MEMORANDUM

TO: SPRING 2010 CONTRACTS STUDENTS

FROM: PROF. TOM RUSSELL

SUBJECT: SPRING 2010 CONTRACTS FINAL

DATE: 17 AUGUST 2010

This was a difficult exam--perhaps the hardest that I have given.

The first question called for an analysis of a requirements contract in a situation of impracticability, that is, 2-306 meets 2-615. Impracticability is a defense, and 2-615 requires allocation. This meant that by the time your analysis got to 2-615 and the allocation issue, you should have circled back to realize that the calculation of damages for the aggrieved grocers required using the lower quantity of shrimp that each grocer would receive if Herring allocated as good faith required him too. And, of course, the issue of good faith meant that Nuevo Shrimp--not a customer at the time when the spill starts--would not have entered into a contract with Herring if Herring had acted in good faith.

The second question was a rather straightforward calculation of expectation damages for Herring. Normally, he would sell 5 million pounds of shrimp at $4.75 per pound. However, the spill has cut his yield in half. Prices for those shrimp, though, are higher now--whether selling to HEB and Nuevo Shrimp or whether selling to all the grocers. Damages equal the difference between what he would have gotten in a normal 5 million pound year and what he will get with just half the amount of shrimp. (Some calculated this using months.) Subtract from that expenses saved.

The third question was a difficult one. Involved were the interaction of the parol evidence rule, warranties, and the shifting burdens that come with inspection and knowledge of a defect. Of premium importance in this question was recognizing the need to start with the parol evidence issue before the warranty questions. Second, it was important to recognize that the buyer's knowledge of the defect may limit the warranties. Third, I wanted you to identify the possibility that he might revoke acceptance.

The fourth matter was a quite straightforward analysis of the release that BP initially asked fishers to sign. I drew the language of the news story from an actual news story. Duress, undue influence, and unconscionability came into play. As well, BP said that they would not enforce the releases; I wanted you to analyze that statement as well.

There were no Battle of Forms issues nor were there any firm offers, although many students found and discussed these matters.

Distribution of Grades

The grades conformed to the law school grading policy. The mean grade was 3.11 and the median was 3.0. In order to achieve this mean, I had to slide nearly everyone's grade up a bit.

The distribution was as follows:

DISTRIBUTION	
A	**6**
A-	**8**
B+	**13**
B	**15**
B-	**13**
C+	**4**
C	**1**
C-	**1**
D+	**0**
D	**0**
D-	**0**
F	**0**
TOTAL	**61**

Please note that consistent with law school policy, these grades are final. That is to say, there is no opportunity for you to argue or bargain with me in order to receive a higher grade.

Student Sample Answers

As is my practice, below you will find a number of high-scoring student answers. My description of the answers for which I hoped is at the top of this memo. All of the students answers below depart substantially from the ideal.[1]

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[1] Future students reading this memo will profit from rewriting the answers using my suggested models as a guide.

Part 1.

Student Sample Answer #1

1. NFC'S CONTRACTS WITH STORES AND RESTAURANT

Applicable Law

- These contracts are for the sale of goods; UCC applies.

Enforceability

- Offer and Acceptance:
  - The contracts between NFC and the grocery stores represents an offer by NFC; ten years of performance by the stores clearly indicates acceptance under 2-204, which allows formation by "conduct by both parties" recognizing a contract.
  - The facts do not include a written contract between NFC and Nuevo. Performance on both sides evinces offer and acceptance under 2-204.
- Consideration
  - NFC's consideration is the promise to provide shrimp. The grocery stores' consideration is the promise to pay 5% below wholesale; Nuevo's consideration is the promise to pay 30% above wholesale.

Content

- NFC's contracts with the grocery stores is nonspecific as to price and quantity.
  - Price
    - UCC 2-305(1)(c) allows an open price term where the price is fixed by an agreed market standard; here, each contract sets the price as a percentage

above or below wholesale price, which is available through trade publications like "Shrimp News International." This satisfies the UCC requirements for price terms.

- Quantity
  - NFC's contracts with the stores are requirements contracts, which omit specific quantities and instead base quantity on the buyer's needs. Although traditionally considered unenforceable due to vagueness, UCC 2-306 explicitly authorizes such contracts, so long as the requirements are in good faith and not unreasonable in light of normal estimates or past requirements.
  - NFC's contract with Nuevo appears to be an output contract, also authorized by 2-306, for 20% of NFC's total catch (10% of 50% of NFC's "normal" catch). This is sufficiently definite for enforcement.

Breach

- Injured Stores
  - 2-306(1) echoes 1-203 and requires the seller in a requirements contract to act in good faith, defined for merchants by 2-103(1)(b) as "honesty in fact and . . . observance of reasonable commercial standards of fair dealing." (NFC qualifies as a "merchant" under 2-104(1).) 2-615 outlines what constitutes fair dealing in case of failure of presupposed conditions. Because only a part of NFC's capacity has been affected, Herring is required by 2-615(b) to allocate his remaining goods among his customers in a "manner which is fair and reasonable." He is further required (2-615(c)) to notify his buyers seasonably

not only of delay or non-delivery, but also of the estimated quota they will receive. Herring's notification was likely seasonable; however, his decision to allocate 80% of his remaining goods to one store, and 20% to a customer not then under contract, is unlikely to be considered fair and reasonable, and thus will be considered breach.

- Nuevo
  - If specific performance (see below) is granted to the injured stores, NFC must either stop selling to Nuevo or reduce Nuevo's share to an amount commensurate with the "fair and reasonable" allocation standard of 2-615. If there is no agreement concerning the duration of their business relationship, NFC may choose the former course and not be in breach; otherwise, NFC should choose the latter course, which likely would be excused under 2-615.
- H.E.B.
  - NFC may likewise be forced to reduce its allocation to H.E.B.; again, this would be excused by 2-615.

<u>Damages</u>

- Injured Stores
  - <u>Liquidated Damages</u>: There is no liquidated damages provision.
  - <u>Expectation</u>: The grocery stores will seek to be put in the position they would be in had there been full performance. In the event of non-delivery or repudiation, the buyer may recover the difference between the market price at the time they learned of the breach (2-713) or repudiation (2-723) and the contract price. At

the time of NFC's repudiation, the market price was about 25% higher than normal; however, as the contract price was 5% below wholesale, damages would be limited to the difference between the amount they pay for cover and the amount equal to 5% below the inflated market price. They may also claim incidental damages under 2-715 for expenses incurred in effecting cover. Consequential damages may be recoverable under 2-715, if NFC had reason to be aware of them. The facts do not indicate any such damages.

- Reliance: The injured stores may have damage claims for expenses incurred in reliance on their normal delivery of shrimp.
- Restitution: It does not appear that any payments were made in advance, thus NFC has not been unjustly enriched, and restitution damages are not available.
- Specific Performance: 2-716 authorizes specific performance "where the goods are unique or in other proper circumstances." Comment 2 to 2-716 states that output and requirements contracts involving a particular source or market present the typical specific performance situation. The injured stores likely will seek to have NFC's performance per 2-615 compelled by the court -- unless regular fishing resumes and the whole thing is moot by that point.

- Nuevo
    - If specific performance compels NFC to stop selling to Nuevo, and this constitutes breach (see above), Nuevo could seek damages based on expectation and reliance as described for the injured stores, above, based on its own price agreement of 30% above wholesale.

- H.E.B.
    - Assuming NFC merely reduces H.E.B.'s allocation per 2-615, H.E.B. is unlikely to have enforceable damage claims.

Defenses

- Herring may claim that the two-week delay between his informing the stores of nondelivery and their demanding a share of his remaining catch is not a "reasonable time" under 2-616, thus terminating the contract. However, even if a court otherwise might agree, this will likely fail because of Herring's failure to comply in the first place with the allocation requirements of 2-615(b).
- Statute of Frauds: Per 2-201, NFC's agreements likely are for greater than $500 and thus within the statute. There is a writing for the grocery store contracts. We do not know whether there is a writing for Nuevo, so it is possible that Herring can use the statute as a defense to the formation of a contract.
- Mitigation: Injured parties are required to mitigate their damages where reasonable. NFC will seek to reduce damages in light of reasonable cover costs, as described above.
- Impossibility: NFC of course will claim impossibility under 2-615, and the oil spill situation satisfies both the unexpected contingency and governmental order clauses therein. However, 2-615(a) specifically grants this exception only to sellers who comply with the allocation and notification requirements of subsections (b) and (c), which NFC did not. Herring may claim it would be unreasonable to expect him to transport shrimp from Westnewstate to the injured stores, but however this claim

might be viewed, the stores have rendered it moot by displaying their willingness to drive to Westnewstate to pick up the shrimp. This defense likely will fail.

- Conclusion
    - Herring should attempt to work out a fair allocation of his catch between all four stores and Nuevo, perhaps with a better discount for the injured stores. Under the circumstances, proceeding fairly and openly probably is the best way to avoid litigation altogether.

Student Sample Answer #2

1. Newstate Fishing Company (NFC)'s Shrimp Contracts

H.E.B., Giant Eagle, Kroger, Safeway:

Next week, Herring should prorate the shrimp fairly among the grocers. Today, Herring should notify them that he will be allocating deliveries reasonably and give each an estimated quota.

WHAT LAW APPLIES?

Bonebrake: The predominant thrust of the contracts is shrimp; UCC governs (UCC§2-105).

ENFORCEABILITY

NFC **promises** shrimp and the grocers **promise** payment. The contracts are signed writings that provide sufficient price and quantity (UCC§2-305 and §2-306). UCC fills any gaps (UCC§2-204).

Statute of Frauds: no issue.

CONTENT OF THE DEAL

Course of performance helps determine this because the contracts have existed 10 years (UCC§2-208). NFC delivers dockside all the shrimp required at ex-ship price minus 5%. The grocers pick up the shrimp once a week, taking at least 90%.

* The contract does not specify that the shrimp will come from the Gulf of Newstate. This may be an issue for NFC.

BREACH

- NFC failed to supply the grocers "all the shrimp [they] require."
- Even if NFC's breach is excused, the grocers were notified of the non-delivery but not of their allocation quotas. Although the managers "understood," they are probably still entitled to their fair share (UCC§2-615(b)).

* There may be a breach now but the best solution is to let NFC make it up later in their relationship.

REMEDIES

If NFC's breach is excused, NFC must favor contracting customers and prorate supplies fairly. (UCC§2-615(b) note 11). H.E.B. received more than a fair share of shrimp. NFC's sale to Nuevo, the new customer, was probably bad faith. Giant Eagle, Kroger,

and Safeway have rights to fair shares and grievances for portions of the shrimp delivered to H.E.B and Nuevo during the first three weeks of the season.

DAMAGES

"***Calculation assumptions***"

The following calculations assume:

• NFC catches equal amounts of shrimp each week

• The spill affects the entire season

• NFC continues to be permitted to fish <u>only</u> in Westnewstate, where it adds no more boats, and the catch this year equals 50% of its past annual catch:

(50% of 5,000,000 = **2,500,000**).

• Shrimp season is April 15- August 12, and has 17 weeks.

• Market price had increased by 25% at the beginning of shrimp season and remains constant.

Expectation:

<u>If breach is unexcused</u>:

- H.E.B has no damages yet.

- Had the contract been performed, the other grocers expected "all the shrimp [they] required." Their damages will be the difference between the market price at the time they learned of the breach and the contract price plus incidentals and consequentials, minus costs saved (UCC§2-713(1)):

$6.25/lb (market price at time of notice of breach) - **$5.94**/lb (contract price) = **$0.31**/lb, to be multiplied by the "average" annual shrimp purchase for each grocer (as determined by past course of performance and good faith (UCC§1-203, §2-208)).

- Incidentals *may* include:

• Costs of trucks, drivers, and gas for the trips to and week-long stay in Westnewstate (Herring will argue this was unreasonable).

• Money spent on substitute shrimp for which the grocers paid more than NFC's contract price.

- Consequentials may include reasonable costs resulting from contracts the grocers previously entered to sell the shrimp (Herring will present a *Hadley* argument that he was not on notice of these consequences).

<u>If breach is excused</u>:

- This year, H.E.B should only get 40% of the total catch (1,000,000 lbs). Nuevo should get none. The remaining 1,500,000 lbs should be prorated among Giant Eagle, Kroger, and Safeway.

- For the three missed deliveries, Giant Eagle, Kroger, and Safeway, together, will claim <u>**$27,352.85**</u>:

2,500,000 lbs /17 (# of season deliveries) = 147,059 lbs/week. Of this, H.E.B. gets to buy 40%, leaving 88,235 lbs.

88,235 x $0.31 = **$27,352.85**, to be prorated among the remaining grocers.

* NFC should just make this up to the other grocers in future dealing.

Reliance:

Alternatively, Giant Eagle, Kroger, and Safeway may ask for money spent in reliance on the contract (UCC§1-103, RST§349), including money spent in anticipation of transporting, stocking, and storing the shrimp. This is probably less than the expectation damages.

Restitution:

The grocers have conferred no benefit to NFC.

DEFENSES

Impossibility/Impracticability:

<u>NFC should claim</u>:

BP's spill, a force majeure, was an unexpected occurrence that caused the failure of a basic assumption of the contracts: that NFC can fish the Gulf of Newstate. Objectively, if this had been foreseen, it is unlikely that NFC would have assumed this risk.

<u>Grocers may claim</u>:

• NFC should have anticipated this risk; it could have easily been built it into the contract.

• NFC just doesn't want to perform because it won't make as much profit. The shrimp don't *have* to come from the Gulf of Newstate; the contract may not be impossible. (ConAgra).

However, fishing or importing shrimp from elsewhere is probably commercially impractical and would alter the essential nature of the performance. NFC probably has an excuse to breach (UCC§2-615(1)).

Nuevo: NFC might be excused from Nuevo's contract. If not, and if NFC breaches, Nuevo's expectation damages will be negative: the contract price will never be less than market price (but Nuevo may have substantial incidental, consequential, and reliance damages).

Student Sample Answer #3

1: HEB/Safeway/Kroger/Giant Eagle v. Newstate Fish Co.

What Law Applies:

Shrimp are goods therefore the UCC governs this transaction.

Enforceability:

Offer and Acceptance:

Newstate Fish offered to supply all the shrimp the stores require with delivery dockside and the stores accepted in a reasonable manner by performing and sending trucks to the dock. UCC§2-206.

Consideration:

Promise for a promise. Newstate Fish promised to supply all the shrimp required and the stores promised to pay ex-ship wholesale price minus 5% with dockside delivery.

Promissory Estoppel:

If consideration is deemed inadequate, there was reasonable reliance under RST§90 (through UCC§1-103 escape hatch), because the stores relied on Newstate Fish for the shrimp supply.

Content:

Gap filling: Under UCC§2-204 this contract is valid despite missing terms because the parties intended to make a contract, there is a reasonable certain basis for a remedy, and there is enough information to tell what the contract will look like. Since the price in the contract is somewhat open, UCC§2-305(1)(c) allows a price to be fixed in terms of some agreed market, in this case from "Shrimp News International" less 5%. UCC§2-306 allows for contracts for requirements of the particular buyer and the contract is not too indefinite so long as the quantity is in good faith and reasonable.

Warranties: There were no express warranties created by Newstate Fish. Since this contract is governed by the UCC, the code gives implied warranties of merchantability that the shrimp will be merchantable since Newstate Fish is a merchant with respect to shrimp. UCC§2-314. The contract made no attempt to disclaim such warranties.

Breach:

Newstate Fish did not deliver shrimp to Kroger/Safeway/Giant Eagle dockside.

Newstate Fish can say he should be excused from delivery of shrimp because of an unforeseen shutdown of major supply sources (Gulf of Newstate) his performance has become commercially impracticable because of the unforeseen oil spill. Newstate Fish should then allocate the catch from the Westnewstate operation proportionally among the four stores based on the requirements of the stores. Therefore, 40% of the total current catch would go to HEB and while the balance would be distributed proportionally to the other three stores. UCC§2-615 Newstate Fish may want to favor the needs of the grocery stores over new customers such as Nuevo Shrimp, especially because of the history of contracts with the stores.

Damages:

Liquidated Damages: No liquidated damages clause in this contract.

Expectation: If Newstate Fish breaches on ALL contracts with HEB/Kroger/Safeway/Giant Eagle the stores could (assuming prices have risen 25% as in Westnewstate) cover at $6.25/lb where as the stores would pay an increased contract price of $5.94/lb for a difference of .31/lb multiplied by how many pounds of shrimp they require (UCC§2-712) plus any incidental damages like reasonable costs for delivery and connected to covering. There are likely no consequential damages to recover because Newstate did not know of any particular requirements or needs in advance. Expectation damages would be reduced by any expenses the

stores saved. If the stores cannot cover, they would receive the same damages under UCC§2-713.

If Newstate Fish continues to supply HEB with shrimp, there would be no breach of contract with HEB and no expectation damages.

Reliance: The stores reliance interest would be any expenditures made in reliance on the contract. While difficult to determine without more information, this may include costs such as materials purchased for use at the processing plant.

Restitution: There has been no benefit conferred on Newstate Fish during this latest period of performance so restitution damages are not applicable.

Defenses:

Statute of Limitations: Assuming the litigation takes place within a timely manner, there is no defense under the statute of limitations.

Statute of Frauds: No statue of frauds defense because the contract is likely for goods for $500 or more and there is a written contract signed by Herring, against whom enforcement would be sought. UCC§2-201.

Mitigation: HEB/Kroger/Safeway/Giant Eagle have a duty to mitigate damages. Even if the stores could not find shrimp locally, they would likely be able to buy from a provider in another part of the world.

Impossibility: Newstate Fish might be able to show that providing the shrimp to the other three states was physically impossible because the oil spill. Newstate Fish could show that the oil spill was an unexpected occurrence, the risk of which was not allocated by agreement, and performance of the contract was commercially impracticable.

1.1.<u>Nuevo Shrimp v. Newstate Fish Co.</u>

What/Enforceability/Content/Breach: Generally see claim 1 assuming same contract was used, except that Nuevo promised to pay 30% more than ex-ship price. Newstate Fish may decide not to provide Nuevo a portion of shrimp under the UCC§2-615 because the restaurant is a new contract and customer.

Damages: See claim 1 except for:

Expectation: Nuevo expected to pay about $8.25/lb assuming the 25% increase in price and Nuevo's contract for 30% over ex-ship. Assuming Nuevo could cover for any shrimp Newstate Fish didn't deliver, they would have no

damages because the market price of $6.25 is $2 less than the $8.25 Nuevo is likely paying Newstate Fish.

Defenses: Generally see claim 1, for mitigation Nuevo would likely be able to find shrimp from other sources at lower prices.

Part 2.

Student Sample Answer #1

2. POTENTIAL REMEDIES FROM BP

- In recent years, the average wholesale price for shrimp has been $5/lb, and NFC has sold on average 5 million pounds annually.
- NFC has typically sold at least 90% of its catch to the chains at 5% below wholesale, ($4.75/lb). It has sold 10% or less to smaller retailers and wholesalers, presumably at full price.
- This 90/10 split averages NFC's normal gross earnings to $23,875,000 per year ($21,375,000 from chains; $2,500,000 from others).
- Wholesale prices since the spill have been about 25% above normal, or $6.25/lb.
- NFC is now doing about 50% of its normal business - 40% (2 million lbs/yr) with H.E.B. at the regular 5% discount rate ($5.94/lb.), and 10% (500,000 lbs/yr) with Nuevo at 30% above wholesale ($8.13/lb.).
- Annually, this would make NFC's gross earnings $15,945,000 -- $7,930,000 less than normal.
- Thus, a court could divide $7,930,000 by the number of months in the shrimp season, multiply the result by the number of shrimping months NFC ultimately is unable to

work at full capacity, and use that result as the basis for damages. Any expenses saved by not operating the full fleet would be subtracted.

- Note 1: The 90/10 split is the one most favorable to NFC. As this ratio is variable, and NFC sometimes sold its entire catch to the chains at 5% off, a court might calculate the damages based on that number instead, which would reduce the annualized loss by $125,000.
- Note 2: If specific performance is decreed and NFC must start selling its entire catch to the chains at 5% off, its ultimate losses will be higher. The difference would depend on when NFC shifts Nuevo's 10% to the chains.

Student Sample Answer #2

2. <u>Newstate Fish Co. v BP</u>

Liquidated Damages: As there was no contract between Newstate Fish and BP, there was no liquidated damages clause to consider.

Expectation: At the average price of $4.75/lb revenue from HEB was $9,500,000 based on 2 million pounds sold. At the current price of $5.94/lb, Newstate Fish can expect to earn $11,800,000 in revenue from sales to HEB. Assuming Newstate Fish is able to operate at 50%, they will lose between $11,875,000 and $14,850,000 in revenue.

Newstate Fish can claim to be a lost volume seller because they could sell as much shrimp as they could catch and Gulf of Newstate provided an unlimited supply. Although Newstate Fish normally sold 5 million pounds of shrimp, that only represents 3-5% of the total shrimp catch available in Gulf of Newstate. As a lost volume seller, Newstate Fish can recover for lost profits (including reasonable overhead) plus incidentals. UCC§2-708(2). Assuming an average selling price of $4.75/lb multiplied by 5 million pounds of shrimp, Newstate Fish had revenues of $23,750,000 a year from shrimp. The $23,750,000 amount would need to be reduced by costs to reflect the profits of Newstate Fish and also subtract revenues from Westnewstate sales. Reasonable overhead may still be included in the damages. With the current increased shrimp prices,

damages would be $8,900,000[2] which would need to be reduced by costs to find profits, while still including any reasonable overhead.

Newstate Fish can receive incidental damages reasonably incurred as a result of the oil spill for the remaining 50% of the business that is not operable. UCC§2-710.

Expectation damages would be reduced by any expenses saved (such as salary, boat repairs, gas) by not operating at 100%.

BP will argue that Newstate Fish cannot be a lost volume seller because fishing limits would create a boundary on the available supply of shrimp.

Reliance: Although no official contract exists between the parties, Newstsate Fish relied on the fact that they would be able to harvest shrimp during the entire season at 100% capacity and should be able to recover expenditures related to that reliance. This might include any nets, licenses, gas, boats, training, insurance, tackle, maintenance, and any expenses leading up to the start of the season for the 50% of the fleet that cannot work due to the oil spill.

Restitution: Newstate Fish did not confer a benefit on BP so restitution is not applicable.

Defenses:

> **Mitigation:** BP will try to limit damages by saying the Newstate Fish had a duty to mitigate. They will say that Newstate Fish could have moved all of their boats to Westnewstate to operate as close to normal as possible.

Part 3.

Student Sample Answer #1

<u>3. NFC v. BMI</u>

Herring should immediately reject/revoke acceptance of the machine and sue BMI for breach.

WHAT LAW?

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[2] $23,750,000-$14,850,000= $8,900,000. Historical revenue- revenue at increased price from Westnewstate= Lost Revenue.

Bonebrake: Machines are goods; UCC governs.

ENFORCEABILITY

BMI's manager (BMI) **offered** to sell the machine for $450,000. Herring **accepted** but provided a condition precedent. BMI agreed to the condition. If the condition is not met, no deal.

Consideration: machine for money. Herring's condition precedent needs no consideration (UCC§2-209).

Statute of Frauds: there is a writing.

CONTENT

Parol Evidence:

- The "merger" clause (a partial "no oral modification" clause) attempts to integrate the writing. But, evidence offered to establish liability for conditions precedent will be admitted, including oral negotiations and the Post-it.
- A Willistonian jurisdiction may only analyze the writing, but a Corbinesque jurisdiction will admit evidence to show representations, warranties, and misunderstandings (including the Buyernomics report and the circumstances of the contract).
- BMI wrote the contract, had most control, and was on notice. BMI never ran tests to verify conformity with the purity law. Herring tested the capsules, but the facts don't indicate whether he communicated this to BMI and BMI may still be responsible for the

risk that the capsule line may not adequately perform. The "misunderstanding" issue could go either way.

Express Warranties:

- Warranties help determine what seller agreed to sell: BMI *promised* a machine that would produce fish-oil capsules compliant with Icelandic purity laws (UCC§2-313(a)).

Although Herring inspected a *model* vitamin-E capsule machine, he understood that it was illustrative; not an exact representation. Herring even made his condition known at that time.

- The *sample* capsules that Herring inspected, which did not comply, directly contradicted the other express warranties. Warranties are to be interpreted as consistent, but implied warranties of fitness for a particular purpose will trump inconsistent express warranties (UCC§2-317(c)).
- BMI will say the sample inspected by Herring was a *description* of the machine that Herring accepted, and that is what BMI delivered. The court will likely reject this argument, because exact specifications displace inconsistent samples (UCC§2-317(a)).
- One possibility: Herring will only get a machine that conforms to the sample he inspected.
- The clause "[e]xcept as expressly provided in this Agreement" does not undo the express warranties. The parol evidence rule may admit evidence showing what representations or warranties were "expressly provided."

Implied Warranties:

- BMI is a merchant because it sells machines, so the goods must pass without objection under the contract description. Merchantability was not mentioned in the disclaimer, so the *implied warranty of merchantability* applies (UCC§2-316). Exactly what the contract description *is* will be an issue (UCC§2-314(2)).

- BMI had notice of the particular purpose of the capsule line. Herring relied on BMI's expertise. Thus, an *implied warranty of fitness for a particular purpose* was created (UCC§2-315). This warranty was probably disclaimed, assuming the clause was conspicuous.

BREACH

The machine cannot produce capsules that comply with the Icelandic law.

• If the court finds that Herring's requirement is a condition precedent only, its failure to occur kills the deal but provides no claim for damages.

• If the requirement is a promise made by BMI, then failure to comply constitutes breach and the failure is material. Herring would still have to pay for the machine if BMI cures, although he may claim losses caused by the delay.

• If the requirement is a promissory condition, as is most likely here because BMI agreed to it, then the failure discharges Herring from performance obligations *and* entitles him to damages for his losses.

REMEDIES

- Herring should reject the goods for non-perfect tender (UCC§2-601) and provide prompt notice to BMI. Acceptance only occurs after a reasonable inspection time (UCC§2-606).
- If Herring has waived his right to reject, which is possible because he already produced and tested several hundred capsules, he must revoke acceptance by showing that the defect is substantial and previously undiscoverable (UCC§2-608).
- If time for performance has not expired, BMI can cure (UCC§2-508). If it has expired, Herring is entitled to damages.

DAMAGES

No liquidated damages clause.

Expectation:

- The goal is to place Herring in as good a position as he would be in had the breach not occurred. He may claim the difference between the value of a machine that complies with the Icelandic law and the value of the machine he got, plus incidental and consequential damages (UCC§2-714).
- If Herring covers, he may claim the difference between the contract price and the cover price, plus incidentals and consequentials, minus expenses saved (UCC§2-712). If he enters an alternate transaction with the U.S., he will want lost profits (consequentials).

The New Business rule may be a problem, but Herring's profits are not speculative; he can predict what he will sell to this market.

- Incidentals: Herring has a claim for money reasonably spent on transportation and installation. He may also have a claim for the $30,000 spent on testing.
- BMI, wanting to reduce the damages it owes, may claim that Herring must mitigate, that Herring could sell other kinds of capsules, or that he might actually make *more* money in the U.S. so he has no claim for lost profits.

Reliance:

Herring may claim reliance damages (UCC§1-103). This is money he spent relying on the contract, which includes $125,000 for the concrete and building, now a dead weight loss unless Herring plans on buying a new machine. Reliance may also include the $30,000 for testing (if Herring paid for that), travel, trucking expenses, and composition testing. BMI will claim that these expenses were unreasonable.

Restitution:

Herring can't use his machine. To get back to square one, he may return it, recover his $450,000, and walk away from the deal.

DEFENSES

Misunderstanding: BMI will claim he misunderstood who was to ensure that the capsules met specifications. He will cite to the contract clause supporting this, the Buyernomics report, and the samples he gave to Herring for testing to show that he reasonably thought Herring assumed responsibility. However, at the time of offer, BMI knew of the condition and could have cleared up the misunderstanding.

Limitation of Remedy: BMI may claim a right to repair the machine or replace the nonconforming parts (UCC§2-719).

Student Sample Answer #2

Newstate Fishing Co. v. BMI

Bonebrake test

The purpose behind this contract was for NFC to obtain a machine that could produce fish oil capsules. BMI did not specially design or make this machine for NFC; it had already been produced and was available for Skip to see as a model at BMI's factory. Consequently, the thrust of the contract was to provide a good, which is governed by the UCC.

Offer

BMI offered to sell the equipment for $450,000 if NFC would pick up the machine at the BMI plant.

Acceptance

After negotiations, both parties signed a contract for the equipment sale, and NFC picked up the equipment.

Consideration

NFC agreed to pay BMI $450,000 in exchange for a capsule machine.

Deal contents

To determine whether BMI agreed to provide a capsule machine capable of generically producing fish oil capsules or special capsules that met Icelandic regulations, we must consult the parol evidence rule. The judge generally makes the determination of whether the written agreement is fully integrated. Despite the language in the written contract claiming that the document represents the "entire agreement," a Corbinesque judge might relax the parol evidence rule and allow additional evidence to show whether there truly was a full integration. In a Willistonian jurisdiction, the writing is paramount and, in this case, the prior communications between the parties probably are excluded.

Any parol evidence allowed cannot contradict the terms contained in the final expression, but it can be used to supplement or explain those terms. UCC 2-202. The prior communication showing NFC made their requirements known to BMI on multiple occasions does not directly contradict any terms in the written contract, which only makes references to BMI's belief that it hasn't made any misleading statements to NFC and that it makes no warranties other than those expressly provided. On the other hand, BMI would point to NFC's voluntary undertaking of the capsule testing. It was Herring who had concluded that the capsule line was usable with some tweaking and, assuming Herring didn't raise any objections, signaled that the machine was satisfactory. If parol evidence is allowed, the court may use the written evidence produced by the consultants stating that BMI would conduct the final testing to find that NFC

agreed to pay $450,000, and BMI agreed to build a machine capable of producing fish oil capsules saleable in Iceland.

Warranties

BMI made no express warranties, and in fact added language attempting to disclaim all warranties, to NFC regarding the machine; however, BMI did not explicitly state "merchantability" in its disclaimer, so there remains an implied warranty of merchantability, since BMI is a merchant of capsule machines. UCC 2-314; 2-316. Because the machine is capable of producing fish oil capsules that pass muster in markets outside of Iceland, the court is unlikely to find that the machine is not merchantable.

There may be an implied warranty of fitness for a particular purpose provided BMI not only knew of NFC's particular purpose for purchasing the machine but also knew NFC was relying upon its judgment and that NFC actually did rely on BMI's judgment. UCC 2-315. BMI appears to have disclaimed this warranty, but to be effective, the disclaimer must be conspicuous (i.e., the text of this disclaimer would have to stand out from the surrounding words and would likely have to be displayed on a prominent page of the contract).

Breach

Assuming the court finds that capsules conforming to Icelandic regulations were a part of the contract, NFC may reject the machine under the perfect tender rule by seasonably notifying the seller, provided it hasn't yet accepted the machine. UCC 2-601; 2-602. If acceptance has been machine, the court is unlikely to allow revocation, since NFC's acceptance was not induced by BMI assurances. UCC 2-608.

Damages

Assuming that there is a breach and BMI doesn't cure, NFC may claim expectation or reliance damages. Under the expectation interest, NFC would seek lost profits during the time it couldn't produce the capsules, reliance damages of $125,000 for the concrete slab and metal building to house the machine, and incidental damages for the money spent to hire truckers to haul the machine. Lost profits might prove difficult to estimate, however, since NFC was never in the business of manufacturing the capsules, only in distributing them. A court may employ the new business rule and reject the idea that an estimate of profits could be ascertained. NFC's continued distribution (and subsequent profit) of the capsules under the previous arrangement may further impede its ability to claim lost profits. For this reason, NFC would be more likely to succeed in claiming reliance damages for the expenditures made in preparation for the machine's arrival.

Furthermore, if NFC keeps the machine and sells capsules to other markets, damages will be limited to the difference between the value of a machine capable of producing Iceland-approved capsules and the value of this machine.

Student Sample Answer #3

3.**<u>Newstate Fishing Co./BMI</u>**

Applicable Law—The UCC governs. Despite testing and design modification, the machine is a good per the bonebreak test. Also, no installation or ongoing machine servicing was provided.

Enforceability

Offer/Acceptance—Yes. There was an objective manifestation of mutual assent. The conduct by both parties was sufficient to show agreement (§2-204)).

Consideration—Yes. Herring promised to pay $450,000 in return for BMI's promise to give supply Herring with the machine.

Promissory Estoppel—Yes. Herring had a reasonable reliance on the promise that he was receiving a machine compliant with Icelandic Law.

Content

Parol Evidence Rule—The contract's language attempts to limit enforceability solely to the contract's "four corners."

Herring should try to admit two items that exist outside the contract as evidence of intent: (1) telling BMI that he would only be interested in buying the capsule line if it could produce capsules according to the specifications required by the Icelandic purity law; and (2) Herring giving

BMI the written post-it, which contained the URL for the purity law, and BMI affirmatively responding "this shouldn't be a problem."

To admit this evidence, Herring must argue that the contract was partially integrated to allow addition of prior intent. Then, he must argue that the aforementioned evidence will not contradict the contract. Rather, it will assist to interpret and establish meaning as a supplement, utilizing §213 (3). Furthermore, Herring should argue that the machines ability to manufacture capsules compliant with the Icelandic law was a condition precedent.

BMI should respond that under the parol evidence rule, the integration is complete and not subject to change. If that fails, he must argue that the evidence will contradict the contract, rather than supplement it. If the evidence is deemed contradictory, §213(2) will apply and the existing contract is enforceable.

<u>Express Warranty</u>—Express warranties do not have to be verbal or use words like "guarantee" or "warranty." However, BMI's statement that conforming to the URL is an affirmation on the machine and represents his opinion. Furthermore, BMI made no representation that the capsules produced by the machine would be Icelandic law-compliant. Accordingly, there is no express warranty.

<u>Implied Warranty: Merchantability</u>—The machine creates capsules that probably are sellable in United States markets; it would pass without objection in the marketplace. Accordingly, Herring has no claim.

<u>Implied Warranty: Fitness for Particular Purpose</u>— Herring has a strong claim with §2-315. Herring relied on BMI's skill and judgment to produce a machine for the particular purpose of being compliant with Icelandic law. In addition, BMI was aware of this reliance and Herring's intent to manufacture capsules compliant with the Icelandic law. Accordingly, the law is extremely favorable to Herring on this issue.

BMI should "frame" their counterargument by downplaying the substance of the aforementioned communication, challenging Herring's memory, or claiming the URL was incorrect on the post-it.

<u>Misunderstanding</u>—BMI, possessing superior and constructive knowledge, had the responsibility to clear up any alleged misunderstanding. (§20)

Breach—BMI will argue no breach occurred because they performed per the written contract. However, Herring is in advantageous legal position because of the aforementioned implied warranty of fitness for particular purpose. Consequently, breach occurred when the machine failed to manufacture capsules compliant with Icelandic law.

Remedies

<u>Liquidation Damages</u>—Liquidation damages is not applicable if the contract did not specify a predetermined damage amount if BMI failed to perform.

<u>Expectation Interest</u>—For Herring, the EI will be the most lucrative. It includes: (1) the monetary difference between a machine that can produce capsules compliant with Icelandic law and $450,000 (2-714(2)); (2) the incidental damages of the expense of finding an acceptable machine and the cost of hiring truckers to haul the machine from BMI to Herring's plant (2-715(1)); and (3) the consequential damages of lost profits from their commercial relationship with Iceland (2-715(2)) and the labor costs incurred and lost productivity because plant employees cannot perform their duties with a deficient machine.

Two issues make recovery of lost profits problematic. First, Herring must demonstrate that the lost profits were foreseeable to BMI (*Hadley* switch). Second, Herring must show that the lost profit claims are not too speculative or uncertain. The machine was for a new business venture. Herring had no experience as a manufacturer.

However, two facts work in his favor. First, Herring's business is established with a verifiable record . Second, Herring has an ongoing

relationship with Icelandic retailers resulting in an annual net profit of $300,000.

Herring is not entitled to recover the $30,000 for the testing phase because it occurred before the time of contracting.

Reliance Interest—The RI is the costs Herring incurred while relying that the machine would perform compliant with Icelandic law and includes: (1) the cost of hiring and training employees to execute manufacturing and operate the new equipment; (2) the cost of hiring truckers to haul the machine from BMI to Herring's plant; and (3) $125,000 for the concrete slab and new metal building constructed in preparation of the machine's arrival.

Restitution—Under 2-711(1), Herring can recover the price paid for the machine ($450,000).

Specific Performance—This remedy is rare and inappropriate because an acceptable substitute machine provided by BMI would not be extraordinarily unique.

Defenses

Statute of Limitations—The SoL probably began to toll in February 2010 when the breach was discovered. Depending on Newstate's jurisdictional

law regarding the SoL, Herring must file a claim within the correct time frame. Otherwise, BMI will have a solid defense under the SoL.

<u>Mitigation</u>—BMI may claim that Herring has not attempted to use the machine to make capsules in other markets. Such substitute action could mitigate the damage Herring suffered.

Part 4.

Student Sample Answer #1

4.**<u>BP/ Local Fisherman</u>**

Enforceability

<u>Offer/Acceptance</u>—Yes. An objective manifestation of mutual assent was demonstrated when the fishermen signed the release prepared by BP.

<u>Consideration</u>—Yes. BP promised to pay the fishermen for labor. The fishermen promise to provide labor and adhere to the terms of the release.

<u>Promissory Estoppel</u>—Maybe. BP meets the reliance requirement because it is frantically attempting to avoid financial disaster. However, the fishermen can argue that one cannot reasonably rely on desperate people signing away their legal rights.

Content

Form Contracts— BP's releases were probably form contracts. Accordingly, two issues may render the contracts unenforceable. First, the release language "…all claims and damages arising in any way from or resulting from the oil spill…" is extremely vague. When a contract is too general, its enforceability is undermined.

Second, many of the fisherman who signed the contract were not proficient in English. The releases were probably written in English. If so, enforceability is further weakened.

Defenses

Statute of Frauds—Fisherman cannot make a SoF defense because there is a writing.

Duress—The fishermen have a strong legal defense with duress. A court likely will consider the financial desperation of the fishermen and rule that demanding forfeiture of legal rights in exchange for work constituted duress. The fishermen should argue that ruining a person's livelihood and then offering them money if they sign a piece of paper is analogous to metaphorical "holding a gun to her head."

BP probably will argue that duress is not applicable because it did not to anything illegal. To resolve this issue, one must utilize the common law instead of the UCC because labor is a service rather than a good. In *Mitchell,* the court held that although the duress was short of threatening illegal action, it was sufficiently coercive to establish a duress defense.

Undue Influence—This defense is possible if a potential employer meets the requisite relationship required.

Unconscionability—§2-302 is not applicable because the release was contained in a service contract. In common law, courts have roaming authority to find unconscionability. The fisherman should stress the unequal bargaining power in relation to BP, and that surrendering the litigation rights that could result in tremendous wealth was inherently unfair. BP should contend there was adequate consideration and that the fishermen had the option of refusing the offer.

In addition, each side faces a non-doctrinal problem. For the fisherman, unconscionability defenses are rarely successful. On the other hand, BP is facing a public relations catastrophe regarding the releases and the spill. If litigated, the judge and jury may be very unsympathetic to BP.

Capacity— Illiteracy is not included in capacity and is not a valid defense for the fishermen who could barely read or write.