

July 1974
QUESTION NO. 2

On September 15, 1970, Buyer and Seller signed a written document which reads as follows:

"Buyer agrees to buy and Seller agrees to sell all of Seller's production of wooden hand-painted and hand-carved toy animals for the period commencing January 1, 1971 and ending December 31, 1973, at a price of \$1.00 per item. Buyer may at any time cancel this agreement upon giving 10 days notice to Seller.

In the event that Seller refuses to sell all of his production to Buyer, Seller shall pay Buyer the sum of 50¢ for each 'animal' produced but not sold to Buyer as liquidated damages but not as a penalty."

During 1971 and 1972, Seller sold Buyer 300,000 items under the agreement for which Buyer paid \$300,000.

In late 1972 the wholesale market price for items of the kind described in the agreement had increased to \$1.50 per item. In December 1972, Seller informed Buyer that his price to Buyer would have to go up to \$1.50 per item as Seller's costs for materials and labor were rising. Seller also stated that competent woodcarvers were hard to obtain and if he didn't increase wages, he would lose several of the experienced woodcarvers in his plant and this would reduce his output. Buyer insisted that Seller comply with the terms of the agreement.

Commencing in January 1973, Seller refused to sell to Buyer at the price of \$1 .00 per item and sold his product elsewhere at the price then prevailing in the market of \$1.60 to \$1.70 per item. By March 30, 1973, at least 50,000 items had been sold by Seller to persons other than Buyer.

On April 2, 1973 Buyer consulted you and stated that he had to pay other suppliers from \$1.70 to \$2.00 per item for items of the type described in the agreement. Buyer asked you (i) whether he could compel Seller to deliver the items to him, (ii) whether he could prevent Seller selling to others and (iii) what money damages, if any, he might recover from Seller. What advice would you have given Buyer in response to his inquiries of April 2, 1973? Discuss.

Answer A to Question 2

(i) In order for Buyer to be able to compel seller to deliver the items to him there must first be an existing and enforceable contract for the court to enforce. This requires an offer and acceptance, consideration, conditions performed and no defenses.

Here there is no problem with the offer and acceptance for this outputs contract. There is sufficient description of the subject matter, a price term, time for performance.

Consideration here is the mutual promises of the parties to sell and buy the outputs of the seller. At old common law there would have been some problem with this as sufficient consideration since one party could go out of business and thus his promise to buy or sell was considered illusory. However, now the courts allow these promises to be sufficient legal consideration since the alternative of going out of business is not considered a viable one. Also since the parties here are merchants, dealers in goods of the kind under the contract, the UCC allows the enforceability of such outputs contracts.

The buyers option of cancelling on 10 days notice was a problem at old common law since it was considered he had promised nothing since he could get out of it. However today and under the UCC such an option to cancel does not make the promise illusory since buyer has incurred some legal detriment in promising to buy. There are no conditions to performance which have not been performed by Buyer. Presumably, he has offered to take delivery and tender money for the toys at the time set for performance.

The only defense the seller may be able to assert to discharge his duty to perform is impracticability of performance. Here, because the wholesale price has gone up 50% and because he will lose his woodcarvers which would reduce output he may claim that this makes it impractical to perform and his duty should be discharged. At common law, this would not be sufficient impracticability to discharge his duty, it requires more hardship on seller and something that was not a contemplated risk at time of contract. Here the risk that the price would rise over a 3 year period was probably within the contemplation. Under the UCC, such discharge is available if the risk of such changes were not in contemplation of parties and it would be unconscionable to hold, A to the contract. Here the risk was probably contemplated by parties, and the loss of output by loss of woodcarvers does not reach the level of unconscionability.

In order to get specific performance of this contract buyer must show the legal remedy is inadequate, there is mutuality of remedy, the decree would be feasible to enforce and there are no defenses.

Adequacy of legal remedy was required by the equity courts to prevent conflict over their jurisdiction and the law courts. Here the legal remedy (damages) is adequate since buyer has already been able to buy other similar items to take care of his needs. Apparently, then the items are not unique and thus there is no need to force seller to deliver them to plaintiff buyer.

If the court were to find the legal remedy of damages inadequate then there is mutuality of remedy under all the views since either party could compel specific performance at time of contract, at time of suit, and at time of decree. Also under the modern view the court can condition the decree on buyer accepting and paying for the goods.

There is also no problem with enforcement, since the goods are easily identified in the contract terms and the court would merely order delivery to occur. The equitable defense of laches may be available if the court were otherwise going to decree specific performance since the seller has delayed 5 months and defendant has sold toys to others. Thus he has changed his position detrimentally and seller may have waited too long to bring the suit.

(ii) The court will usually imply a negative covenant in contracts that give exclusive rights to a party that the other party may not sell to anyone else. This is one such implied covenant for this contract since seller agreed to sell all to buyer. He would be breaching contract if he sold to another.

Whether a court will enjoin the seller from selling to others depends on the same considerations discussed above under specific performance. In addition most courts require some independent significance for the negative covenant. Here it could be argued that this occurs because seller wants to prevent others from getting defendant's toys. This would almost force defendant to sell to plaintiff which is the purpose for enforcing the negative covenant.

But because of the adequacy of damages discussed above, plaintiff probably would not be able to enjoin seller from selling to others.

(iii) Damages.

The court will award damages under the liquidated damages clause if there has been a breach of the contract. (see discussion above under (i) enforceability of specific performance) There has been no discharge of seller's duty to deliver and no excuse hence a breach has occurred.

The liquidated damages will be awarded if it was impractical or

impossible for parties to determine damages in event of a breach and the damages clause is a reasonable attempt to fix damages. Here, there was no impossibility of determining damages since the price of dolls was known and the quantity was determinable by output of seller. Hence, the court would probably consider this to be a penalty and not enforce it.

The seller may recover the difference in price between the contract and market price at time at place of performance. Here, this would be as the dolls were produced. Hence he could recover the 60 cents to 70 cents additional the dolls were being sold for on the market.

Under UCC he may "cover" and recover the price of cover above the contract price, here 70 cents to \$1.00 he had to pay for the dolls he purchased on the market. This is assuming his "cover" was reasonable. He has to try to get the best price he can as long as commercially reasonable. He could also recover any consequential damages for having to "cover", expenses of finding cover, transportation, etc.

Answer B to Question 2

Buyer v Seller

A valid contract appears to have been formed. All essential terms are present. There is mutual assent. The contract is bilateral giving both parties immediate rights.

1. Was there valid consideration?

At common-law an agreement to buy all the output of a manufacturer or seller was illusory. However, modern courts in upholding the expectations and intentions of the parties, will allow an output contract where there is an objective standard to measure performance. Here, buyer is to buy all that seller will produce, and as long a buyer acts in good faith when he orders the goods and keeps the orders within reasonable bounds, the courts will uphold the output requirement.

The second problem involving consideration, is whether the power of Buyer to cancel at any time satisfies mutuality of obligation. The facts indicate that buyer must notify seller 10 days prior and according to modern decisions the requirement of giving notice satisfies the requirement for mutual consideration.

2. Is seller discharged from fulfilling the contract in the third year?

Seller attempts according to the facts to have his duty excused or discharged to continue making delivery of earnings at the old price. Seller's argument might be that it is impossible for him to continue in business at the contract price. Under this theory there is the doctrine of impracticability which states that if the cost of performance is greatly in excess of the ability of the party charged with performance his duty will be discharged. The usual example is excessive cost. A majority of courts will not allow the doctrine, while a minority recognize this doctrine of impracticability. However, this is of little avail to Seller since Buyer can forcefully argue that the rise in costs is a risk that Seller was aware of when he contracted. So this argument by Seller will probably fail. Seller is in breach. Another argument for Seller to excuse future performance is that the contract is divisible. There are several elements of this excuse. 1, each unit of performance must be capable of being performed separately; 2. each unit of performance gives mutual benefit to the parties. However, even if this excuse is to apply to Seller, he is still liable for the remaining unperformed part of the contract in damages.

3. Damages.

A) can Buyer get specific performance?

Buyer cannot satisfy all the elements to succeed in a suit for specific performance. Although a valid contract has been formed, with the specificity that allows the court the opportunity to fashion a decree, it is doubtful that the legal remedy is inadequate.

Since the facts indicate that Buyer acquired like goods on the open market the items are therefore not unique chattel. Otherwise all the other elements are present. Mutuality exists under all views: Fry's - at time of contract; Pomeroy's - at time of suit; Ames' - at time the decree is fashioned, and under the Restatement view - since Buyer is willing and able to tender and render to Seller the benefit of his bargain.

The decree is likewise feasible to enforce, since both parties are within the jurisdiction of the court. Nor does Seller have a defense to specific performance. Hardship: i.e., inadequate consideration is not available as a defense since there are no other factors of "sharp practice." Nor laches since Buyer is acting within a "commercially reasonable time?"

B) Can Buyer enjoin the sale to others?

Probably, not. for the reason that the legal remedy is adequate.

c) Money Damages.

1. Is Buyer limited to the liquidated damages? This is a close question of fact. The rules that apply to liquidated damages clauses, is that the court will allow the clause to be effective if it will reasonably compensate the parties. However, if the clause is merely to ensure performance and the amount stated is not adequate to compensate the non-breaching party, the clause will be disregarded. Here, several factors must be balanced. In any case, the clause cannot be punitive. At 50 cents a piece, it does not appear punitive by buyer to insert the clause, put in the contract to be oppressive. So on those grounds it is a valid clause.

Buyer has had to pay 70 cents to \$1.00 to acquire like goods. This appears to be reasonably close to the liquidated price of 50 cents. This is another basis to conclude the liquidated damages clause is fair.

However, if we look at Seller's conduct, in analyzing his performance, because his conduct has been willful, a court in measuring whether he has discharged his duty by substantial performance would hold against seller: and make him liable in damages for that part he has failed to perform.

2. What Measure of damages?

if the liquidated damage clause is upheld Buyer could be barred from any recovery and would take only 50¢ per item.

If the clause is barred Buyer can get the difference between the contract price and the prevailing, market price he paid: i.e. his benefit of the bargain.