasons supporting it are well stated by Prof. Williston as follows:

> "There is a line of cases running back to 1845 which holds that, after an absolute repudiation or refusal to perform by one party to a contract, the other party cannot continue to perform and recover damages based on full performance. This rule is only a particular application of the general rule of damages that a plaintiff cannot hold a defendant liable for damages which need not have been incurred; or, as it is often stated, the plaintiff

must, so far as he can without loss to himself, mitigate the damages caused by the defendant's wrongful act. The application of this rule to the matter in question is obvious. If a man engages to have work done, and afterwards repudiates his contract before the work has been begun or when it had been only partially done, it is inflicting damage on the defendant without benefit to the plaintiff to allow the latter to insist on proceeding with the contract. The work may be useless to the defendant, and yet he would be forced to pay the full contract price. On the other hand, the plaintiff is interested only in the profit he will make out of the contract. If he receives this it is equally advantageous for him to use his time otherwise."

* * *

Reversed.

Notes

1. In terms of the formula from the *Restatement (Second) of the Law of Contracts* § 347, how did Luten Bridge want to calculate its damages? On what grounds did the county oppose Luten Bridge's calculations? Would the result be the same under the *Principles of European Contract Law*?

2. Toward the end of the opinion, the court quotes a famous treatise by Professor Samuel Williston. Professor Williston says: "If a man engages to have work done, and afterwards repudiates his contract before the work has been begun or when it had been only partially done, *it is inflicting damage on the defendant without benefit to the plaintiff* to allow the latter to insist on proceeding with the contract." (Emphasis added.) Why would allowing Luten Bridge to recover the full contract amount inflict damages on Rockingham County but not benefit Luten Bridge?

7-4. RELIANCE DAMAGES

Under American Law, the plaintiff may choose to recover "reliance" damages instead of "expectation" damages. The *Restatement* says:

§ 349. *Damages Based on Reliance Interest*

As an alternative to the measure of damages stated in § 347 [i.e., expectation damages], the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.

The commentary explains the plaintiff may seek reliance damages "if he cannot prove his profit with reasonable certainty." *Id.* § 349 cmt. a.

For example, suppose that a homeowner hires a builder to construct a fence for $2000. The builder expects to make a profit of $400 on the project. After the builder expends $250 making plans and surveying the property, the homeowner repudiates the contract. The builder could recover $650 in expectation damages or $250 in reliance damages. But the builder might find it easier to prove the amount of reliance damages.

The *Principles of European Contract Law* does not contain a rule providing for the recovery of reliance damages. But the commentary contains this statement:

> Some laws allow the aggrieved party to claim reliance interest instead of expectation interest. This is possible under DANISH law where the aggrieved party can claim it, even though he would thereby be put in a better position that he would have been had the contract been performed. . . . In GERMANY reliance interest may be claimed if the aggrieved party terminates the contract and thereby is excluded from getting expectation interest. . . . GREECE has a specific provision permitting equitable damages . . . .

Principles of European Contract Law, Part I & II 441 (Ole Lando & Hugh Beale, eds., 2000).

Notes

1. Why might the plaintiff find it easier to prove reliance damages than expectation damages?

2. Under the rules stated in *Restatement* § 349, can the plaintiff's recovery in reliance damages ever exceed the plaintiff's recovery in expectation damages?

Problem

Consider the following example from the *Restatement (Second) of the Law of Contracts* § 349, illustration 3:

> A contracts to build for B a factory of experimental design for $1,000,000. After A has spent $250,000 and been paid $150,000 in progress payments, B repudiates the contract and A stops work. A's expenditures include materials worth $10,000 that he can use on other jobs.

If neither party proves with reasonable certainty what profit or loss A would have made if the contract had been performed, what can A recover as reliance damages?

7-5. LIQUIDATED DAMAGES

Sometimes a contract specifies the measure of damages that a party will have to pay for breaching the contract. For example, a commercial lease

might say that the tenant will have to pay $1000 if the tenant fails to meet the deadline for a monthly rental payment. Damages that are specified in a contract typically are called "liquidated damages."

Under American law, courts will enforce liquidated damages only if their amount is "reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of the proof of loss." *Restatement (Second) of the Law of Contract* § 356(1). A contract may not use liquidated damages to punish a party for breaching the contract. "A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty." *Id.*

European contract law is much less restrictive. It permits the parties to set liquidated damages at any amount, unless the amount is "grossly excessive." The *Principles of European Contract Law* contains the following provision:

> Article 9:509. *Agreed Payment for Non-performance*
>
> (1) Where the contract provides that a party who fails to perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party shall be awarded that sum irrespective of its actual loss.
>
> (2) However, despite any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the loss resulting from the non-performance and the other circumstances.

The commentary explains that the stipulated amount of damages "will be enforced whether its purpose was to coerce the debtor to perform his principal obligation (penalty clause) or to serve as a pre-estimate of the loss suffered by the creditor in case of non-performance (liquidated damages)." *Principles of European Contract Law, Parts I & II* 455 (Ole Lando & Hugh Beale, eds. 2000). *See also* German Civil Code § 343(1) ("If a payable penalty is disproportionately high, it may on the application of the obligor be reduced to a reasonable amount by judicial decision. In judging the appropriateness, every legitimate interest of the obligee, not merely his financial interest, must be taken into account. Once the penalty is paid, reduction is excluded."); French Civil Code Art. 1152 ("Where an agreement provides that he who fails to perform it will pay a certain sum as damages, the other party may not be awarded a greater or lesser sum. Nevertheless, the judge may even of his own motion moderate or increase the agreed penalty, where it is obviously excessive or ridiculously low.")

Notes

1. Apart from establishing a penalty to discourage breach, why might parties want to liquidate damages in advance instead of simply relying on the expectation damage formula? Do penalty clauses come at a cost?

2. Suppose that a store agrees to pay a painter $200 to make a sign advertising a new line of products at the store. The contract gives the painter 3 days to perform, and says that the painter will forfeit the entire $200 if the painter is late. Is this contract enforceable under American contract law or European contract law? As a matter of economics, should it be enforceable?

7-6. SPECIFIC PERFORMANCE

Sometimes the plaintiff will not ask the court to require the defendant to pay money damages, but instead will seek an order requiring the defendant actually to do what the defendant promised. This remedy is called "specific performance." For example, if an art dealer promises to sell a unique painting to a collector, and then fails to deliver it, a court might order the dealer to perform by handing over the painting.

In the United States, specific performance is considered a special remedy, which is not always available. For example, courts will not grant specific performance if they believe that money damages would provide an adequate remedy. In addition, they also will not grant specific performance in cases if they determine that the contract was unfair to the defendant. The *Restatement (Second) of the Law of Contracts* contains the following rules:

> § 359. *Effect Of Adequacy Of Damages*
>
> (1) Specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party.
>
> * * *
>
> § 360. *Factors Affecting Adequacy of Damages*
>
> In determining whether the remedy in damages would be adequate, the following circumstances are significant:
>
> (a) the difficulty of proving damages with reasonable certainty,
>
> (b) the difficulty of procuring a suitable substitute performance by means of money awarded as damages, and
>
> (c) the likelihood that an award of damages could not be collected.
>
> § 364. *Effect of Unfairness*
>
> (1) Specific performance or an injunction will be refused if such relief would be unfair because
>
> (a) the contract was induced by mistake or by unfair practices,

(b) the relief would cause unreasonable hardship or loss to the party in breach or to third persons, or

(c) the exchange is grossly inadequate or the terms of the contract are otherwise unfair.

(2) Specific performance or an injunction will be granted in spite of a term of the agreement if denial of such relief would be unfair because it would cause unreasonable hardship or loss to the party seeking relief or to third persons.

European contract law does not contain these restrictions on specific performance. The *Principles of European Contract Law* instead has this provision:

Article 9:102: *Non-Monetary Obligations*

(1) The aggrieved party is entitled to specific performance of an obligation other than one to pay money, including the remedying of a defective performance.

(2) Specific performance cannot, however, be obtained where:

(a) performance would be unlawful or impossible; or

(b) performance would cause the obligor unreasonable effort or expense; or

(c) the performance consists in the provision of services or work of a personal character or depends upon a personal relationship, or

(d) the aggrieved party may reasonably obtain performance from another source.

(3) The aggrieved party will lose the right to specific performance if it fails to seek it within a reasonable time after it has or ought to have become aware of the non-performance.

The greater restrictions on specific performance in the United States are an undeniable difference between American law and European Civil Law. But in practice, the difference may not effect many cases. Professor Dr. Ingeborg Schwenzer has written:

> In German law as well as in other continental legal systems, specific performance is the backbone of the obligation . . . . This is in sharp contract to Anglo-American law where specific performance is only granted in exceptional cases. If the debtor fails to perform, the creditor may generally sue first for specific performance. However, the difference between Anglo-American law and German law are less important in practice than it might at first glance appear. Especially in commercial transactions, the creditor typically has no interest in suing for specific performance . . . .

Ingeborg Schwenzer, The Law of Contracts 183, in *Introduction to German Law* (Werner F. Ebke & Mathew W. Finkin, eds. 1996).

Notes

1. Would a court order the art dealer in the hypothetical above to deliver the painting under American contract law or European contract law?

2. What are examples of other cases in which specific performance might be appropriate?

3. Why might American contract law view specific performance as a special remedy, preferring that the plaintiff receive money damages?

McKINNON v. BENEDICT

Supreme Court of Wisconsin

38 Wis.2d 607, 157 N.W.2d 665 (1968)

This is an appeal . . . from an injunction which restrained the defendants, Roy A. Benedict, Jr., and Evelyn M. Benedict, from operating a trailer park and campsite on certain resort property located in Vilas county. The Benedicts have appealed from this judgment.

The Benedict property is approximately an 80-acre tract located on the shores of Mamie Lake, one of the chain of Cisco Lakes, on the Michigan-Wisconsin border. It is operated as a resort known as Bent's Camp. The Benedict property is completely surro[unded by the McKinnon tract of approximately 1,170 acres. The McKinnons have lived on Mamie Lake since 1925, although at the present time they reside there only during the summer months and during the Christmas holidays. During the remainder of the year, the McKinnons reside in Arizona, where Roderick McKinnon is an investment counsellor. He is a member of the Wisconsin State Bar and at various times practiced law with the Milwaukee firms of Miller, Mack & Fairchild and Whyte, Hirschboeck, Minahan, Harding & Harland. During World War II, he was in intelligence work for the United States government. He served with the United States State Department and was, at one time, vice president of Cleaver- Brooks Company.

Until 1961, Bent's Camp was operated by a Mr. and Mrs. L. L. Dorsey. This property, although abutting Mamie Lake, is divided by county trunk B. The resort area is located near the lakeshore to the northeast of county trunk B and consists of 14 cabins and a main lodge. The area of Bent's Camp south west of county trunk B is a small, undeveloped parcel of timberland. During 1960 the Dorseys were interested in selling the property. Their agent, one Handlos, located the Benedicts as prospective buyers. They, however, were in need of financial assistance to make the purchase, and they were referred

to Roderick W. McKinnon, who agreed to loan the Benedicts the sum of $5,000 as a partial down payment. This loan was made on the basis of an understanding that the Benedicts would continue to operate Bent's Camp as an American plan family resort. On August 31, 1960, McKinnon wrote a letter to the Benedicts incorporating the terms on which the advance was made:

> Dear Roy:
>
> It is my understanding that in consideration of my advancing you $5000. for use as a downpayment on Bent's Camp we agree between one another as follows:
>
> (1) You and Mrs. Benedict will sign a non-interest bearing note for $5000. due January 1, 1961, and a first mortgage on your cottage in Gogebic County, Michigan. If you should sell this property or your property in Wheaton, Illinois prior to the time the note is paid, you will pay the note out of the proceeds.
>
> (2) As soon as convenient after your acquisition of Bent's Camp, we will sign a recordable agreement providing that for a period of 25 years no trees will be cut between my land and Bent's Camp, nor between Bent's Camp and County Highway "B' nor will any improvements be constructed or placed closer to my property than the present buildings. This restriction will have no application to any of your land lying west of County Trunk "B" nor to your separate 40- acre "woodlot." If you wish, we will supply trees to be planted in this area at no cost to you.
>
> (3) In the event you desire, we will from time to time designate certain trees or certain areas on our property where you may cut fire wood at no cost to you.
>
> (4) I will help you try to reach a satisfactory solution concerning the lease held by Mrs. J. Stuart Vair. I will also try to generate business for your camp and to otherwise assist you in getting the operation well organized.
>
> If the foregoing meets with your approval, will you and Mrs. Benedict please sign below and return one copy for my files.

The approval was signed by both of the Benedicts, and the letter was returned to McKinnon. Thereafter, the Benedicts executed a note in the sum of $5,000 and a mortgage on their cottage property in Michigan. The promised $5,000 was shortly thereafter transmitted and used as a down payment. The loan was paid in full in the spring of 1961. The Benedicts thus had the use of the $5,000 from early september, 1960, to April, 1961, a period of about seven months. The Benedicts purchased the property from the Dorseys on a land contract at a price of $60,000. That land contract provided that, while the Benedicts continued to be obligated to the Dorseys under the terms

of the contract, they would replace all personal property so as to maintain it in substantially the same state as at the time of the agreement. They also agreed that no timber would be cut except for firewood without the written consent of the Dorseys and that the premises were to be operated substantially in the same manner as they had been operated by the Dorseys in the previous years.

At the time the land contract was executed, Bent's Camp consisted of 14 cottages, only five of which could be used for resort purposes. Between 1961 and 1964, the Benedicts invested $20,000 in cottages, installing bathrooms and kitchens so that all of the cabins were habitable. Roy Benedict testified that during the period between 1961 and 1964, the income from the operations of the American Plan resort substantially decreased and that it became increasingly difficult to make the land-contract payments.

One of the conditions of the letter of August 31, 1960, was that McKinnon would attempt to reach a satisfactory solution concerning the lease held by Mrs. J. Stuart Vair. The record shows that Mrs. Vair held a fifty-year lease on one of the cabins at an annual rental of $5 per year. The record reveals only one attempt, and that unsuccessful, on the part of McKinnon to 'reach a satisfactory solution.' The agreement also provided that McKinnon would try to generate business for the camp and otherwise assist in getting the operation well organized. The record indicates no attempt whatsoever on the part of McKinnon to get the operation 'well organized.' There was evidence that at least one small group had spent a few days at Bent's Camp at the suggestion of McKinnon, but it is apparent that the amount of business generated by him was almost nil.

Because of financial pressures, the Benedicts, in the fall of 1964, decided to add to a trailer park and facilities for a tent camp. A trailer park was laid out just to the northeast of county trunk B. In the fall of 1964, Roy Benedict bulldozed the hills in that area and installed sewer, water, and electric facilities for 18 trailers at a cost of approximately $8,000. In the spring of 1965 work was commenced on a campsite on a hill located to the south of the cottages and across the bay from the McKinnon property. The Benedicts have invested to date approximately $1,200 on this campsite, most of which was expended for grading.

In June of 1965, McKinnon wrote to benedict stating:

> I have heard indirectly that you are making some fairly major changes in the operation of Bent's Camp.
>
> Although I do not know the exact nature of the changes, I am confident that you and Ev will bear in mind our agreement of August 31, 1960 * * *. I enclose a photostatic copy.

When the McKinnons returned to Wisconsin in June of 1965, they became aware of the nature of the work done by Benedict and immediately

commenced suit to enjoin defendants 'from the acts done or being done and uses to be made or being made' of the property. The McKinnons relied not only on the agreement of August 31, 1960, but also alleged the violation of county zoning and trailer ordinances and alleged a trespass across a point of land, wholly surrounded by the Benedict property, which was owned by McKinnon.

After a trial before the court, the trial judge found for the plaintiffs in accordance with the demands of the complaint enjoining the defendants from further bulldozing or hill leveling and from conducting on the premises a trailer park or a mobile home camp. The renting of any portion of the land for trailers or campers was prohibited by the judgment, and the Benedicts were restrained from using the premises for any other purpose than as an American Plan summer resort until August 31, 1985. It is from this judgment the defendants appeal.

HEFFERNAN, Justice.

* * *

The question posed, then, is whether the agreement was enforceable against the Benedicts. No action at law has been commenced for damages by virtue of the breach of the restrictions; and, in fact, the plaintiffs in their complaint claim that they have no adequate remedy at law. We are thus not confronted with the question of damages that may result from the breach of this contract and confine ourselves solely to the right of the plaintiffs to invoke the equitable remedy of specific performance, in this case the enjoining of the defendants from the breach of the contract.

28 Am.Jur., Injunctions, sec. 35, pages 528, 529, points out that:

> Courts of equity exercise discretionary power in the granting or withholding of their extraordinary remedies, and this is particularly true in a case where injunctive relief is sought * * *. The relief is not given as a matter of course for any and every act done or threatened to the person or property of another; its granting rests in the sound discretion of the court to be exercised in accordance with well-settled equitable principles and in the light of all the facts and circumstances in the case * * *.

In Maitland v. Twin City Aviation Corp. (1949), 254 Wis. 541, 549, 37 N.W.2d 74, 78, we stated that an injunction "should not be granted where the inconveniences and hardships caused outweigh the benefits." It is frequently stated that an injunction will not be granted where to do so shocks the "conscience" of the court. These rules are equally applicable whether the right which the plaintiff seeks to enforce arises out of a conveyance, a use of property (nuisance) which would be detrimental to the plaintiff's interests, or whether it arises out of a simple contract.

* * *

These, of course, are ancient principles of equity and date back at least to Smith v. Wood (1860), 12 Wis. 425 (*382). The court in Mulligan v. Albertz (1899), 103 Wis. 140, 143, 144, 78 N.W. 1093, 1094, summarized policies of the Wisconsin court in this regard, and we consider these principles applicable to this case:

> An action for the specific performance of a contract is an application to the sound discretion of the court. It does not come as a matter of course. The jurisdiction to compel it is not compulsory. “A court of equity must be satisfied that the claim for a deed is fair and just and reasonable, and the contract equal in all its parts, and founded on an adequate consideration, before it will interpose with this extraordinary assistance.” (Citing cases)
>
> * * *

The facts in this case must be examined in light of these accepted principles of equity.

The bargain between the McKinnons and the Benedicts has proved to be a harsh one indeed. If the terms of the agreement of August 31, 1960, are to be enforced literally, the Benedicts have for a period of twenty-five years stripped themselves of the right to make an optimum and lawful use of their property. The agreement provides that no improvements can be constructed closer to the McKinnon Property than those buildings and improvements that were in existence in 1960. This limits any possible expansion to the precise lakeshore area occupied by the buildings of Bent’s Camp on that date. While the restriction does not apply to the area beyond the road to the west of county trunk B, that area is at the farthest point of the property from the lake and is the least desirable for any resort or camp purposes. McKinnon by this agreement sought the maintenance of the exact status quo for a period of twenty-five years. Even though additional cottages of the type presently existing were desired, they could not under this agreement have been erected except in the narrowly defined area.

There was clear testimony that Benedict found difficulty in meeting his land-contract obligations, and his efforts to construct a campsite and trailer camp were motivated by the desire to put the resort on a more stable financial basis. While it is understandable that McKinnon may object to the erection of a trailer park and a campsite on adjacent property, nevertheless, they are legal and proper uses, assuming that they conform with the ordinances and statutes and do not constitute a nuisance; and any contract that seeks to prohibit them on a neighbor’s property must be supported by consideration that has some relationship to the detriment to be sustained by the property owner whose uses are thus curtailed.

The great hardship sought to be imposed upon the Benedicts is apparent. What was the consideration in exchange for this deprivation of use? The only

monetary consideration was the granting of a $5,000 loan, interest free, for a period of seven months. The value of this money for that period of time, if taken at the same interest rate as the 5 percent used on the balance of the land contract, is approximately $145; and it should be noted that this was not an unsecured loan, since McKinnon took a mortgage on the cottage property of the Benedicts in Michigan. In addition, McKinnon stated that he would "help you try" to reach a solution of the problem posed by Mrs. Vair's occupancy of one of the cottages on a fifty-year lease at $5 per year. His one attempt, as stated above, was a failure; and McKinnon's promise to generate business resulted in an occupancy by only one group for less than a week. For this pittance and these feeble attempts to help with the operational problems of the camp, the Benedicts have sacrificed their right to make lawful and reasonable use of their property.

In oral argument it was pointed out that the value of the $5,000 loan could not be measured in terms of the interest value of the money, since, without this advance, Benedict would have been unable to purchase the camp at all. To our mind, this is evidence of the fact that Benedict was not able to deal at arm's length with McKinnon, for his need for these funds was obviously so great that he was willing to enter into a contract that results in gross inequities. Lord Chancellor Northington said "necessitous men are not, truly speaking, free men." Vernon v. Bethell (1762), 2 Eden 110, 113.

We find that the inadequacy of consideration is so gross as to be unconscionable and a bar to the plaintiffs' invocation of the extraordinary equitable powers of the court.

While there is no doubt that there are benefits from this agreement to McKinnon, they are more than outweighed by the oppressive terms that would be imposed upon the Benedicts. McKinnon testified that he and his wife spend only the summer months on their property. Undoubtedly, these are the months when it is most important that there be no disruption of the natural beauty or the quiet and pleasant enjoyment of the property, nevertheless, there was testimony that the trailer camp could not be seen from the McKinnon home, nor could the campsite be seen during the summer months of the year, when the leaves were on the trees. Thus, the detriment of which the McKinnons complain, that would be cognizable in an equity action, is minimal,[1] while the damage done to the Benedicts is severe.

Considering all the factors—the inadequacy of the consideration, the small benefit that would be accorded the McKinnons, and the oppressive conditions imposed upon the Benedicts—we conclude that this contract failed to meet the test of reasonableness that is the sine qua non of the enforcement of rights

1. McKinnon testified that the value of his property had depreciated in the amount of $50,000. That testimony was properly admissible, but its probative value was slight, especially since plaintiffs' expert real estate witness stated that he was unable to testify to the amount of the depreciated value.

in an action in equity.

* * *

Notes

1. On what grounds did the court deny specific performance? What remedy can the plaintiff's obtain?

2. How would this case come out under the *Principles of European Contract Law?*

7-7. PUNITIVE DAMAGES

Punitive damages are damages designed to punish rather than to compensate. In the United States, courts do not impose punitive damages upon a party merely for breaching a contract. Section 355 of the *Restatement (Second) of the Law of Contracts* explicitly says: "Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable." As explained in Section 7-5 above, even if the parties have attempted to use a liquidated damages clause in their contract to impose punitive damages, a court would not enforce the clause.

The *Principles of European Contract Law* contains no provision authorizing a court to award punitive damages for breach of contract when the contract is silent on the subject. But as discussed in section 7-5 above, the parties can agree to the payment of punitive damages under Article 9:509 unless the amount is "grossly excessive in relation to the loss resulting from the non-performance and the other circumstances." As one treatise on German Law explains: "[D]amages are not awarded to *penalise* the contract breaker. Punitive or exemplary damages are not awarded. . . . It should be noted however that German Law has no difficulty in giving full effect to *penalty claus es*." Basil S. Markesinis, et al., *The German Law of Contract* 443-44 (2d ed. 2006).

Despite the general prohibition on punitive damages in the United States, plaintiffs regularly ask for them. And defendants often attempt to use the prohibition to reduce damages that in reality are not punitive damages. These common efforts on both sides rarely succeed, as the following cases illustrate.

Note

Sometimes a party can commit a tort simultaneously with breaching a contract. When that happens, the aggrieved party may recover punitive damages for the tort. The *Restatement (Second) of the Law of Contracts* provides this example:

> A borrows money from B, pledging jewelry as security for the loan. B, tortiously as well as in breach of contract, sells the jewelry to a good faith purchaser for value. A's right to recover punitive damages is governed by Restatement, Second, Torts § 908.

Id. § 355 illus. 5.

In this illustration, the good faith purchaser for value would obtain title to (i.e., ownership of) the jewelry, depriving A of any right to recover possession of it. *See* U.C.C. § 2-403(2) ("Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."). Selling the collateral would be a form of "conversion," a tort that embraces among other things "the unauthorized delivery of a chattel to a person not entitled to its immediate possession." *Restatement (Second) of the Law of Torts* § 235. Tort law allows the victim to recover punitive damages for tortious conduct that "is outrageous . . . because of the defendant's evil motive or his reckless indifference to the rights of others." *Id.* § 908.

HINGIS v. TACCHINI

New York Supreme Court, Appellate Division

303 A.D.2d 275, 758 N.Y.S.2d 12 (2003)

[Professional tennis player Martina Hingis entered an endorsement contract with Sergio Tacchini, S.p.A., an Italian sportswear manufacturer. As part of the endorsement contract, Hingis wore Tacchini's tennis shoes. While wearing the shoes, she suffered physical injuries. Consequently, Hingis sued Tacchini in the New York Supreme Court,* seeking compensation and punitive damages for "provision of tennis shoes that were unsuitable for use in competition and caused plaintiff injury, failure to correct the defective tennis shoes after learning of plaintiff's injury, and efforts to prevent plaintiff from securing a new endorsement agreement." The trial court granted Tacchini's motion to dismiss on grounds of forum non conveniens. Hingis appealed, arguing in part that the New York courts should adjudicate the lawsuit because Italian contract law does not permit a plaintiff to recover punitive damages.]

Per curiam.

Order, Supreme Court, New York County (Sherry Klein Heitler, J.), entered on or about September 30, 2002, which . . . granted defendant's motion to dismiss the complaint on the ground of forum non conveniens, unan-

* The "New York Supreme Court" has a misleading name. It is not the highest court in New York; on the contrary, it is a trial court subordinate to the New York Supreme Court, Appellate Division and the New York Court of Appeals. Justices of the New York Supreme Court are assigned to cases pursuant to an "individual assignment system" (IAS). Consequently, New York Supreme Court justices are sometimes called "IAS judges," and the New York Supreme Court is sometimes called the the "IAS court."

imously affirmed, without costs.

The balance of relevant factors weigh against retention of the action (see Islamic Republic of Iran v. Pahlavi, 62 N.Y.2d 474, 479, 478 N.Y.S.2d 597, 467 N.E.2d 245, cert. denied 469 U.S. 1108, 105 S.Ct. 783, 83 L.Ed.2d 778): neither party is a New York resident; the action involves an endorsement contract that was neither negotiated nor signed in New York; the endorsement contract provides that it "shall be governed by the law of Italy" and that any claims connected with it are to tried in the courts of Milan, Italy; and a previous commenced action involving this same contract and these same alleged torts is pending in Milan (see Richtree Inc. v. Movenpick Holding, 301 A.D.2d 412, 752 N.Y.S.2d 871; see also Union Bancaire Privee v. Nasser, 300 A.D.2d 49, 751 N.Y.S.2d 440). In addition, it appears that plaintiff's injury was sustained over a period of more than a year during which she had competed all over the world wearing defendant's shoes. That plaintiff happened to receive treatment for the injury in New York, among other places, does not create a connection with New York so substantial as to warrant retention of the action. Since any action in New York would be governed by Italian law, it does not avail plaintiff that punitive damages are unavailable under Italian law. In any event, as the IAS court found, under New York law, plaintiff's claim for punitive damages is at best dubious, and all of plaintiff's other claims herein have substantial equivalents under Italian law.

Note

The opinion says that "under New York law, plaintiff's claim for punitive damages is at best dubious." Why is that? What would Hingis have to show in order to recover punitive damages?

VERGIETTE v. SAMARA

United States District Court for the District of New Hampshire

1995 WL 66260 (D.N.H.)

BARBADORO, District Judge.

Francois Vergiette obtained a default judgment on a breach of contract claim against Rijk Samara from the District Court of the Hague, Netherlands. The judgment obligated Samara to pay Vergiette 90,000 Dutch guilders, plus interest and costs, and supply Vergiette with information concerning certain assets within eight days of being served with the judgment. The judgment also specified that Samara would be liable for a 5,000 guilder per day penalty for each day he failed to produce the information required by the judgment. Prior to filing suit in this court, Vergiette recovered the 90,000 guilders Samara owed pursuant to the judgment. Samara, however, never produced the

information required by the judgment. Nor did he pay the interest and costs due pursuant to the judgment.

Vergiette commenced the present action to recover the unpaid interests and costs and the 5,000 guilder per day penalty Samara became obligated to pay by failing to produce the information required by the judgment. . . .

I. FACTS

The parties collaborated on several business transactions from 1980 through 1991. On July 22, 1991, they entered into an agreement to terminate their business relationship and allocate compensation for past and pending ventures. In pertinent part, the agreement required Samara to pay Vergiette (1) 100,000 Dutch guilders; (2) an unspecified fee that the agreement describes as "the investment manager's ten percent"; (3) another unspecified fee that the agreement refers to as "ten percent of the dividend earned by the exploration of a sailing vessel known as 'Te Vega'"; and (4) 25% of the net profit generated by any sale of Te Vega. The agreement also contained a clause that allowed Samara to fulfill his obligations under the agreement by paying Vergiette 25% of the profits generated by the sale of a residence referred to in the agreement as "De Bloemert." Samara subsequently paid Vergiette 10,000 guilders, but otherwise failed to perform his obligations under the agreement. In January 1992, Samara, under court order, arranged for a bank guarantee to cover the 90,000 guilder balance due under the agreement.

In February 1992, Samara filed suit in the District Court of the Hague seeking to set aside the agreement. Vergiette filed a cross-action for the 90,000 balance, plus interest. After Samara defaulted, the court ordered judgment in Vergiette's favor in the amount of 90,000 guilders, plus interest and costs. The court also ordered Samara to produce information regarding the sale of Te Vega and De Bloemert within eight days of receiving notice of the judgment. A 5,000 guilder per day penalty was imposed for every day he remained in default beyond the eight day period. Samara was served with the judgment on April 13, 1993. He did not provide the information ordered by the court within the eight days or anytime thereafter. The 90,000 balance was, however, paid out of the bank guaranty.

Thereafter, Vergiette filed suit in this court to enforce the judgment of the Hague court. . . .

Subsequently, the magistrate judge issued a report and recommendation. With respect to the first count, he recommended that the penalty provision of the Hague court's judgment not be enforced on the grounds that its punitive nature ran afoul of New Hampshire's strong public policy against punitive damages. . . .

II. DISCUSSION

Vergiette objects to the magistrate judge's report and recommendation on two grounds. First, he argues that the magistrate judge mischaracterized the nature of the penalty provision, stating that the provision is not punitive but rather necessary to vindicate the authority of the court. Furthermore, he argues that comity is the guiding principle in deciding whether to recognize and enforce foreign judgments, and because there is no public policy in New Hampshire against vindicating the authority of its courts, this court should not follow the magistrate judge's recommendation. . . .

A. Enforcement of the penalty

. . . . It is well-settled, however, that while "a final judgment obtained through sound procedures in a foreign country is generally conclusive as to the merits," where enforcement would offend the public policy of the enforcing state, the judgment may not be recognized or enforced. Ackermann v. Levine, 788 F.2d 830, 837 (2d Cir.1986). "A judgment is unenforceable as against public policy to the extent that it is 'repugnant to fundamental notions of what is decent and just in the State where enforcement is sought.' " Id. at 841 (citations omitted); see also In re Breau, 132 N.H. 351, 359, 565 A.2d 1044, 1049 (1989) (comity consistent with nonrecognition of foreign judgment that contravenes forum's strong public policy); MacDonald v. Railway, 71 N.H. 448, 457, 52 A. 982 (1902) (foreign law not given effect when contravenes important, established policy of forum). Where a federal court rests jurisdiction on diversity of citizenship, it will look to the law of the state in which it sits to determine whether enforcement offends an established public policy. Sangiovanni Hernandez v. Dominicana de Aviacion, 556 F.2d 611, 614 (1st Cir. 1977).

Vergiette seeks enforcement of a provision of the Hague court's judgment which imposed a penalty on Samara for his failure to comply with that court's order. The imposition of monetary penalties for the failure to comply with a court's order does not conflict with the public policy of New Hampshire. See Kidder v. Kidder, 135 N.H. 609, 612, 609 A.2d 1197, 1199 (1992) (court imposed monthly fine payable by husband to wife until husband complied with court order to produce mortgage document). "[T]he trial court . . . has the power to impose a monetary fine for a continued noncompliance with its orders . . . and has broad remedial power to impose penalties for contempt." Id. Thus, while this state has long expressed its aversion to punitive damages, see, e.g., Vratsenes v. N.H. Auto Inc., 112 N.H. 71, 72, 289 A.2d 66, 67 (1972), it has recognized that punishment for civil contempt that is remedial, coercive, for the benefit of the complainant, and which continues until compliance by the contemptor, is a valid means of enforcing a court's order, Town of Nottingham v. Cedar Waters, Inc., 118 N.H. 282, 285, 385 A.2d 851, 853 (1978); see also Kidder, 135 N.H. at 612.

While I disagree with the magistrate judge's characterization of the penalty provision, I still find that Vergiette's claim to enforce the judgment is fatally flawed. A party seeking to enforce a foreign judgment must show that it is a final judgment "'determining entitlement to money, status or property interests.' " In re Breau, 132 N.H. at 380 (emphasis added) (citations omitted); see also Restatement of Conflict of Laws (Second) § 101 ("a valid judgment for the payment of money will be enforced in other states only in the amount for which it is enforceable in the state where it is rendered"). Vergiette has not shown that he, rather than the Dutch court, is entitled to the accrued penalty under Dutch law. Thus, I overrule Vergiette's objection to this portion of the magistrate judge's report and recommendation.

* * *

Note

Does this case involve the award of punitive damages for breach of contract? If not, what kind of damages were awarded?

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