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ESSAY QUESTION FROM 5/96 CONTRACTS EXAM.

# QUESTION THREE

Bedford Gear Inc. ("Bedford") is a relatively small, family owned manufacturing concern with annual sales of approximately \$5 million. In late 1994, Bedford's founder and president, Bob Bedford ("Bob"), decided to investigate the use of computer technology to simplify the company's compliance with the federal tax laws. Bob wrote several producers of computer software and requested literature about their federal tax law programs. Three responded, including Solution Software Inc. ("SSI"), the producer of a software program known as "Tax Relief". SSI's catalogue listed a price of \$900 for Tax Relief. On November 10, 1994, after reviewing SSI's catalogue, Bob telephoned SSI's sales representative, Sarah Abraham ("Sarah"), to discuss some of the specific features of Tax Relief. Encouraged by Sarah's explanations, Bob ended the call stating, "You'll be hearing from us by the end of the week."

On November 11, 1994, Bob prepared and mailed a purchase order to SSI. The purchase order (i) identified Bedford as purchaser of one copy of Tax Relief at a price of \$900 and (ii) contained the notation, "Attention, Ms. Sarah Abraham." No other information was provided. Upon receipt of the purchase order 2 days later, SSI promptly shipped a copy of Tax Relief to Bedford. The shipping package to Bedford contained instructions for use of the program and a separate, printed slip of paper on which the following language appeared: "Thank you for your order. Our acknowledgement and billing statement will be shipped under separate cover." Upon receipt of the SSI package on November 16, 1994, Bedford immediately put Tax Relief to use in accordance with SSI's instructions (so as to track its financial data and simplify the preparation of Bedford's federal tax return for the coming 1995 tax year).

On November 19, 1994, SSI sent an acknowledgement and a separate billing statement to Bedford in a single mailing. The acknowledgement, which was prepared and signed by Sarah on SSI's printed form, referenced the Bedford purchase order, the one item purchased (Tax Relief) and the \$900 price. On the back of this printed form appeared, among other things, the following: "In no event shall SSI be liable for loss of profits or other economic loss, indirect, special, consequential, or similar damages arising out of any breach of the agreements or obligations under this contract." Bob received SSI's November 19 mailing in due course and, without reading the back of the acknowledgement form, arranged for prompt payment of the \$900 purchase price.

Bedford used Tax Relief throughout 1995 to track its financial data. In early 1996, Bedford used Tax Relief (and the instructions provided by SSI) to prepare the company's 1995 tax return. Because of a defect in the software, compounded by an error in the instructions, Bedford underpaid its 1995 federal income taxes by \$200,000. After interest and penalties of \$50,000 were assessed by the IRS (and after Bedford paid an attorney \$10,000 to persuade the IRS not to impose a lien on Bedford's property and file criminal charges), Bedford demanded \$60,000 from SSI. SSI regretted the incident and offered to refund the contract price of \$900.

Question: Is SSI liable to Bedford for \$60,000? Please answer this question under the Uniform Commercial Code ("UCC").

PROF. REGAN

SRING 1996

CONTRACTS EXAM

ANSWER Key FOR

RUESTIN THEOD

MAX PTS: 53 Highest Score: 34

QUESTION THREE

(Bedford's claim against SSI for consequential damages; UCC)

Key Issue: Is disclaimer in SSI's acknowledgement part of the contract and therefore effective to bar conseq./incid. damages?
[1 pt]

Preliminary Discussions -- BEFORE Purchase Order -- Not an Offer Offer (obj. test) is manifest. Willingness to enter into a bargain. [Rest. 24] [1 pt]

Events before Bedford sent P.O. not offer/accept:

-- Bed.'s inquiry to mitple sellers
-- SSI's sending catalogue (a solicitation)

-- Bob Bed.'s t/call to Sarah Ab. of SSI for info ending with you will be hear. from us [1-2 pts]

### Contract Formation

- Offer? Purchase Order on 11/11 was an offer. [1 pt]
- Acceptance? yes.
  - (a) 11/13 ship't by SSI: -- via 2-206(1)(b) and SSI's "prompt shipment" and
    - -- 2-206(2) notice of acceptance w/in reas. time, i.e., Bed.'s 11/16 receipt of ship't w/encl. slip re "thanks" & state't that SSI to send acknowledgement under "sep. cover". [1-2 pts]
  - (b) 11/19 SSI acknowledgement under 2-207(1): -- def. and seas. express. of acceptance -- operates as accept. despite addit'l terms -- no "unless" clause lang. by SSI so cannot be a c/offer [1-3 pts]
  - (c) confirmation?
    -- if K formed earlier [per (a) above] via 2-206,
    then acknowledgement is "confirmation" under
    2-207(1)
    -- no diff. however bec. no "unless" lang. in ack't,
    so SSI's addit'l terms must be disposed of
    under 2-207(2) anyway
    [1 pt]
  - (d) 2-207 policy: end rigidity of c/l mirror/im. rule and precise momentum for finding K in keep. w/ commercial realities [1 pt]

#### Contract Terms -- Warranties

- 1. Issue: Does K incl. implied warranties? Yes.
  - -- Neither P.O. nor Ackn't mentions warranties so UCC gap-fillers govern [1 pt]
  - -- UCC 2-314 creates implied W'y of Merchantability, unless affirm. excluded; included under 2-314(2)(c) are fit for ordinary purposes [1-2 pts]

APPLIED: Tax Relief product failed for ord. purpose, bec/ prod. failed to accurately aid Bed. re normal fed. inc. tax req'ts [1 pt]

-- UCC 2-315 creates impl W'y of fitness for Partic.

Purpose where (1) seller had reason to know of partic. purpose and (2) buyer relying on seller's skill etc.

[1-2 pts]

APPLIED: Facts a bit thin here, but 11/10 t/call to Sarah incl discussion of "specif. features" and "S's explanations" so possibly met here also re prod. failed Bed.'s partic. needs. [1 pt]

## Contract Terms -- SSI's Disclaimer of Conseq./Inc. Damages.

- Key Issue: Whether K incl. SSI's disclaimer is governed by 2-207(2) re disposition of addit'l terms stated in acceptance or written confirmation. [1 pt]
- Rule: 2-207(2) states that addit'l terms are construed as:
  - -- proposals for addition to K, but
    - between merchants, such proposals automatically become part of K unless
      - (a) offer expressly limits assent to offer's terms: or
      - (b) proposals materially alter K; or
      - (c) recipient of proposals gives notice of objection w/in reas. time [1-2 pts]

#### 3. 2-207(2) RULE (RE ADDIT'L TERMS) APPLIED:

- (a). Proposals not accepted by Bed. so disclaimer only poss. via "betw. merchants" sentence of 2-207(2) [1 pt]
- (b). Betw. Merchants? Yes. There is an argument to be made here [see 2-104(1),(3)] but for 1st yr. K class purposes we accept both as merchants via sophisticated businesses [1 pt]
- (c). Bed.'s P.O. did not limit acceptance to terms of Bed.'s offer so 2-207(2)(a) does not prevent disclaimer from becoming part of K. [1 pt]
- (d). <u>Bed. did not object to terms</u> so 2-207(2)(<u>c</u>) does not prevent disclaimer from becoming part of K. [1 pt]
- (e). <u>Material Alterations under 2-207(2)(b) ?</u> If material, then Bed. <u>not</u> bound by its silence. If <u>not</u> "material" then Bed. is bound by its silence and disclaimer is part of K.

#### -- MATERIALITY APPLICATION:

- \* Pevar said materiality usually a fact issue
  \* Pevar also said, however, that clauses
  limiting remedies, as here, generally are
  material (p. 364)
- \* Official Comment 4 to 2-207 gives illustrative support to finding of materiality here by stating that disclaimer of warranties "would normally" materially alter K; c/same here bec/ limit. on damages has virtually same effect as warranty disclaimer [\$900 recovery v. \$60k recovery]
- (f). <u>Conclusion:</u> Bed. wins this battle of the forms. Bec/ disclaimer = material alteration of K, disclaimer is <u>not</u> part of the K. The default rules on conseq./inc. damages govern.
- -- UCC 2-719(1),(3) permits parties to limit or exclude conseq./inc. dmges. but not done so here [1-2 pts]
- -- UCC 2-715(1),(2) explicitly make incid. & conseq. dmges. avail [1-2 pts]

#### Contract by Conduct Alternative -- 2-207(3)

- IF exchange of writings or prompt ship't did not ring k bell [not realistic on these facts], 2-207(3) is source of (1) K and (2) terms.
  - 2. Rule re 2-207(3):
    -- Need conduct of both parties suff. to establish K; and
    -- terms supplied by (1) terms on which writings agree
    and (ii) UCC supplemental terms for rest (gap-fillers)
  - Contract-by-Conduct Rule APPLIED:
- (a). Conduct sufficient? Yes. P.O., ship't and Ackn't, followed by use of goods and prompt pay't of p.price. [1 pt]
- (b). Terms:

  -- writings only agree on item, quantity (1)
  and price (\$900) but do not agree on critical disclaimer Q? so UCC
  gap-fillers apply

  [1 pt]
- -- gap-fillers (see above) permit inc. & conseq. dmges. via 2-715, there being no exclusion under 2-719
  [1 pt]

#### Does Bedford Satisfy 2-715?

- Rule on consequentials: 2-715(2) allows recovery of "any loss" resulting from seller's breach if:
  - -- loss results from general <u>or</u> partic. req'ts of buyer; and
  - -- seller has reason to know of needs; and
  - -- dmges. c/not reas. be prevented [1-2 pts]

### 2. RULE APPLIED:

(a). Loss does flow from general reg'ts of Bed. re ordinary use of product re fed. taxes. Ditto to extent characterize this as partic. reg'ts [1 pt]

#### (b). Seller reas. to know?

- (i) Gen.: Yes, bec. ord. use of product; dmges. of interest & penalties, & counsel fees re IRS woes plainly foreseeable w/ this product if defective. [1-2 pts]
  (ii) Partic.: Arguably yes via 11/10 t/call and P.O. stating attn. Ms. Abraham. [1 pt]
- (c). <u>Dmges. not reas. preventable?</u> How was Bed. to know until too late <u>BUT</u> perhaps Bed. accts. should have picked up on signif. increase in cash flow (\$200k) as red flag of poss. error etc. on taxes. [1-2 pts]

#### Incidental Damages?

- Rule: Available under 2-715(1) re "any other reas. expense incident to the ... breach." [1 pt]
- Applied: I see all \$60k as conseq. but could segment pieces under incid., e.g. atty fees, as incid. to breach.