

### ESSAY QUESTION NO. 3

#### Answer this question in booklet No. 3

Pat owns a small T-shirt manufacturing business. In the past six months, consumer demand for Pat's shirts has steadily increased. Pat has kept careful track of her monthly revenue and is reasonably certain that her sales will double in the next six months. To accommodate this future demand, Pat needs to expand her operations into larger facilities.

Pat met with Dennis to discuss finding suitable new rental space for her company. Dennis recently had foot surgery, and was under the influence of pain medication when he met with Pat. During their meeting, Pat explained to Dennis that she was "hoping" to find space that would meet certain criteria: the space had to encompass "approximately" 4,000 square feet; and the space had to have an open floor plan to ensure efficient manufacturing and to accommodate some large equipment.

Pat told Dennis, "If you agree to find me space that I can use, I will pay you \$5,000. Also, you must agree to find me the new space within 30 days, or else I'm going to lose a lot of money. If you fail to do so, you will have to pay me \$50 as liquidated damages for every day thereafter as an incentive until you find a suitable location for me." As Pat was speaking, Dennis was simultaneously having a conversation on his cell phone, but he looked at Pat and responded, "I'll do my best."

Dennis re-injured his foot soon after his meeting with Pat, and was unable to look for a space for Pat until the 25<sup>th</sup> day after their meeting. On the 35<sup>th</sup> day, Dennis found a location and showed it to Pat. According to the floor plan, the space consisted of three rooms totaling 3,900 square feet. Pat believed that the space did not meet her criteria. However, since she was in desperate need of space, she decided to rent it anyway. When Dennis asked for his \$5,000 fee, Pat refused to pay him.

1. Explain whether the requirements for valid contract formation were met, and discuss the arguments for and against finding an enforceable contract between Pat and Dennis.
2. Assuming Pat and Dennis entered into a valid contract, explain whether Dennis breached the contract. If Dennis breached, what defenses may he raise? Explain.
3. Assuming Dennis breached, explain whether Pat may legally enforce the \$50 dollar per day liquidated damages provision.



## GRADER'S GUIDE

### \*\*\* QUESTION NO. 3 \*\*\*

#### **SUBJECT: CONTRACTS**

1. Contract Formation (55 points)

The following requirements are necessary to form a valid contract: (1) an offer including all essential terms; (2) an unequivocal acceptance of those terms by the offeree; (3) consideration; and (4) intent to be bound by the contract. See Young v. Hobbs, 916 P.2d 485, 488 (Alaska 1996). See also Ford v. Ford, 68 P.3d 1258 (Alaska 2003).

A. Offer/Essential Terms

An “offer” is an expression by one party of an assent to certain terms. See Government Employees Ins. Co. v. Graham-Gonzalez, 107 P.3d 279, 283 (Alaska 2005). Restatement (Second) of Contracts § 24 (1981) defines offer as “the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.”

Here, Pat tells Dennis that she will pay him \$5,000 if he agrees to find her new rental space that she can use. In her discussion with Dennis, she also describes certain criteria for the space she is looking for and a timeframe for his performance.

The facts are unclear concerning what the space requirements Dennis is tasked with finding for Pat. While Pat stated two criteria to Dennis that she hoped the space would meet, she arguably did not make these criteria strict requirements of the space Dennis was to find for her. Thus, these criteria could simply be interpreted as “wish list” items. Put another way, Pat did not expressly tell Dennis that the space must meet these criteria. Furthermore, she only requested that Dennis find her a space that “she could use.” If Pat were able to use a space that did not satisfy these criteria, then Dennis would have met the terms of her offer without finding a space that satisfied these criteria. This issue is not only relevant to determining whether a breach occurred (discussed in Question #2), but also to whether the terms of Pat’s offer are reasonably certain to constitute a valid offer.

An agreement is unenforceable if its terms are not reasonably certain. See Davis v. Dykman, 938 P.2d 1002, 1006 (Alaska 1997); Hall v. Add-Ventures, Ltd., 695 P.2d 1081 (Alaska 1985); Restatement (Second) of Contracts § 33 (1981). Based on Pat’s verbal offer, it is possible that a court might find the terms of the offer insufficiently clear to constitute a valid offer - not only

because it is unclear whether Pat's offer requires Dennis to find space that meets the criteria or just "useable" space, but also because the two criteria as expressed by Pat leave room for interpretation as to what exactly has been requested. (See Question #2).

#### B. Unequivocal Acceptance

In order for a contract to be formed, acceptance of an offer must be unequivocal and in exact compliance with the terms of the offer. See Thrift Shop, Inc. v. Alaska Mut. Sav. Bank, 398 P.2d 657, 657 (Alaska 1965). "Acceptance of an offer is a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer." Restatement (Second) of Contracts (1981) § 50.

In response to Pat's offer, Dennis simply tells her that he will do his best. Arguably, this response does not constitute unequivocal acceptance because Dennis does not affirmatively accept Pat's offer. Instead, Dennis merely states that he will use his best efforts. Implied in Dennis's response, however, is an agreement to undertake finding space for Pat in the first instance. Thus, it is likely that Dennis would be found to have accepted Pat's offer, at least to the extent of finding her new rental space.

#### C. Consideration

Dennis's agreement to find Pat suitable rental space in exchange for \$5,000 constitutes valid consideration for their agreement. See Restatement (Second) of Contracts § 71 (1981) (to constitute valid consideration, a return promise must be sought by the promisor in exchange for his promise and given by the promisee in exchange for that promise). See also Black's Law Dictionary 245 (7th ed. 2000) (consideration is defined as something of value -- such as an act, a forbearance, or a return promise -- received by a promisor from a promisee.)

#### D. Intent to be Bound

To be a valid contract, the parties must objectively manifest an intent to be bound. See Brady v. State, 965 P.2d 1, 8 (Alaska 1998); Zeman v. Lufthansa German Airlines, 699 P.2d 1274, 1281 (Alaska 1985). Mutual assent can be found in the objective meaning of a word's use. Id. A party cannot rely on his subjective intent to defeat the existence of a contract if his words and actions objectively and reasonably led another to believe a contract had been entered. Id.

Here, both Pat's and Dennis's actions demonstrate the requisite intent to form a contract. Pat made an offer, and Dennis, although not explicit in his response, still objectively manifested his intent to be bound by agreeing to do his best. There is an argument, however, that even objectively Dennis may not

have manifested an intent to be bound based on the fact that he was obviously having another conversation on his cell phone when he stated he would try his best. So, it could be argued that his statement might relate to his other conversation. The facts indicate that he was looking at Pat when he responded, however, and so the better objective view is that he was speaking to Pat and not to the person at the other end of the telephone. Accordingly, the parties likely objectively manifested an intent to be bound.

#### E. Arguments for No Contract

##### (1) Dennis's Lack of Capacity (Drugs and Pain)

The facts indicate that Dennis was under the influence of pain medication when he spoke with Pat. Thus, there is an argument that Dennis was incapacitated and mentally incapable of entering into a contract. Consequently, he would not have the requisite capacity to be bound. See Sykes v. Melba Creek Mining, Inc., 952 P.2d 1164, 1167 (Alaska 1998); Restatement (Second) of Contracts § 12 (comments a and c) (1981). However, if the pain medication was of the sort that did not affect Dennis's mental capacity (i.e., a non-narcotic like aspirin or ibuprofen), or the dosage was suitably small, then the medication would likely not have affected his capacity to enter into the agreement. Further, although the facts are silent, it is also possible that Dennis's pain could affect his capacity for decision-making. Dennis's incapacity, if any, would in part determine whether the contract was voidable by Dennis or that no contract was in fact formed. See Restatement (Second) of Contracts §§ 7, 12 (comments a and c) (1981).

##### (2) Pat's Offer Requiring Space "She Can Use" Is Indefinite

As stated above, there are two ways to interpret Pat's offer. The first is that Dennis must find a space that meets Pat's two criteria. The second is that he must simply find a space that Pat can use. If the latter, the fact that Pat may use her sole judgment to decide whether she can use the space does not make the agreement unenforceable. See Restatement (Second) of Contracts § 34 (1981) ("[T]he terms of a contract may be reasonably certain even though it empowers one or both parties to make a selection of terms in the course of performance"). Pat is furthermore required to accept performance in good faith. See id., comment b (any discretionary power granted by a commercial contract must be exercised in good faith and in accordance with fair dealing). Accordingly, if Dennis is only required to find Pat space that she can use, then this offer is still definite enough to constitute a valid offer.

##### (3) Statute of Frauds

Alaska Statute 09.25.010, Statute of Frauds, states that an agreement employing an agent or broker to sell or purchase real estate for a commission

must be in writing and subscribed by the party charged in order to be enforceable. See A.S. 09.25.010(a)(8). Here, Pat has hired Dennis to locate rental space. The statute of frauds therefore does not apply.

F. Argument for Contract -- Parties' Actions Evince a Contract Was Made (Implied Contract)

A contract may be implied through the actions of the parties. See Anderson v. Tuboscope Vetco, Inc., 9 P.3d 1013, 1018 (Alaska 2000). Even if the formal requirements of contract formation were not met, Pat's and Dennis's subsequent actions certainly evince the existence of an agreement between them. Accordingly, a court would likely find an implied contract existed, regardless of any infirmities in its oral formation.

2. Whether Dennis Breached the Contract (30 points)

Dennis may be found to have breached the contract in a few ways. First, Pat expressly asked that Dennis locate her space within 30 days (and, as a penalty for failing to do so, \$50 would be deducted from his fee for each day beyond that point). Since Dennis located the space on Day 35, he breached this term. However, Dennis might argue that his breach was excused based on his medical condition which rendered him incapable of performance during the first 25 days of the contract. See Restatement (Second) of Contracts § 261 (1981) (where a party's performance is made impracticable without his fault by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged); see also Restatement (Second) of Contracts § 262 (1981), comment a (incapacity discharges the obligor's duty to render performance). While Dennis's injury may have left him unable to search for a space for Pat in the first 25 days, he did have 5 days in which to locate a space. Accordingly, it may not have been truly impracticable for Dennis to satisfy the timeframe in the contract. Also, if Dennis was responsible for his re-injury, his performance would likely not be excused for impracticability since he would be the cause of his own inability to perform.

While the facts indicate that Dennis's re-injury prevented him from looking for space, Pat could argue that Dennis's injured foot did not prevent him from searching for space via telephone. Thus, while certainly a major inconvenience, Dennis's medical condition may not have made it truly impracticable for him to meet his obligations.

Whether Dennis breached the contract also depends on the precise nature of the space Dennis was obligated to find. As discussed above, Pat's offer could be construed to mean that Dennis must find a space that satisfied both criteria. Alternatively, Pat expressly requested only that Dennis find a "space that I can use." Thus, there is ambiguity with regard to Dennis's obligations.

A. Offer: Space that Pat Can Use

Assuming Pat's request was for Dennis to find her a space that she could use, then Dennis arguably satisfied his end of the bargain (albeit late as discussed above), because Pat did elect to use the space. While Pat agreed to enter into a lease only because she was in dire need of space, the fact remains that she was able to use the new space for her business as evidenced by her agreeing to rent the space. Thus, Dennis arguably satisfied his obligation to find useable space for Pat, and did not breach this provision.

B. Offer: Meeting Both Criteria

If Pat's offer required Dennis to satisfy both criteria, then it is possible Dennis breached these requirements.

(1) Approximately 4,000 square feet

Pat desired a space that is "approximately" 4,000 square feet. The space located by Dennis contains 3,900 square feet. The facts do not indicate whether Dennis had any reason to know how close to 4,000 square feet he needed to be in order to satisfy this requirement. Because Pat did not specify a square footage value that could be objectively met, a trier-of-fact could find that a space within 100 square feet of 4,000, i.e. within 2.5 percent, is close enough to constitute it being approximate, and thereby satisfying Pat's condition. If so, Dennis did not breach.

(2) Open floor plan

Pat also desired a space that had an "open floor plan" to ensure an efficient manufacturing process and to accommodate large equipment. The facts indicate that the space found by Dennis had three rooms which totaled 3,900 square feet. It is unclear whether this layout constitutes an open floor plan as Pat requested. If Dennis had reason to know that certain equipment or the manufacturing process would not fit into the three-room space, then he would likely be found to have breached this provision since Pat made clear this was the purpose for her requesting an open floor plan. However, if Dennis had no knowledge or reason to know of these space requirements, then a trier-of-fact could find a space containing only three rooms -- each room thus averaging 1,300 square feet -- constitutes an open floor space. If so, Dennis did not breach this requirement.

C. Other Defenses:

(1) Waiver: Waiver is the intentional relinquishment of a known right. See National Bank of Alaska v. J.B.L. & K. of Alaska, Inc., 546 P.2d 579,

587 (Alaska 1976). Absent knowledge of its right or claim, a party cannot be said to have waived it. See id. Here, Dennis can argue that by renting the location, Pat accepted the condition of the space, and accordingly waived any right to claim Dennis breached their agreement.

(2) **Materiality:** An examinee may also discuss the materiality of Dennis's breaches. A material breach is one that will or may result in the other party not receiving substantially what that party bargained for. See Machado v. State, 797 P.2d 677, 683 (Alaska App. 1990) (citing J. Murray on Contracts § 167, at 323 (1974)); see also Restatement (Second) of Contracts §§ 241-42 (1981). If Dennis's breaches are not material, then a court would likely find that Dennis upheld his end of the bargain sufficient to require Pat to perform, i.e. pay Dennis's fee, less any damages caused by his breach. See Restatement (Second) of Contracts § 241 (comment a). If Dennis's breaches are considered material, then Pat's obligations may be discharged entirely. See Restatement (Second) of Contracts § 237; Wirum & Cash, Architects v. Cash, 837 P.2d 692, 707 (Alaska 1992).

### 3. Enforcement of Liquidated Damages Provision (15 points)

Parties are generally free to stipulate in advance an amount to be paid as compensation for damages that result from a breach of contract. See Carr-Gottstein Properties, Ltd. Partnership v. Benedict, 72 P.3d 308, 311 (Alaska 2003). The stipulated amount, however, which is also called liquidated damages, must attempt to compensate the non-breaching party for the breach, and may not serve as a penalty to punish the breaching party. Id. at 312. Alaska employs a two-pronged test in deciding the validity of a liquidated damages provision. First, such a provision is proper only where it would otherwise be difficult to ascertain actual damages. Id. Second, the amount must be a "reasonable forecast of the damages likely to occur in the event of breach." Id.

Here, Pat states that she is using the liquidated damages provision, which deducts \$50 per day from Dennis's fee after 30 days, as an "incentive" to help insure Dennis finds a space quickly. The fact that Pat calls this deduction an "incentive" is a red flag, and strongly suggests that the provision is, in fact, more akin to a penalty clause that punishes Dennis in the event he breaches.

In addition, the facts indicate that Pat has been keeping careful track of her company's profits and has forecast a doubling of her sales in the next six months. Thus, it would seem reasonable that Pat could closely approximate her damages if her expansion plans were delayed. It is unclear based on the information provided whether the \$50 per day liquidated damages amount is a reasonable approximation of her damages.

Accordingly, it is likely that Pat's "liquidated damages" provision will be held unenforceable because Pat has essentially admitted that it is a penalty. Further, even were it intended to be a true liquidated damages provision, because Pat could likely estimate her damages, it would be held unenforceable on this basis as well.

Because it could be construed simply as an incentive clause, a court may find this is not a liquidated damages provision at all. However, Pat's statement to Dennis indicates the \$50 per day amount is to cover her damages in the event Dennis breaches his obligation to find her a space within the time allotted. Furthermore, the call of the question requires the examinee to assume this term is a liquidated damages provision.