FEBRUARY 1995

Question 1

Neptune is an upscale seafood restaurant that opened in a convenient downtown location six months ago. It has become well known for the quality of its food and service. It has several dishes featuring salmon that are particularly popular with patrons.

Neptune entered into a valid written contract with Seafood Uptown Providers (SUP) under which SUP agreed to supply Neptune with 250 pounds per week of fresh Pacific salmon at $4.00 per pound for the next year.

Three months after the making of the contract, a large widely publicized oil spill occurred in Pacific coast waters. The spill greatly reduced the catch of salmon. Salmon began selling on the open market for at least $5.00 per pound. SUP then told Neptune that it would supply salmon only at a price of $6.00 per pound. Neptune refused to pay more than the contract price. In fact, SUP has found a new customer willing to pay $6.00 per pound, and it is selling its entire supply (about 450 pounds of salmon per week) to that customer.

Neptune, faced with the prospect of having to obtain salmon for its daily restaurant menu and also for special events that it caters, found a supplier willing to meet about one-half of Neptune's weekly requirement for salmon at $5.00 per pound. With further effort, Neptune might have filled a portion of the remaining weekly requirement for salmon at $6.00 per pound, but was uncertain to what extent salmon would continue to be obtainable and how high the market price might go. Neptune decided instead to reduce its menu offerings of salmon and to cancel several catering contracts.

Within a month after reducing its menu offerings of salmon, Neptune experienced a 25% decline in its restaurant business from the previous month. It also had a 75% decline in new bookings for catering jobs.

Neptune still has the immediate and long-term problem of how to obtain a reliable source of salmon, and wants to sue SUP

What rights and remedies does Neptune have against SUP, what damages, if any, might Neptune recover, and what defenses, if any, should SUP assert? Discuss.

<u>ANSWER A TO QUESTION 1</u>

Neptune v. Seafood Uptown Providers

Valid Contract and Governing Law:

A contract is an agreement between parties that gives rise to rights and duties the breach of which the law gives a remedy. The valid contract between Neptune and Seafood Uptown Providers (SUP) is one for a transaction for the sale of goods and, as such, is governed by article 2 of the Uniform Commercial Code (UCC). The UCC generally imposes a higher standard of conduct on merchants who regularly deal in the goods of the kind sold, and by their business hold themselves out as having superior knowledge of such goods. SUP is in the business of supplying salmon and is therefore a merchant.

Anticipatory Repudiation:

The issue arises whether SUP's notification to Neptune that it would no longer supply salmon to Neptune at $4.00 per pound constitutes an anticipatory repudiation. An anticipatory repudiation requires an unequivocal indication to a party that the other party shall not perform. This requires conduct that induces more than mere nervousness on the part of the non-breaching party. Here, SUP has not only advised Neptune that it shall not perform under the contract, it has also contracted with another party to sell its entire supply of salmon. Under the circumstances, SUP no longer has any salmon supply available to Neptune, and its communication to Neptune is unequivocal, demonstrating no uncertainty. SUP's action constitutes an anticipatory repudiation.

Non-Breaching Party's Rights on Anticipatory Repudiation:

Upon an anticipatory repudiation, the non-breaching party may elect one of the following alternatives:

1. Urge performance;
2. Treat the anticipatory repudiation as an offer to rescind and treat the contract as discharged;
3. Wait until the time for performance, suspending its own performance, and sue for breach at that time; or
4. Treat the contract as in breach and sue immediately.

In this case, it's impractical to urge SUP to perform because it has committed its entire salmon supply, and Neptune does not want to treat the contract as discharged. If Neptune waits to sue, it still has the present problem of meeting its need for a salmon supply. Neptune's best remedy is to sue immediately for breach (see discussion re: remedies infra).

Breach by SUP:

The issue is whether SUP is in breach of the salmon contract, giving rise to Neptune to exercise its remedies. Where a party has an absolute duty of performance and all conditions have been either satisfied or excused, the failure to perform that duty constitutes a breach. SUP's duty to supply Neptune with salmon on a monthly basis is absolute and has not been discharged; therefore, SUP is in breach of its contractual duties, and Neptune is entitled to exercise its remedies.

Remedies:

The issue is what remedies are available to Neptune for SUP's breach of the salmon contract. Generally, the remedies available to a party upon the breach of a contract include damages, restitution, rescission, reformation, and specific performance.

Damages:

Damages give the non-breaching party the benefit of its bargain by assuring its expectancy had the other party performed. Damages may be compensatory, consequential or punitive. Punitive damages are generally unavailable in the contract context.

Damages that are awarded must be foreseeable, unavoidable, causal, certain and definite. Neptune will urge that it is entitled to damages for finding a replacement supply, for losing its catering contracts, and for lost profits attributable to its restaurant and catering services. It will argue that the damages were a foreseeable result of its loss of supply of salmon; that the loss was unavoidable because Neptune was not at fault for SUP's breach; that the loss was a direct and proximate result of SUP's breach; and that the amount can be determined by reference to past business profits and costs for replacement supply, which are ascertainable and sufficiently definite. (See infra re calculation of damages.)

SUP's Defenses:

SUP's strongest defenses are that damages in this case were not unavoidable and are insufficiently certain. It will also argue that it was not reasonably foreseeable that its breach would result in Neptune's loss of existing catering contracts, of which it was likely unaware, and in its overall loss of business.

Unavoidability:

SUP will argue that Neptune's losses were certainly avoidable because it had the opportunity to contract with other vendors to replace the balance of its salmon supply at $6.00 per pound but failed to do so. Had Neptune contracted to acquire an additional 125 pounds of salmon a week for $6.00 per pound, it would not have suffered loss of contracts or loss of business based on its revised menu. Therefore, a portion of Neptune's damages were, in fact, avoidable. More over, a party has a duty to mitigate its damages, and the failure to do so will reduce its damages award.

Certainty:

SUP will also argue that Neptune's lost business profits are insufficiently certain to be compensable. Neptune is a new business, less than a year old. Although it has a nine month history of success, it does not have sufficient background to track seasonal business throughout an entire year. SUP will argue that its lost profits may be attributable to other factors. SUP will likely prevail on this argument.

Measure of Damages:

The appropriate measure of damages for a breach by the seller is either:

1. the difference between the market price ($5.00/lb.) and the contract price ($4.00), or
2. the difference between the price of replacement goods ($5.00) and the contract price ($4.00).

In addition, the non-breaching party is entitled to consequential and incidental damages. This measure of damages applies only to the 125/Ib./week for which Neptune contracted after SUP's breach. As discussed above, additional damages were avoidable and uncertain.

Other Defenses:

SUP will also assert as defenses that performance was both impossible and impractical because of the oil spill.

Impossibility:

Impossibility is determined by an objective standard. It must have been impossible for any party to perform under the circumstances. Here, impossibility did not preclude SUP from performing because another supplier could have performed.

Impracticality:

Impracticality is determined by a subjective standard. The oil spill must have been unforeseeable, making performance much more burdensome. Generally, an increase in price is not a basis to assert the defense of impracticality. Therefore, the defense is unavailable to SUP.

Specific Performance:

To be entitled to specific performance, the non-breaching party must show that damages are inadequate, the terms of the contract are sufficiently definite for specific performance, enforcement is feasible, enforcement is mutual (not mutuality of remedy), and no defenses are available.

Damages Inadequate:

Damages are inadequate in this case because the goods are difficult to replace although common. This usually applies to unique goods, but because of the oil spill, the salmon supply is greatly diminished. Neptune will likely prevail on the argument that damages are inadequate.

ANSWER B TO QUESTION 1

I. Neptune v. SUP

Rights and Remedies of Neptune

A. Rights

In order for Neptune to have rights under the contract, a valid contract must exist. Here, the facts indicate a valid written contract is present. Therefore, Neptune will have legal rights.

Breach - Voluntary Disablement

When a contract exists, a major breach will allow the aggrieved party to recover damages. The breach must be substantial or major. By selling its entire supply of salmon to a new customer, SUP has breached its contract with Neptune. The facts indicate that the new customer was willing to pay more than the Neptune-SUP contract. Therefore SUP is in breach of its contract with Neptune.

UCC

The UCC applies to the contracts for the sale of goods. It also has special provisions for contracts involving merchants. Salmon is a good. It is tangible property. Therefore the UCC applies.

Merchants

A merchant is someone who has special skill or knowledge in connection with the goods which form subject of the contract. SUP is a merchant because he deals in these types of goods. Neptune is a merchant because he is a continuous buyer of these types of goods in connection with his restaurant.

B. Remedies

Common Law

There are several methods of recovery under common law contracts.

Expectation Damages

The purpose of expectation damages is to put the aggrieved party in the same position it would have occupied had the contract been performed. Here the contract price was $4.00 a lb. for salmon. The current market price is between $5.00 to $6.00 per pound. Therefore Neptune can recover the difference between the contract price of $4.00 and the fair market price of $5.00 or $6.00.

Neptune will argue that $6.00 is the true market price because that is what SUP is selling it for, and what another supplier is willing to sell it for.

Consequential Damages - Hadley

Neptune could seek consequential damages for its loss of profit due to the menu reduction and the cancellations of catering contracts. In order to recover for consequential damages, Neptune must show that SUP was aware of the consequences at the time the contract was entered into.

Neptune will argue that SUP knew it (Neptune) was a seafood restaurant, and that if SUP breached the contract, that Neptune would be forced to limit its menu and refuse or cancel catering contracts.

SUP will argue that while it was aware that Neptune was a restaurant which served seafood, Neptune never expressly stated they would reduce their menu, etc. SUP will argue these are not recoverable damages because they were not foreseeable.

Mitigate

The aggrieved party has a duty to avoid increasing the injuries he has received due to the breach. This requires the aggrieved party **lo** lake affirmative steps to reduce his damages.

Neptune will argue that it fulfilled its duty to mitigate when it found a supplier to supply 1/2 its needs at $5.00 per pound. Neptune will further argue that it was not necessary for it to look further in an attempt to get its total needs met. It will assert that its actions were reasonable.

SUP will argue that had Neptune used reasonable efforts, it would have located the supplier who could have supplied a portion of the remaining weekly needs. This would have reduced Neptune's damages further. (i.e., Neptune would not have had to reduce menu or cancel catering contracts).

UCC Remedies

Under the UCC, the aggrieved party is entitled to recover the difference between the market price at the time of breach and the contract price. Here, it appears that the market price is between $5.00 and $6.00. The contract price was $4.00 per pound. Therefore, Neptune can recover the $1-$2 per pound difference between the contract price and the market price.

Cover Price

Under the UCC, the aggrieved party may choose to recover the difference between the price the aggrieved party had to pay to obtain substitute goods and the contract price. Here, that would be the difference between the $5.00 cover price with the new supplier and the original contract price of $4.00.

Equitable Remedies for Neptune

Equitable remedies are available to aggrieved party if the legal remedies afforded are inadequate, a decree is feasible, balancing of hardship indicates it is proper, there is a property right to be protected. There is also the remedy of specific performance.

Injunction

The court can fashion an injunction if necessary. Here it does not appear to be the case.

Specific Performance

Inadequacy of legal remedy? The good here (salmon) does not appear to be of such a unique character as to warrant specific performance.

II. SUP Defenses

A. Impossibility

SUP will argue that due to the oil spill it is impossible for them to obtain salmon at the price contemplated at the time of contracting. However, this defense will fail because it is still possible to obtain salmon in the proper quantity to fulfill the Neptune-SUP contract.

B. Impracticability

SUP will argue that the cost of obtaining the salmon has become so high that it is too difficult to perform under the contract. Increased price is not alone sufficient to indicate the defense of impracticability.

C. Equitable Defenses

SUP will argue that since the goods involved are not unique, and they are available in the market place, the court should not grant to Neptune specific performance. SUP will argue that the legal remedies of expectation damages are sufficient.

D. Statute of Frauds

SUP could attempt this defense. However, it will fail as there was a valid written contract stated in the facts.

July 1979

QUESTION NO. 8

Dr. Avery, the only dentist in Three Forks, recently collapsed while playing tennis, complaining of severe chest pains. The local general practitioner diagnosed Avery's disorder as a massive heart attack and told him to give up his practice. Complying with his doctor's orders, Avery sold his practice to Dr. Lamb. Lamb agreed to purchase Avery's practice including equipment, accounts receivable and good will for $50,000. The following provision was included in the agreement signed by the parties:

> "The seller further promises not to practice dentistry in Three Forks or within a 50-mile radius thereof so long as the buyer continues to practice dentistry in Three Forks. Should the seller violate this provision, the buyer shall be entitled to recover from the seller as liquidated damages a sum equal to 25 percent of the seller's gross income from the practice of dentistry for as long as the seller continues to practice dentistry in violation of this provision."

Subsequent medical tests established that Avery had not suffered a heart attack but had strained his abdominal muscles while playing tennis. Avery returned to Three Forks and after unsuccessfully attempting to buy back his practice from Lamb resumed dental practice in Three Forks.

Lamb consults you. What are his rights against Avery, and what relief, if any, can he obtain in an action against Avery? Discuss.

Answer A to Question 8

I. Validity of the Contract

Generally, of course, the law does not approve of restraints on trade and competition, whether arrived at by contract, or otherwise. Contract law does allow, however, reasonable restrains -- reasonable in terms of both time and geographical proximity -- on competition in connection with the sale of a business. This is allowed in order that a seller may sell and a buyer may buy and kept, the goodwill a seller has built up in a business. Absent such restraints, nothing would prevent the seller from simply opening a new business next door, appropriating all his goodwill (keeping his old customers), and, in the long run, small business would be much less marketable.

Here we do have a sale of a business. Also, we have what seems to be a reasonable geographic radius -- 50 miles. (Of course, reasonableness is at least partially a question of fact and circumstance, and the answer might be different if Avery's business were in New York). The most troublesome aspect of the contractual restraint is the time restraint -- so long as Lamb practices. A given court might well hold the entire restraint and therefore the contract voidable on the ground that the restraint is unreasonably restrictive in terms of time. However, the better view is that the provision is valid -- it is limited to the time when Lamb will be practicing (limited. to the bargain), and therefore have some real significance to Lamb in terms of what he contracted to buy. I would tell Lamb that in my judgement the contract is not invalid because of the trade restraint.

A second question is whether the contract is rescindable by Avery (or whether Avery can defend against an action by Lamb on the same ground) due to mistake. Clearly Avery entered into the contract under a mistake of fact -- his physical condition -- and the mistake is quite reasonable as well, being based on a doctor's diagnosis.

However, the traditional and majority view is that a contract is not rescindable for unilateral mistake of fact. The mistake here is unilateral it goes to Avery's motivation in entering the contract and forms no part of the bargain insofar as Lamb is concerned. ccordingly, in a majority of jurisdictions, Avery could not rescind and Lamb has an enforceable contract. However, some jurisdictions will allow recission so long as the seller's hardship more than outweighs the buyers putative loss of benefit of the bargain. A few states, including California, go further and hold rescission appropriate in cases of unilateral mistake of fact so long as the buyer can be returned to the status quo. If Lamb consulted more in one of these jurisdictions, I should need more facts that appear in the question -- on the hardship to Avery, the benefits to Lamb, and the possibility of Avery returning Lamb to the status quo. By inference, however, since the contract is fully executed and Lamb presumably has been practicing for some time, it may well be that even the status quo is impossible and therefore Avery cannot rescind no matter what law applies.

II. Remedies A. Damages

The first question is whether the liquidated damages provision in the contract is enforceable. The Courts will not enforce liquidated damages clauses that appear to be penalties. Generally, liquidated damages provisions are upheld only where the somewhat inconsistent conditions of: (1) a good faith attempt by the parties to estimate actual damages; and (2) a situation where damages are likely to be hard to measure in case of bread; are met, and the damages are tailored to the situation -- to the substantialness of the breach. I would advise Lamb that the chances are this liquidated damages clauses would be enforceable -- the damages flowing from Avery's wrongful competition seem difficult to measure, and an estimate that 25% of his business will be goodwill wrongfully appropriated which he had previous "sold" to Lamb, and the size of damage award is tailored to the magnitude of the breach -- a percentage of Avery's business activity which is presumably causually connected to the amount of injury (goodwill appropriate) he caused Lamb.

Therefore, I would tell Lamb that in my judgement he has an enforceable contract and may recover the liquidated damages a provided. And even if I am mistaken on the liquidated damages clause, he will be able to collect the actual amount of damages we can prove.

B. Injunction

In addition to collecting damages -- whether liquidated or actual -- for Avery's past breach, I would advise Lamb that we can probably obtain an injunction preventing Lamb from competing in Twin Fall s in the future. Of course, in this context the injunction would in effect be a specific performance of the negative covenant (not to compete) in the contract. Equity will generally enforce such covenants if they are valid (discussed above) and if the other equitable criteria are met.

To specific enforce a negative covenant such as this, equity requires (as it usually does) that the remedy at law be inadequate. The remedy at law in this case is damages. Damages are clearly inadequate as the breach is a continuing one and Lamb can only sue for accrued damages. Hence, he is threatened with having to bring a multiple number of suits, and this is sufficient to make damages inadequate.

Additionally, if the liquidated damages provision is struck down, very arguably damages are inadequate because they would he so speculative and difficult of proof (loss of goodwill). Traditionally in such case -- such as copyright and trademark infringement -- the legal remedy is considered inadequate (of course, this reasoning also supports the argument of why the liquidated damages clause should he upheld).

Secondly, there is no mutuality problem with specific performance here. So for as we can tell from the facts, the contract would have been specifically performable at Avery's request at the time of contracting (Fry's view), at the time the action was brought (Pomeroy's view), or at the time a decree will issue (Ames' view). Additionally, since Lamb has already fully performed his side of the contract, there is no problem with insuring his performance and hence no mutuality problem under the Cardozo - Restatement position.

There appears to be no defenses to equity jurisdiction, such as unclean hands or laches. The only possible argument by Avery would he that the liquidated damages clause is a substitute for specific performance and hence the sole remedy. The argument would lose, however, since only rarely will equity jurisdiction be defeated by a liquidated damages clause, and only where it is clear that the parties intended liquidated damages to be the sole remedy, an intention that does not appear from the face of the contract here.

Finally, there are no feasibility problems with specific performance. All that is required is an order (injunction) telling Avery not to do what he is doing.

No affirmative action or supervision by the Court is required.

Answer B to Question 8

1. Enforceability of covenant not to compete.

Lamb ("L") would have an action in breach of contract against Avery ("A") if he can establish that the covenant in his contract with A is valid and enforceable. Courts generally construe such covenants strictly but will give them enforceable effect if they are reasonable in scope, area, and duration. This covenant is probably reasonable in that it is limited to the practice of dentistry, which is the subject matter of the contract, and is reasonable in its area restriction in that it is limited to Three Forks and the surrounding area, which probably within the area of the purchased dental practice. However, since by its terms it is to continue indefinitely, all courts would find this unreasonable in scope and not enforce this covenant fully.

Courts differ in how they treat such a covenant which is found overly broad in effect, at least in one respect. The more conservative rule is to strike the covenant completely, but the more modern rule is to enforce the reasonable portions of the covenant and construe unreasonable portions as, in the case of time, extending only for a reasonable period.

Even if the court should strike out the entire provision, however, it may find an implicit covenant of A not to compete directly against L in the sale by A of the goodwill of his practice to L together with the other assets. As such L might still have a cause of action against A for breach of contract for failure to honor this implicit covenant.

A might argue that his continued medically-caused disability to continue practice was a condition subsequent to the effectiveness of the sale contract and thus his rehabilitation is the failure of the happening and he is not required to perform. However he could not prove this condition even if it were so since it would be deemed parol evidence and not admissible in light of the integrated contract, which by its terms (the restriction on competition) appears to contemplate that it may practice dentistry in the future.

Assuming the anticompetitive covenant is found enforceable, L's rights to recover would probably be limited by the liquidated damages provision of the contract. Such a provision is enforceable if damages for breach are not otherwise readily ascertainable and if the damages provided for are reasonably related to the substance of the contract and therefore do not act as a penalty. In this situation, where L has purchased an ongoing practice which is subsequently interfered with in violation of the contract, it does not appear that damages could be ascertained with certainty because of the potential for fluctuation in business and the many external variables. In any event a multiplicity of suits would be required for L to obtain damages over the effective period of the contract. Thus the first requirement appears to have been met to enforce the liquidated damages provision. Secondly, the measure of damages appears to be a reasonable basis for remedying the wrong to L for resumption of practice by A in that they are related to the subject matter of the practice. However, the percentage may be too high and deemed a penalty.

Finally, if all of the above fails, L can probably seek and obtain recession of the contract and damages for his reliance on its terms. Such recission could be based on a mutual mistake of fact going to the subject matter of the contract; that is, A's disability to practice dentistry. Arguably this is a material reason for the contract and since it was mutually mistaken by the parties, an action in recission would at least allow L to recover his $50,000 and any other expenses incurred which were reasonably foreseeable as a result of his reliance on the existence of the contract.

If the liquidated damages clause is deemed penal and therefore unenforceable, or if the entire covenant against competition is stricken out, together with its liquidated damages clause, L may still be entitled to an injunction prohibiting practice by A in such a way as to endanger the goodwill purchased by L. As discussed above in connection with liquidated damages, ordinary money damages would be an inadequate remedy because they cannot be specifically ascertained and would involve a multiplicity of suits. Furthermore, a property interest is involved (although not strictly required by courts in equity any longer), and mutuality of remedy (or at least of performance, which is all that is generally required) is available. Also, supervision of such a decree if drafted in negative form would present no enforceability problems. Thus it is likely that L could obtain an injunction, limited in scope, prohibiting A's direct competition. This is particularly true because an equity court is less likely to consider hardship to the enjoined party where the enjoined activity is wilful rather than innocent, as is the case here where A has deliberately breached his contract obligations.