CONTRACTS: LAW IN ACTION

SECOND EDITION

Volume II
The Advanced Course

Stewart Macaulay John Kidwell William Whitford



Contracts: Law in Action

Second Edition

Volume II The Advanced Course

Stewart Macaulay

Malcolm Pitman Sharp Professor and Theodore W. Brazeau Professor University of Wisconsin Law School

John Kidwell

Kathleen M. & George I. Haight Professor and Associate Dean for Academic Affairs University of Wisconsin Law School

William Whitford

Professor Emeritus University of Wisconsin Law School



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Editorial Offices
744 Broad Street, Newark, NJ 07102 (973) 820-2000
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
701 East Water Street, Charlottesville, VA 22902-7587 (804) 972-7600
www.lexis.com

PREFACE TO THE SECOND EDITION

We revised our book for a number of reasons. Most importantly, our original book and this revision reject the idea that contract law is no more than a small collection of timeless principles. Contracts problems change as the society changes. Corporate lawyers also have been busy, seeking ways to use the form of contract to ward off liability to employees and consumers. Fashions in scholarly work reflect changes in the academy as we move through cycles of classical contract, realist judging in the grand style, dedication to the consumer movement, reductionist pursuits of efficiency, default rules and formalism, and, perhaps, the coming new realism that reflects a law and society perspective. We have reviewed the entire book to see where we should reflect these changes and new developments, but the major effort has been devoted to bringing up to date our materials on such matters as unconscionability, form contracts printed in fine print or hidden in other ways (particularly in the area of computer programs), and the growing uses of arbitration to repeal the reform statutes of earlier decades. These are the interesting and important matters coming before the courts when this revision was prepared, and we expect these topics to have a fairly long shelf life.

At the same time, those who have used Contracts: Law in Action in the past will find much of the book unchanged or only slightly modified. After teaching Contracts: Law in Action and earlier photocopied versions for about twenty years. the authors think that the book works. Moreover, it has worked for instructors who emphasize very different approaches in their teaching. The original book and the revision both take the "Law in Action" part of the title seriously. Putting contract problems in context makes the course both more theoretical and more practical at the same time. Whatever one's theoretical outlook, there is a high price to be paid if he or she forgets such things as that law is not free, most disputes end in settlement, crafting nice sounding legal standards is one thing but finding evidence to establish a cause of action is another, and all institutions, including the market, are flawed. American contract law is messy and often contradictory. Even when the form of the rules stay more or less the same, their application varies from court to court over time. Yet our contract law's flaws have not blocked great economic progress or caused recessions. We quote Wittgenstein near the beginning of the course: "Is it even always an advantage to replace an indistinct picture by a sharp one? Isn't the indistinct one often exactly what we need?" At the very least, the answer to this question cannot just be assumed away. We also have been pleased to discover that many of our former students find that our course prepares them to hit the ground running when they begin practice. We have tried to focus on live contracts problems that our students will face when they become lawyers.

We are heavily in debt to contracts teachers at schools other than Wisconsin who have used *CLA*. We have had an e-mail list for those interested in the book. Our friends at other schools have contributed ideas and suggestions, and they have asked us to explain why we did certain things. Sometimes we have been

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able to explain choices we made long ago, and when we could not we rethought what we had done. We have learned a great deal from these friends. While we risk leaving out people who deserve mention, we wish to thank particularly Tom Russell, Tom Stipanowich, Sandy Meiklejohn, Alan Hunt, Jean Braucher, Peter Linzer and Carolyn Brown. In addition, we staged a conference in the fall of 2001. We gathered many who had used the book and other friends whose contributions we wanted to hear. The papers were later published in 2001 Wisconsin Law Review 525-1006. The papers, discussions and final articles helped us in the revision process.

The authors are not the only people at Wisconsin who have taught from the book. We have a small group program in which each first year student gets one class of around twenty students, and Contracts 1 often has been that class. This means that we have many contracts teachers at Wisconsin. Those teaching the course have met for lunch once a week during the semester. The authors have been challenged by the experiences and questions of their colleagues. In addition to Joe Thome who was thanked in our original preface and who continued to teach from the materials until recently, we should acknowledge the many contributions of Kathryn Hendley, Lawrence Bugge, Gordon Smith and Lori Ringhand (now at the University of Kentucky Law School). Lori was a beginning law teacher when she joined us, and she helped us re-write the employment-atwill material and paid particular attention to the teaching notes that we have made available to those who used the book. She has revised them, pulling together the one set created by Kidwell and the other by Macaulay. Our colleague Marc Galanter decided not to participate in the second edition of Contracts: Law in Action. He has not taught contracts for some time. However, he did present a paper at our 2001 contracts conference, and the revision still reflects his many contributions to the original version of the book. Also, Nicole Denow (J.D., Wisconsin, 2001) was a talented and hard working research assistant in the revision of the materials dealing with policing contracts, and Nora Kersten (J.D., Wisconsin, 2002) did many memos which were helpful in expanding some of the notes, or in verifying that no changes were required.

We also owe a debt to the thousands of law students who have worked their way through *Contracts: Law in Action* and its photocopied predecessors. For example, Donovan Bezer, then a student at Rutgers Law School, sent us his reactions that we found provocative. Other students have known one or more of the parties who appear in the cases in the book or they have known much about the kinds of transactions involved. We have been reassured that the book has prompted students to see the hard choices lurking behind what seem to be the simple rules of contract law. Americans, of course, always want to have their cake and eat it too. One student, who identified herself as a liberal, sent us an email, saying, "this class has put me in touch with my inner Republican, and I am not sure that I like *him.*" Students have also reminded us that most of them are twenty something, and what we see as things "everyone knows" are but ancient history to them. Students stay about the same age while authors age. Thus, we have tried to change examples so that they will not date too fast and explain a

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little about such "commonplace things" as the Vietnam conflict, OPEC and the consumer movement and other manifestations of Pre-Reagan politics as well as what were ice houses, dial telephones and typewriters. While we find it hard to believe, many of our students have never heard of Shirley MacLaine, Lee Marvin or Bette Davis. We, on the other hand, are not great followers of River Phoenix. All of these stars, of course, play the parts of litigants in contracts cases.

During the past decade or so, the National Conference of Commissioners on Uniform State Law and the American Law Institute has attempted to revise Article 2 of the Uniform Commercial Code. We debated what to do with the proposed revisions. Then our friend Dick Speidel found the process intolerable and felt that he had to resign as the Reporter after twelve years of work. At the time this is being written, it seems unlikely that there will be ambitious changes to Article 2, with the possible exception of the addition of a highly controversial separate statute dealing with computer-related transactions. There is a risk that states may end up moving in the direction of creating "Ununiform Commercial Codes." As a result, we decided not to include material on the proposed revisions. Instructors, of course, may want to offer their classes particular proposals as a way to raise policy questions about the current law. However, we think that it is hard enough finding your way around Article 2 without having to navigate two or more versions.

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Chapter 1

FORMATION OF CONTRACT

The major focus of the following chapters is performing contracts. We consider questions such as the effect of a seller's only slightly defective performance. Must the buyer accept it with, perhaps, an offset for its flaws? Or does close count only in horseshoes and hand grenades? Suppose a seller tenders defective goods. Can it have a second chance and cure its performance or does the buyer have a right to call off the deal? Should courts consider whether the buyer really was hurt by the defective tender or whether it wants out only because it can get the goods cheaper? Suppose a seller is almost certain that buyer will not be able to pay for the goods when the day for performance comes. Must seller continue performance or can seller stop unless buyer can offer assurances that it will pay when the time comes?

However, we cannot begin the course with these questions. We need to establish familiarity with two opposed models of the contracting process; judicial answers to questions of performance often reflect assumptions about how deals are made. The first model sees the parties' contract as a blueprint for performance. It is assumed that buyers and sellers do or should attempt to fashion an agreement in which they specify obligations very precisely and allocate all the risks of possible contingencies. Contract drafters bring the future back to the present. Since we cannot know the future in advance, the drafter deals with the possibility of a war, a depression, a strike and so on. Ideally, if something goes wrong as parties perform a contract, all the parties, lawyers, and judges need do is read a written document and discover what is to happen in this event.

The second model acknowledges that many contracts reflect long term continuing relationships with a rich history that take place in a business and social context. Instead of a magic moment when everything is defined, the contours of the parties' bargain emerge as they perform it through time. While they may have agreed to terms at the outset, everything is always subject to formal or tacit renegotiation. Moreover, those accepting this second model of bargaining processes understand that a written document signed by the parties is not necessarily their bargain-in-fact. For example, the contract may be drafted by elite lawyers at the home office, but the actual agreement is negotiated and performed by people in the field. In this world, we should be surprised when there is no gap between the real deal and the paper deal.¹

Those who feel more comfortable with the first image of bargaining are likely to solve questions concerning performance by looking to what the parties agreed at the point they made their deal. They will be uneasy when the parties left too much unprovided for. Those who are more comfortable with relational contracts will view written documents signed by the parties as but one factor to consider in

¹ Some might opt for a third model, in which it is acknowledged that people don't really thoroughly embody their intentions in advance of an exchange, but which nevertheless endorses the appealing fiction that they do, in order to increase predictability and social order.

solving problems. They will seek fair results in light of the way things turned out, with risk assumption being just one factor among many which are relevant to what is fair.

Because questions of performance often turn on whether the parties made a deal and what its terms were, we must begin with some of the classic dilemmas concerning how courts know whether the parties closed a deal and how they discover what the bargain means. People often communicate in a sloppy fashion. They sign documents that say things they don't mean. While every bargain rests on what the parties assume about the world, at times buyer and seller assume very different things, or things that turn out to be wrong. Courts must respond to all these situations.

Thus, we begin with questions that law teachers often call issues involving formation and interpretation of contracts. Then we consider performance questions. As we do, we discover that formation and interpretation issues influence the solutions. Finally, we return to unpleasant surprises in a different context. One party discovers she has made a very bad deal and seeks relief, arguing that she shouldn't be required to absorb the losses associated with what has happened.

We begin this part of the materials by considering how the American legal system legitimates holding people bound to what judges, lawyers, and scholars call contracts. Why do we care? The reasons judges accept as common sense may influence how they decide cases. Judges and lawyers form a community with a common language. Judges want to explain their decisions so that lawyers will understand and accept them. Sometimes other audiences may respond to a judge's explanations. For example, newspapers and television may attack a decision. Judges are like the rest of us; they do not like to appear foolish or stupid before any audience.

The relationship between law and legitimacy is unclear. Law contributes something to our view that we live in a just, decent, or tolerable society. Americans tend to regard their legal system as at least acceptable, particularly when they compare it with those found in totalitarian states. It is less clear that Americans honor the results in particular cases. Nonetheless, the legal system itself may have enough prestige so that any norms applied by legal officials seem just. In part, this claim rests on our assumption that the legal system is autonomous enough from other centers of power so that it can apply its procedures, make decisions, and enforce them impartially. Both the King and the Chase Manhattan Bank are under the law. Moreover, legal officials are selected in ways Americans find acceptable. They are experts, selected by Presidents or governors in recognition of their skill or, alternatively, elected and seen as expressing the will of the people. This view suggests that politics should play no role in judicial selection.

Finally, some see particular norms as the law because they naturally flow from legal science, reflect common sense, and are dictated by wise policy choices. We should not, under this view, question the result in a particular case. Experts, far removed from power and politics, have decided. Their decisions reflect legitimate rules.

You probably noticed a few problems with this account. Many, if not most, Americans do not believe that the legal system is autonomous and free from the

influence of those who hold power in society. On one hand, some think that legal officials use their power to favor the wealthy and influential. On the other hand, some think those with wealth can play the legal game better even if the rules are applied evenly and fairly by officials. Then, too, some think that a judge is a lawyer who knew the governor. Some see nothing wrong with assigning "seats" to assure that a Catholic, a Jew, a Black and a Woman will sit on the highest courts. It is a way of symbolizing that a particular group is both worthy and powerful.

Many challenge the idea that law reflects common sense. Any book which collects quotations will offer the classics. For example, "'[i]f the law supposes that,' said Mr. Bumble, 'the law is an ass, a[n] idiot." (Dickens, *Oliver Twist*, ch. 51); "In a thousand pounds of law there is not an ounce of love." (John Ray, English Proverbs); "The law is a sort of hocus-pocus science, that smiles in yer face while it picks yer pocket; the glorious uncertainty of it is of main use to the professors than the justice of it." (Charles Macklin, *Love a la Mode*, Act ii, scene 1 (1759)); "Laws are spiders' webs, which stand firm when any light and yielding object falls upon them, while a larger thing breaks through them and escapes." (Solon).

We face a major problem in specifying the link between a claim to legitimacy and the attitude of a particular audience. Most people, after all, know very little about particular laws or the legal system. We can wonder whether those who lose when they come before the courts are impressed by the majesty of the law. Few convicted murderers, for example, comment favorably on the skill with which the judge instructed the jury. Indeed, perhaps the major audience for the law's claims to legitimacy are lawyers. Whatever the impact of law on our views about legitimacy, do these attitudes affect our behavior? Do people obey or disobey law because they think it just or unjust?

Having said all this, we can observe that lawyers and judges do make legitimacy claims. Much of the business of law school consists of studying this rhetoric. Although the legitimacy claim often is assumed, law professors, lawyers and judges exert great effort to show that a rule or procedure reflects some version of the good, the true, and the beautiful. The problem comes when we recognize that each side usually can claim plausibly that a decision in its favor will carry out an important value. If this is true, how do we persuade judges and legislators? How do we predict what they will do? If both sides had equally able lawyers, would all cases end in ties?

In the pages that follow we will first look at explanations offered for holding or refusing to hold people to obligations which might be called contracts. We will try to select problems important to modern business. We will also set the stage for the remaining materials which raise problems of performing contracts. We will see that the two questions are closely related. Whether or not I have performed my promise often turns on what, if anything, the courts will say that I promised to do.