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Contracts

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In any given twelve-month reporting period there is, for some reason, a case emphasis on particular problems in each major classification of the law. The field of contracts is no exception. For the period covered by this volume, two basic contract problems float to the surface in the pool of reported appellate decisions. They will be treated separately.

I. Additional Compensation: The Obligation to Pay "More Money".

The first problem discussed, and illustrated by a number of recent cases,[1] relates to the obligation to pay "more money"

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1. The cases are, and will be discussed in the following sequence: Healy v. Brewster, 23 Cal. Rptr. 917 (1962); Healy v. Brewster, 59 Cal.2d 455, 30

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for merchandise or services than that provided for in the original contract. There are various background situations which activate the demand for "more money," but the most common are unanticipated cost increases or fluctuating market prices.

The one industry that in recent years has repeatedly faced this problem, at least in the reported cases, is the construction industry. In a most interesting series of opinions, all dealing with the case of *Healy v. Brewster,*[2] the problem was dissected and examined in detail. These opinions are valuable, not only because of what they decide, but because they demonstrate the many different techniques of offense and defense that are available.

The operative facts of the *Healy* case, as gleaned from Justice Burke's opinion,[3] were as follows: Healy, as general contractor for construction of an air strip for the County of Los Angeles, entered into a subcontract with Brewster to remove soil from areas designated as borrow pits, and to compact it in place as the subsoil for the airstrip. The contract required the excavating, transporting and compacting of approximately 182,000 cubic yards of dirt. The county had supplied the general contractor with corings of subsurface conditions including the borrow pits. None of the legends

Cal. Rptr. 129, 380 P.2d 817 (1963); Healy v. Brewster, 251 Cal. App.2d 541, 59 Cal. Rptr. 752 (1967); Wunderlich v. State ex rel. Dept. of Pub. Works, 65 Cal.2d 777, 56 Cal. Rptr. 473, 423 P.2d 545 (1967); E. H. Morrill Co. v. State, 65 Cal.2d 787, 56 Cal. Rptr. 479, 423 P.2d 551 (1967); Souza & McCue Constr. Co. v. Superior Court, 57 Cal. 2d 508, 20 Cal. Rptr. 634, 370 P.2d 338 (1962); City of Salinas v. Souza & McCue Constr. Co., 66 Cal.2d 217, 57 Cal. Rptr. 337, 424 P.2d 921 (1967).

2. The *Healy* case was appealed to the district court of appeal and, for the reasons set forth in an opinion written by Justice Burke, the judgment of the trial court in favor of Brewster was affirmed. 23 Cal. Rptr. 917 (1962). A hearing was granted by the California Supreme Court as a result of which the judgment was reversed and a new trial granted. 59 Cal.2d 455, 380 P.2d 817, 30 Cal. Rptr. 129 (1963). The supreme court opinion was written by Justice McComb. The case was retried, a judgment again entered for Brewster, and again the case was appealed to the district court of appeal. Pursuant to an opinion written by Justice Pro Tem Frampton, the judgment of the trial court was again affirmed, 251 Cal. App. 2d 541, 59 Cal. Rptr. 752 (1967). Reference to these cases will hereafter be made by referring to the name of the Justice writing the opinion.

3. 23 Cal. Rptr. 917 (1962).

for the corings indicated the presence of any hardpan. Brewster made no independent soil investigation and relied entirely upon the corings made by the county.

Under the terms of the subcontract with Healy, Brewster agreed to be bound by all the conditions imposed upon Healy in his contract with the county. Those conditions included a statement that the general contractor should make his own inspection of the site, and that the soil information given was to show conditions only as they were believed to exist. The county's statement in reference to the soil tests contained the following:

> [I]t is not intended or to be inferred that the conditions as shown thereon constitute a representation or warranty, express or implied, by the County or its officers, that such conditions are actually existent nor shall the Contractor be relieved of the liability under contract, nor the County or any of its officers be liable for any loss sustained by the Contractor as a result of any variance between conditions as shown on the plans and the actual condition revealed during the progress of the work or otherwise.[4]

Shortly after Brewster moved into the first borrow pit to start excavating, he encountered large amounts of hardpan material. To use such material for the air strip required additional and expensive earth-moving equipment, followed by a pulverizing process that greatly increased Brewster's costs. When Brewster brought this unanticipated difficulty to the attention of Healy and threatened to stop work because of it, he was promised "more money"; that is, he would be compensated for the extra expense if he would finish the job. Healy tried to pass this additional cost on to the county. Upon the county's refusal to pay more because of the hardpan difficulties, Healy refused to carry out his promise to Brewster of additional compensation.

Healy filed a complaint for declaratory relief and Brewster filed a cross-complaint for damages. The trial court, upon

4. 251 Cal. App.2d at 547, 59 Cal. Rptr. at 755 (1967).

conclusion of the first trial of the case, entered a judgment in favor of Brewster for $61,108.05, plus an additional $16,000 for attorneys' fees. It found the promise to compensate for the extra expenses enforceable under the doctrine of promissory estoppel. Upon appeal to the district court of appeal, the judgment of the trial court was affirmed, not on the basis that the doctrine of promissory estoppel was necessarily applicable, but instead on the ground that there was sufficient consideration to render the promise enforceable.

The Supreme Court of California granted a hearing, unanimously reversed the trial court judgment, and granted a new trial.[5] Justice McComb noted that the theory of Brewster's original cross-complaint was for either breach of the original contract or failure to pay for extra work. As the trial court had found that there had been a failure of proof on both theories, Justice McComb was of the opinion that it was error to grant a judgment on the basis of an oral modification of the original contract in that "their trial tactics might well have been different had they known the importance of the oral promise [of modification] during the trial."[6] The opinion did, however, discuss the applicability of the doctrine of promissory estoppel.

Upon the second trial of the case, the pleading properly raised the issue of the enforceability of the oral promise of "more money" in modification of the original contract. It also brought into consideration for the first time the matter of implied warranties. Again, a judgment for Brewster was entered by the trial court, again there was an appeal to the Court of Appeal for the Second District,[7] and again there was affirmance of the trial court with a detailed discussion of the applicability of the different theories applicable to the problem.

5. 59 Cal.2d 455, 30 Cal. Rptr. 129, 380 P.2d 817 (1963).

6. 59 Cal.2d at 464, 30 Cal. Rptr. at 134, 380 P.2d at 822. The doctrine of promissory estoppel and its applicability to the *Healy* case is discussed *infra,* this article.

7. 251 Cal. App.2d 541, 59 Cal. Rptr. 752 (1967).

A. Consideration for Modification

The key code sections for modification of contracts, other than those covered by Article 2 of the Uniform Commercial Code, provide:

> A contract not in writing may be altered in any respect by consent of the parties, in writing, without a new consideration, and is extinguished thereby to the extent of the new alteration. (California Civil Code § 1697)
>
> A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise. (California Civil Code § 1698)

These sections do not use the word "modification" but instead "alteration." However, for the purpose of the situation under discussion the words are synonymous.[8]

From the statutory language it is apparent that there are two basic factual determinations that must be made in working with the consideration problem: (1) whether the modification agreement is executory or executed; and (2) whether it is oral or in writing. As to an executory written modification of an oral contract, Civil Code section 1697 dispenses with the consideration requirement and substitutes in its place the formality of a writing.[9] However, for an executory oral modification of an oral contract all the elements of a contract must be present, including consideration. Section 1698, by use of the word "contract" in the phrase ". . . may be altered by a *contract* in writing, . . ." makes consideration

8. "Alteration" is the word usually used to describe a change made in the figures or language of a written instrument, often done without authority and as part of a fraudulent scheme to change the legal effect of the instrument. Section 3407 of the California Uniform Commercial Code deals with the effect of alteration of commercial paper. This is an entirely different problem from the one being discussed in this article. Here we are dealing with consensual changes in the prior contract obligations of the party, resulting either from oral agreement or a writing integrating that agreement.

9. Dispensing with the consideration requirement and substituting in its place the formality of a writing is a device used in other parts of the California Civil Code. See Cal. Civ. Code §§ 1524, 1541. See also the elimination of the consideration requirement for modification of sales contracts in Cal. Comm. Code § 2209, discussed *infra* in this article.

an indispensable element of every executory modification of a written contract, as contrasted with an oral one.

The *Healy* case involved an oral modification of a written contract. The search for consideration was difficult but ideas developed as the litigation progressed. Consideration is defined in Civil Code section 1605 as follows:

> Any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise.

The stumbling block was that Brewster was already obligated to remove and compact the required dirt from the borrow pits. It was argued by Healy that Brewster was doing no more than he was already legally obligated to do and that, therefore, there was neither detriment to Brewster nor benefit to Healy. This effect of existing duty on consideration has long been the rule of law in California, and most other jurisdictions.[10]

Justice Burke was of the opinion that the *Healy* case fell within the "unexpected difficulty" exception to the "existing duty" bar. His opinion stated:

> However, the general rule has often been subjected to the important qualification that such a promise will be given effect where unanticipated and substantial difficulties arise which cause the contractor to refuse to complete the work at the contract price and the contractee promises the additional compensation to induce the contractor to continue performance.[11]

In applying this "unexpected difficulty" exception it is accepted that the difficulty must not be within the contem-

10. A leading case in California so holding, and referred to in the *Healy* case, is Western Lithograph Co. v. Vanomar Producers, 185 Cal. 366, 197 P. 103 (1921). For a collection of cases, see 12 A.L.R.2d 80. See also WILLISTON ON CONTRACTS, 3d ed., § 130.

11. 23 Cal. Rptr. at 922.

plation of the parties. The court quoted from *King v. Duluth, M. & N. Ry.*,[12] which emphasized this point.[13] The court also distinguished *Western Lithograph Company v. Vanomar Producers*,[14] in that the difficulty in that case resulted from an increase in the market price of labor and materials and, therefore, in that court's opinion, was within the contemplation of the parties.

It was on this issue of contemplation of the risk that Justice McComb differed with Justice Burke. In reviewing the facts of the case, Justice McComb emphasized that Brewster relied entirely on the soil tests made by the county engineer and made no test of his own, and that Brewster was aware that the county had expressly disclaimed liability for any erroneous soil reports. From these facts it can be concluded that Brewster assumed the risk of error in the soil testing; or to say the same thing in a different way, assumed the risk of mistake. If there is no right to be discharged from the original contract under the doctrine of rescission for mistake, then the duty to perform remains and performance of that duty fails as consideration.

In applying the "unexpected difficulty" rule to establish the consideration for the modification agreement, there still remains a cloudy area in California law. Must the difficulty, the risk of which has not been assumed, be such as to be a basis for rescission for mistake? If it is a basis for rescission, the consideration can better be described as the giving up of a right to rescind. The *King* case, in describing a sufficient "unexpected difficulty", stated that the mistake:

> need not be such as would legally justify the party in his refusal to perform his contract, unless promised extra pay, or to justify a court of equity in relieving him from the contract; for they are sufficient if they are of such a character as to render the party's demand for extra pay manifestly fair, so as to rebut all inference that he

12. 61 Minn. 482, 63 N.W. 1105 (1895).

13. The court stated that the difficulties and burdens "must be substantial, unforeseen, and not within the contemplation of the parties when the contract was made." 61 Minn. at 488, 63 N.W. at 1107.

14. 185 Cal. 366, 197 P. 103 (1921).

> is seeking to be relieved from an unsatisfactory contract, or to take advantage of the necessities of the opposite party to coerce from him a promise for further compensation.[15]

In the first *Healy* trial, the trial judge instructed the jury:

> that there had been a mutual mistake of fact on the part of [Healy and Brewster] regarding the nature of the soil to be excavated, and that the execution of the contract having been conditioned thereon to a considerable degree, [Brewster] for a reasonable time after discovering the mistake had the right to rescind the contract, but that he had not exercised such right.[16]

As indicated, if a right to rescind exists, the consideration problem becomes, at least, easier.

The *Restatement (Second) of Contracts* (Tentative Draft No. 2, 1965) adopts the rule of the *King* case in a proposed new section 89D.[17] However, where there is an "existing duty" to perform, it does not call completion of the performance "consideration." The comment to the proposed section explains that to do so would violate the traditional pre-existing duty rule of the *contracts restatement*. Instead, the new section has been placed in a chapter entitled "Contracts Without Consideration." However sensible this *restatement* approach may be, in California it runs into the difficulty of the language of Civil Code section 1698 which requires a "contract." The elements of contract are set forth in Civil Code section 1550 and include "consideration."[18]

15. 61 Minn. at 488, 63 N.W. at 1107 (1895).

16. 59 Cal.2d at 462, 30 Cal. Rptr. at 133, 380 P.2d at 821 (1963).

17. § 89D. MODIFICATION OF EXECUTORY CONTRACT.

"A promise modifying a duty under a contract not fully performed on either side is binding

(a) if the modification is fair and equitable in view of circumstances not anticipated when contract was made; or

(b) to the extent provided by statute; or

(c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise."

18. That section provides: "It is essential to the existence of a contract that there should be:

1. Parties capable of contracting;
2. Their consent;
3. A lawful object; and,
4. A sufficient cause or consideration."

While Civil Code section 1605 gives the common-law definition of consideration, the section immediately following states additional situations that are also a "good consideration" for a promise. That section provides:

> An existing legal obligation resting upon the promisor, or a moral obligation originating in some benefit conferred upon the promisor, or prejudice suffered by the promisee, is also a good consideration for a promise, to an extent corresponding with the extent of the obligation, but no further or otherwise.

This section has been examined many times by California courts and there are numerous statements in the cases that the moral obligation referred to is one resulting from some past legal obligation.[19] However, all the literal wording of the statute requires is "a moral obligation originating in some benefit conferred upon the promisor or prejudice suffered by the promisee." An argument can be made that while "pre-existing duty" may bar the sufficiency of the consideration under section 1605, it does not have that result under section 1606. In other words, the willingness to proceed in spite of the difficulty creates a moral obligation to compensate for the increased costs.

Upon appeal[20] following retrial of the *Healy* case, Justice Frampton affirmed the findings of the trial court on the issue of consideration. Three separate bases were articulated. The trial court had found that promising to pay for work rendered after encountering unforeseen difficulty is enforceable as consideration supported notwithstanding the existing duty. There is no neat and unencumbered holding that such a promise was enforceable without consideration under the approach of section 89D of *Restatement of Contracts* (Second). In his opinion, Justice Frampton set forth Civil Code sections 1605 and 1606 in their entirety. It is difficult to tell whether he

19. See *e.g.* Leonard v. Gallagher, 235 Cal. App.2d 362, 45 Cal. Rptr. 211 (1965); Foltz v. First Trust & Sav. Bank of Pasadena, 86 Cal. App.2d 59, 194 P. 2d 95 (1948).

20. 251 Cal. App.2d 541, 59 Cal. Rptr. 752 (1967).

felt that the pre-existing duty bar does not apply when unexpected difficulty is present, or whether he was following the line of reasoning just set forth that such difficulty at least creates a moral obligation under section 1606.

As a separate basis for consideration, the trial court also had found that Brewster was entitled to rescind for mutual mistake, and that the giving up of that right of rescission was sufficient. Justice Frampton recognized that there can be no rescission for mistake if the party has assumed that risk. In working out his conclusion on this issue, he referred to facts that were not mentioned in either of the two prior opinions. Whether they were even disclosed in the first trial is not known. He pointed out that soil borings are usually handled by using a drill with a hollow cylinder that cuts out a core from the subsurface. The composition of the core is then analyzed and its structure plotted as a vertical profile. What had happened here, unfortunately, was that the county engineer had used a rotary earth drill rather than the customary coring drill. The rotary drill ground up the subsoil as it extracted it. Ground-up hardpan has the same characteristics as sand and sandy loam, which explains why the county engineer's report was so misleading. From these facts Justice Frampton concluded that while Brewster might have assumed the risk of subsoil conditions if the county's borings had been made in the accepted manner, he did not assume the risk when borings were made in a manner he had no reason to anticipate. This is a forceful demonstration of the importance of getting into evidence all facts that bear upon assumption of risk. Too many attorneys have evidence available to them that is never introduced, either because they don't know of its existence because of failure to make a sufficient investigation of their case, or because they fail to realize its importance.

A third basis for consideration was also expressed in the opinion. The court stated: "Also forbearance to press a claim or a promise of such forbearance, may be a sufficient consideration even though the claim is wholly ill-founded."[1]

1. 251 Cal. App.2d at 551, 59 Cal. Rptr. at 758.

The right to pursue a claim is a legal right, even though if pursued no remedy may be granted. To forego such right is therefore a legal detriment, and thus within the definition of Civil Code section 1605. The only weakness of this theory is that the facts must show that the promise to pay was given as a "bargained-for exchange" for the forbearance of, or the promise to forbear, the assertion of the claim. The fact that forbearance is a result of the promise is not enough. It must be a "bargained-for forbearance." It it at least open to question, from the facts related in the opinions, that such a bargaining process took place.

B. Applicability of the Doctrine of Promissory Estoppel

It is again worth noting that, in the first *Healy* trial, Brewster proceeded on the theory that there was either breach of the original contract, or that the hardpan problem was an "extra" for which Brewster was entitled to additional compensation. At the conclusion of the case the trial judge ruled that Brewster's original theories of recovery had not been proven but that the evidence sustained a recovery by application of the doctrine of promissory estoppel. Thereupon the court permitted amendment of the cross-complaint to conform to proof of promissory estoppel, and the jury was given a number of instructions relating to the elements and scope of this theory of recovery.

As previously indicated, the California Supreme Court held it was error and unfair to Healy to have permitted this amendment at this time of the trial. In addition, the court pointed out why the doctrine has no application in a case of this kind. Such discussion is helpful not only in understanding this case but in forecasting when the application of promissory estoppel will be deemed proper.

Justice McComb stated that when there is a request for services in return for a promise to pay money, you have a bargained-for exchange taking place. In such a situation, if the services are detrimental there is good consideration, not promissory estoppel. To use the words of Justice McComb, ". . . it is only where the reliance was unbargained for that there is room for application of the doctrine of promissory

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estoppel."[2] As previously discussed, in the supreme court's view of the case the "pre-existing duty" to perform prevented the services of Brewster from being detrimental, consideration was therefore lacking and the doctrine of promissory estoppel had no applicability.

C. Writing Requirement

When dealing with an executory modification agreement, Civil Code section 1698 requires not only the elements of a contract, but that, in addition, the agreement be in writing.[3] It is like a statute of frauds requirement. At times the writing requirement of section 1698 is confused with the parol evidence rule. Parol evidence is inadmissible to vary the terms on any subject that has been integrated into a written memorandum of the contract.[4] The excluded parol, however, deals with prior or contemporaneous agreements at variance with the writing, and not with agreements *subsequent* to the writing. The reasoning behind the parol evidence rule is that the integration of the terms into written form fixes them as the final terms of the contract, superseding anything to the contrary. Terms subsequent to the writing are new terms never previously integrated, and the requirement that they be in writing is imposed to prevent fraudulent claims of modification. Parol becomes inadmissible because of the protective writing requirement, not because of any concept of finality of the agreement process.

In the *Healy* case the promise to pay more money was oral. For that reason alone it would have been unenforceable had it remained executory. The only thing that saved it was the finding of execution of the agreement.

D. Execution of the Modification

As has already been stated, a modification becomes enforceable under Civil Code section 1698 if there is a written consideration-supported promise, or if there is an executed agree-

2. 59 Cal.2d at 463, 30 Cal. Rptr. at 134, 380 P.2d at 822 (1963).

3. Cal. Civ. Code § 1698 is set forth in the text of this article, *supra*.

4. Cal. Civ. Code § 1639; Cal. Code Civ. Proc. § 1856.

ment. Case law has carefully pointed out that the word "agreement" in this second alternative is to be distinguished from the word "contract" in the first alternative; "agreement" involves no more than mutual assent, while "contract" requires the four essential elements of Civil Code section 1550.[5]

For some reason section 1698 refers only to an executed *oral* agreement. There seems no basis for a differentiation between oral and written agreements as far as execution as an alternative to consideration is concerned. The motivation for enforceability applies with equal force to both. It has long been recognized that once any transaction has been voluntarily performed, the law will not step in and set it aside. The most obvious analogy is to a gift transaction. While a gift promise is not enforceable, a completed gift cannot be revoked.[6] An executed modification agreement, like a gift transaction, may lack consideration. It often is not literally a gift, however, because of absence of any donative intent. But in both situations voluntary execution makes the transaction final for the common reason that the status of parties, once the transaction has been voluntarily performed, should be protected.

While it is not difficult to understand why an executed transaction should be protected, deciding what constitutes execution has proven quite complex. There are two types of modification agreements that call for the payment of "more money." One is the non-consideration-supported promise where nothing is required by the recipient additional to that which he is already obligated to perform. In this situation, execution of the modification will require the money to be paid, since that is the only performance that has been modified. The other type is where the modification involves a consideration-supported transaction, in other words, where something different is required from *both* parties. The Supreme Court

5. In D. L. Godbey & Sons Constr. Co. v. Deane, 39 Cal.2d at 432, 246 P.2d at 948 (1952), Justice Traynor reached the same conclusion by stating: "Section 1698 has a dual operation. On the one hand it invalidates oral contracts of modification that are unexecuted, and on the other hand, it validates executed agreements that might otherwise fail for lack of consideration."

6. Cal. Civ. Code § 1148.

of California decided in *Godbey & Sons Construction Company v. Deane*[7] that where the promise of additional compensation is supported by consideration and the consideration has been received, there is "execution" of the modification agreement even though the promised additional funds have not yet been paid.[8]

These principles became of vital importance in the *Healy* case as the promise to pay "more money" was oral and unenforceable without execution. By finding the promise supported by *executed* consideration, Justice Frampton concluded that under the rule of the *Godbey* case there was an executed modification.

There was also a provision in the original Healy-Brewster contract that it could be modified only by a written agreement. It was argued that this provision prevented any operative effect of the oral modification, execution and Civil Code section 1698 notwithstanding. The court held that such a writing requirement could be waived by the party for whose protection it was inserted and that such a waiver had taken place.

E. Modification under the Uniform Commercial Code

Discussion of this problem would not be complete without some analysis of the solution contained in section 2209 of Article 2 (called Division 2 in California) of the Uniform Commercial Code. This article deals only with "sales" as defined in Uniform Commercial Code section 2106. Section 2209 covers modification and rescission of contracts for the present or future sale of goods, as well as waiver of performance. While *Healy* involved a construction contract and not a sales contract, a study of the amendments made in the official text of Uniform Commercial Code section 2209 by the California Legislature aids in understanding the policy

7. 39 Cal.2d 429, 246 P.2d 946 (1952).

8. In *Godbey*, plaintiff alleged that he had agreed in a written contract to do cement work for the defendant. Later the written contract was orally modified to provide for a new basis of computing the amount of money the plaintiff was to be paid and to require plaintiff to submit daily reports to the defendant. Plaintiff fully performed his side of the bargain, but defendant only paid a part of the amount due under the contract as modified.

behind not only section 2209 but also Civil Code section 1698 as well.

Prior to the passage of the Uniform Commercial Code in California,[9] the modification of sales contracts was governed by Civil Code section 1697 and section 1698, as were all other types of contracts. The official text of the Uniform Commercial Code was carefully studied by many different organizations and their recommendations for amendment were submitted to the Senate Fact Finding Committee on the Judiciary, to whom the legislation had been referred. The State Bar Committee and the Credit Organizations Committee recommended that section 2209 be deleted entirely. The report of Marsh and Warren recommended that the section be retained but substantially amended.[10] The end result was that the section was retained but amended to the following form:

> 2209. Modification, Rescission and Waiver
>
> (1) An agreement modifying a contract within this division needs no consideration to be binding.
>
> (2) A written contract within this division may only be modified by a written agreement or by an oral agreement fully executed by both parties.
>
> (3) The requirements of the statute of frauds section of this division (section 2201) must be satisfied if the contract as modified is within its provisions.[11]
>
> (4) Although an attempt at modification or rescission does not satisfy the requirements of subdivision (2) or (3) it can operate as a waiver.
>
> (5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party

9. Cal. Stats. 1963, ch. 819. The effective date of the U.C.C. in California was Jan. 1, 1965.

10. See Senate Fact Finding Committee on the Judiciary, Sixth Progress Report to the Legislature, at 452 (California 1959–61).

11. Subsection (3) was also omitted from the original enactment of the California Code, but was added by amendment in 1967. See Levy, COMMERCIAL TRANSACTIONS in this volume.

> that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Section 2209(1) follows the official text and departs entirely from one of the basic restrictions of Civil Code section 1698 by eliminating consideration as a requirement for modification. Within the sales field, therefore, it is no longer necessary to worry about the difficulties created by the pre-existing-duty bar.

There still remains, however, a requirement that the request for "more money" or any other modification of terms must be in good faith. The justification for the pre-existing-duty rule has always been that to hold otherwise would encourage commercial blackmail. Were it not for the pre-existing-duty bar, a contracting party, obligated to perform, could without cause refuse performance unless he received "more money"; and the other party, realizing the disaster that would result from cessation of performance, would knuckle under and pay the unjust demand.

The protection from the danger of blackmail under the Uniform Commercial Code, after elimination of the consideration requirement, comes from section 1203 which provides: "Every contract or duty within this code imposes an obligation of good faith in its performance or enforcement," and from section 2103(b), which provides: " 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The comment to the official text of section 2209 explains:

> However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

> The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (section 2–103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under sections 2–615 and 2–616.

California omitted the official text subsection 2209(2) and substituted an entirely new subdivision (2). The official text set forth a writing requirement only if the parties had so provided in the original written agreement, or if the contract as modified fell within the writing requirements of Uniform Commercial Code section 2–201.[12] The California conclusion was to maintain the requirements of a writing or an "executed" agreement as contained in Civil Code section 1698. The result of the *Godbey* case, permitting consideration-supported modifications to be executed by performance of only one of the parties, was legislatively overruled by changing the words to "fully executed by both parties."[13]

As originally enacted in California, section 2209(3) was also omitted. As all modifications while executory are required to be in writing to be enforceable under California's section 2209(2), there appeared to be no reason for section 2209(3). However, as pointed out by Professor Coyne,[14] the oral modification of an oral contract was overlooked. Section 2209(2) deals only with a written contract. Civil Code section 1698, still in effect notwithstanding the Uniform Com-

12. Official text subsection 2209(2) reads as follows: "A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party."

13. D. L. Godbey & Sons Constr. Co. v Deane, 39 Cal.2d at 432, 246 P. 2d at 948 (1952).

14. See Coyne, SOME COMMENTS ON CONTRACTS AND THE CALIFORNIA COMMERCIAL CODE, 1 U. San Francisco L. Rev. 1 (1967).

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mercial Code, permits an oral modification of an oral contract as long as it is supported by consideration. An argument could be made, therefore, that although an oral sales contract covering goods for the price of $500 or more would be unenforceable under the Uniform Commercial Code section 2201, an oral modification of that contract could be enforceable under Civil Code section 1698. To prevent the possibility of any such conclusion, the official text of section 2209 (3) was added in 1967. As to oral contracts not within section 2201, the modification rules of Civil Code section 1697 apply.

The effect of a waiver that fails to meet the requirements for an enforceable modification is covered by subsections 2209 (4) and (5). These provisions require some serious thought on the difference between them. The comment to the official text states:

> 4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

"Waiver" is not defined in the Uniform Commercial Code but the comment provides the clue. A "modification" changes the terms of the contract by agreement. A "waiver" is one party's unilateral election not to require a term to be performed, even though the obligation to perform exists. Section 2209(5) shows that the waiver may be of some executory portion of the contract as well as of some performance presently due. The waiver of executory portions can be retracted at any time prior to material change of position. However, a waiver of a performance that has been due is an executed transaction and the same policy that enforces an executed oral modification enforces an executed waiver. These waiver provisions of section 2209 do not change California law as it existed under Civil Code section 1698, and are in accord with the handling of waiver of the *Healy* case and other contract classifications.

F. Implied Warranty

While the discussion thus far has involved the receipt of additional compensation based on the enforceability of a promise, the *Healy* litigation also exemplifies the availability of a quite different theory, warranty; "more money" may come from a liability created by the original contract rather than from the enforcement of a subsequently promised payment.

The trial court, on the retrial of the *Healy* case, made the following finding:

> The original Healy-Brewster contract which required Brewster to follow the Plans and Specifications constituted an implied warranty by Healy that such Plans and Specifications were workable, correct and sufficient; Healy's submission to Brewster of the logs of corings constitute an express warranty by Healy that such Plans and Specifications were workable, correct and sufficient.[15]

The appellate court affirmed this finding, relying on *E. H. Morrill Company v. State of California*[16] and *City of Salinas v. Souza & McCue Construction Company*,[17] both cases decided by the Supreme Court of California during the reporting period.

There is no doubt that under California law a contractor or subcontractor who has been furnished incorrect information as to soil conditions may have a cause of action under a breach of warranty theory for the increased expense caused by the true state of the soil.[18] It is equally well established that any such potential warranty liability is capable of effective disclaimer. If the mere presence of a disclaimer clause in the contract made the disclaimer automatically effective, the problem would be reasonably easy to solve. Only an

15. 251 Cal. App.2d at 550, 59 Cal. Rptr. at 757 (1967).

16. 65 Cal.2d 787, 56 Cal. Rptr. 479, 423 P.2d 551 (1967).

17. 66 Cal.2d 217, 57 Cal. Rptr. 337, 424 P.2d 921 (1967).

18. Souza & McCue Constr. Co. v. Superior Court, 57 Cal.2d 508, 20 Cal. Rptr. 634, 370 P.2d 338 (1962); Gogo v. Los Angeles, etc. Flood Control Dist., 45 Cal. App.2d 334, 114 P.2d 65 (1941). See also United States v. Spearin, 248 U.S. 132, 63 L.ed. 166, 39 S.Ct. 59 (1918); Christie v. United States, 237 U.S. 234, 59 L.ed. 933, 35 S.Ct. 565 (1915).

interpretation of the clause to determine the scope of its application would be necessary. What has happened, however, is that under certain situations the disclaimer clauses, although present in the contract, have been held to be ineffective.[19] The real problem, therefore, is to recognize or even be able to articulate what invalidates a disclaimer.

The leading California cases that have set the guidelines involve construction contracts with some governmental body which furnished misleading soil information. The *Healy* case was a step removed factually from the cases, the law of which it adopted. It will be recalled that the basic disclaimer of liability from incorrect soil representations was in the prime contract between Healy and the county. That disclaimer was adopted by Healy in his contract with Brewster by the agreement that Brewster would be bound by all conditions imposed on Healy by the county.[20] This gave Healy the benefit of the county's disclaimer clause, but if such disclaimer was ineffective it would not eliminate Healy's warranty liability. On this point the court, on retrial, cited the additional findings:

> In the Court's view, it is unnecessary to the correct disposition of this case to decide whether Healy is entitled to the benefit of the County's attempted disclaimer of warranty as to the accuracy of the Plans and Specifications as a representation of actual soil conditions at the Airport site, since such a disclaimer would not preclude relief from either the mutual mistake of fact or the bilateral resolution of the "hardpan" problem by a new executed oral agreement. However, the Court finds that Healy's warranty of the sufficiency of the Plans and Specifications is superior to the general disclaimer of warranty as to actual conditions.[1]

Judge Frampton did not in any way indicate that this finding was in error. The finding is just a conclusion and the opinion

19. See *e.g.*, Thomas Kelly & Sons, Inc. v. City of Los Angeles, 6 Cal. App. 2d 539, 45 P.2d 223 (1935).

20. See discussion, *supra* in this article.

1. 251 Cal. App.2d at 552, 59 Cal. Rptr. at 759 (1967).

does not point out why the disclaimer was ineffective; it merely states that, under the cases cited, that result takes place. An attempt will be made, therefore, to summarize what factors invalidate a soil condition disclaimer.

Taking the easiest case first, a disclaimer of liability is ineffective where there has been an intentional misrepresentation of soil conditions. In *Souza & McCue Construction Company v. Superior Court*[2] a peremptory writ of mandamus was issued directing the superior court to allow the construction company to amend its answer and cross-complaint so as to include a claim for breach of implied warranty. The court stated:

> A contractor of public works who, acting reasonably, is misled by incorrect plans and specifications issued by the public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented. [citing cases] This rule is mainly based on the theory that the furnishing of misleading plans and specifications by the public body constitutes a breach of an implied warranty of their correctness. The fact that a breach is fraudulent does not make the rule inapplicable. [citing cases] Souza's proposed pleading states causes of action in contract on the basis of the alleged fraudulent breach by Salinas.[3]

The case was then tried and the trial court found that the City of Salinas had materially misrepresented soil conditions, by failing to inform Souza and other bidders of unstable conditions known to it. The court therefore granted judgment against the city. In *City of Salinas v. Souza & McCue Construction Company*,[4] the California Supreme Court (reversing only for the purpose of redetermining the amount of damage) rejected the city's contention that provisions in the contract specifications which required the bidders to "examine care-

2. 57 Cal.2d 508, 20 Cal. Rptr. 634, 370 P.2d 338 (1962).

3. 57 Cal.2d at 510, 20 Cal. Rptr. at 635, 370 P.2d at 339.

4. 66 Cal.2d 217, 57 Cal. Rptr. 337, 424 P.2d 921 (1967).

fully the site of the work" and stated that it is "mutually agreed that the submission of a proposal shall be considered prima facie evidence that the bidder has made such examination" prevents the city's liability. The court stated "it is clear that such general provisions cannot excuse a governmental agency for its active concealment of conditions."[5]

The truly difficult case is where there is no conscious and intentional concealment but the soil conditions turn out to be disasterously other than represented. This in effect is the *Healy* case, and was also the situation in *Wunderlich v. State ex rel. Department of Public Works*[6] and *E. H. Morrill Company v. State*.[7] The Supreme Court of California rendered opinions in the latter two cases on the same day. Both opinions were written by Justice Peek who also wrote the opinion in *City of Salinas.* In *Wunderlich* it was held that the disclaimer protected the state, while in *Morrill* it was held it did not. It takes the closest scrutiny to find the operative differences between the two cases.

In both cases Justice Peek makes it clear that the result flows from a single determination: was there or was there not *justifiable reliance* on the part of the contractor?

In the earlier case of *A. Teichert & Son, Inc. v. State of California,*[8] the court held that the presence of the disclaimer clause eliminates a justification for reliance. That is very close to the approach of Justice McComb in the *Healy* case. Justice Peek, on the other hand, eliminates the disclaimer clause as a conclusive factor. His opinion takes a much deeper inquiry. He carefully analyzes and compares the facts of *Wunderlich* and *Morrill* and decides that there are differences that justify opposite conclusions. A few of the factual differences will be set forth here. Whether the differences he finds establish suffi-

5. 66 Cal.2d at 223, 57 Cal. Rptr. at 339, 424 P.2d at 923.

6. 65 Cal.2d 777, 56 Cal. Rptr. 473, 423 P.2d 545 (1967).

7. 65 Cal.2d 787, 56 Cal. Rptr. 479, 423 P.2d 551 (1967).

8. 238 Cal. App.2d 736, 48 Cal. Rptr. 225 (1965). The court, in holding that absent deliberate misrepresentation a disclaimer clause will always relieve the state of liability, limited the holding in *Souza & McCue v. Superior Ct.* to cases where the specifications contain no disclaimer clauses. To the extent that *Teichert* so limited *Souza,* it was expressly disapproved in *Morrill.*

cient guidelines to render predictable the results of cases yet to be decided is at least debatable.

In *Morrill* there were plans, specifications, and special conditions attached to the written contract. One of those special conditions was a description of the soil in positive terms. In section 4 of the General Conditions was the usual lengthy disclaimer of warranty liability. Judge Peek held that the disclaimer did not overcome the positive statements. He distinguished *Wunderlich* by pointing out that the soil statement in that case was more a representation of what the state's soil tests disclosed, than a positive statement of actual soil condition. Furthermore, he found an important difference in the fact that in *Wunderlich* the reference to the soil conditions also drew attention to the existence of the disclaimer clause, while in *Morrill* the disclaimer was in a separate part of the instruments and the disclaimer was not mentioned by cross-reference in the part of the agreement in which the soil statements were made. It was also pointed out in *Wunderlich* that the contractor had available to him information on which the state's conclusions as to soil conditions were based, a fact found important in other cases having to decide this issue.[9]

Justice Frampton classified *Healy* as being of the *Morrill* type where the disclaimer is not protective. While there was no elucidation in Judge Frampton's opinion as to why *Morrill* rather than *Wunderlich* controlled, the conclusion must necessarily be that the drilling techniques and the manner in which the corings were handled by the county resulted in Brewster's "justifiable reliance" on those corings, notwithstanding the adopted disclaimer.

In summary, about all that can be said is that warranty is one more theory that should be explored carefully when trying to work out a basis for additional compensation for a contractor or subcontractor. When disclaimer is present, the factual search for "justifiable reliance" is going to control the disclaimer's effectiveness.

9. See *e.g.*, Walla Walla Port Dist. v. Palmberg, 280 F.2d 237 (9th Cir. [1960]).

G. Conclusion

Somewhere behind all of this law is a policy decision. From studying the many cases involving these problems, it is apparent that it is very difficult for soil engineers to determine subsoil conditions. Even the best of them cannot predict with certainty what actually will be encountered when the ground is opened. To say that the contractor or subcontractor should make an independent investigation of conditions is no answer. The contractor's engineers are going to encounter the same difficulty of prediction that confronted government engineers.

Contractors certainly are aware of this possibility of soil-test error. In most cases, when the error comes to light and additional expense is imperative, the contracting parties will work out the "more money" by negotiation and without litigation. When negotiation fails, however, and a solution must be court-determined, about all that can be done is to decide whether the parties have determined, by agreement, which is to bear the risk of mistake. If there has been modification of the original contract to fix the loss, then the sole legal question is the enforceability of the modification agreement. If the court has nothing to work with except the original contract, then the risk-assumption problem is more difficult. Now that the California Supreme Court has armed the construction industry with the *Wunderlich* and *Morrill* opinions, it is obvious what will happen. The strongest bargaining power usually lies with the government, or if a subcontract is involved, with the prime contractor. There will now be an incantation of the language of the *Wunderlich* case to avoid the language of *Morrill* in future contracts. The result will be that the contractor will, more than ever, bear the risk of loss. Is this a good policy? These cases usually involve honest mistakes made by both parties. To throw the loss on to the party who is least able to absorb it, simply because he is in no position to protect himself, is something that should be given serious thought. The case law of contracts has had great difficulty over the years dealing with the inequities resulting from unequal bargaining power. If there is to be contractor protection, it may have to come from legislation.

At least the construction industry now has a better idea of when they will become the "stuckee" of these subsoil errors, but from now on there will probably be fewer situations when the contractors can protect themselves from this type of loss by the terms of the original contract. The industry probably will continue to do just as they have in the past—rely on their ability to negotiate a settlement *after* the error has been discovered. There could be an attempt to cover the risk by increasing the amount bid for the job, but competition makes that solution unlikely. Even after these new cases, the contractor's real hope in this area remains the sense of fairness of the other contracting party.

II. Uncertainty: The Incomplete Contract

There has never been a lawyer with any appreciable amount of contract drafting experience who has not run into the problem of what to do when the parties to the agreement wish to defer the determination of some particular term or set of terms until a future date. There are endless reasons for this factual situation, at least one of which is lack of sufficient information at the time of drafting for the parties to be able to decide just how they want things handled.

Before going into the recent cases it is well to point out in general terms what happens judicially to the uncertain agreement. When the parties have stated that agreement on certain matters will be postponed, it may be declared that the postponement feature is proof that all that has gone on to date is part of the feeling-out process—negotiations preparatory to contract formation rather than contract creation.[10] More often uncertainty prevents the existence of a contract where the parties fully intend one, but the agreement fails to provide the basis for the determination of the existence of a breach and the giving of an appropriate remedy.[11] It is a much more painful job for a court to deprive a party of contract expectancy where it is clear that a contract was intended, than to find that it was not reasonable for the party to conclude that the

10. See Restatement (2d) of Contracts § 32(3) (Tent. Draft No. 1, 1964), and comment (c).

11. See Restatement (2d) of Contracts § 32(1) (Tent. Draft No. 1, 1964) and comment (b).

formation process—offer and acceptance—had taken place. At times it is very difficult to tell from a court's decision which of these two types of uncertainty has prevented contract formation.

Coleman Engineering Company v. North American Aviation, Inc.[12] involved a contract for the manufacture by Coleman of special missile trailers for North American to accommodate its Hound Dog Missile. North American had invited bids and its invitation had included its basic specifications, including a "configuration of the payload." Coleman therefore concluded that the vertical center of gravity was established at rail height and submitted a bid, accompanied with a preliminary stress analysis report, showing its center-of-gravity interpretation. North American, after advising Coleman that it had been awarded the bid, delivered a series of purchase orders which contained the terms of the contract. Included was paragraph 9, captioned "CHANGES," by the terms of which North American reserved the right to change specifications. The paragraph also stated, "In such event there will be made an equitable adjustment in price and time of performance mutually satisfactory to Buyer and Seller, . . ."[13] It was this clause that set the stage for the lawsuit. The terms of the contract also contained a "termination for convenience" clause giving the buyer the right to terminate at any time in accordance with section 8–706 of the Armed Services Procurement Regulation which provides, as the formula for payment upon such termination, expenses plus a certain profit.

The controversy began when North American made known its desire to locate the center of gravity at 35 inches *above* rail height. It was their contention that the original specifications did not provide for location of the center of gravity and that their subsequent specification was not a "change," but a completion of the specifications of the original contract. For Coleman to construct the trailers with this higher center of gravity, rather than that originally assumed, meant an increase in cost

12. 65 Cal.2d 396, 55 Cal. Rptr. 1, 420 P.2d 713 (1966).

13. 65 Cal.2d at 400, 55 Cal. Rptr. at 4, 420 P.2d at 716.

of at least $257,000. It was Coleman's position that the specifying of the higher center of gravity was a "change," and that they were entitled to an additional amount and an extention of time for performance, all to be mutually agreed upon in accordance with paragraph 9. Coleman also claimed it was entitled to stop all work until the agreement was reached, and if agreement could not be reached that they were entitled to the payment provided for in the "termination for convenience" clause. North American claimed that not only was no change involved, but that refusal to continue manufacturing would constitute a breach of contract and a discharge of North American from all liability thereunder.

Negotiation failed to provide any settlement, and North American gave notice of its claimed discharge by breach and made arrangements to procure the trailers elsewhere. Coleman sued on the formula of the termination clause, and North American counter claimed for the damages caused by having to buy the trailers elsewhere at a higher price. The trial court entered judgment for Coleman which was affirmed with some modification by the Supreme Court of California. The supreme court opinion was written by Justice Peters, with a dissent by Chief Justice Traynor with whom Justice Mosk concurred. Rehearing was denied. The following is an analysis of those opinions.

A. Existence of the Contract

Before working out any rights thereunder, Justice Peters had to first decide whether there was any contract at all, because of the failure to provide a formula for determination of price and time of performance following a change order. He started out with the basic rule that "if an 'essential element' of a promise is reserved for the future agreement of both parties, the promise gives rise to no legal obligations until such future agreement is made."[14] Justice Peters then adopted the following test to determine whether an element is essential:

14. 65 Cal.2d at 405, 55 Cal. Rptr. at 7, 420 P.2d at 719.

> The enforceability of a contract containing a promise to agree depends upon the relative importance and the severability of the matter left to the future; it is a question of degree and may be settled by determining whether the indefinite promise is so essential to the bargain that inability to enforce that promise strictly according to its terms would make unfair the enforcement of the remainder of the agreement.[15]

As to the effect of failure to agree on unessential terms, the same quotation continues:

> Where the matters left for future agreement are unessential, each party will be forced to accept a reasonable determination of the unsettled point or if possible the unsettled point may be left unperformed and the remainder of the contract be enforced.[16]

It then became necessary to determine whether such basic matters as price and time for performance could ever be anything but "essential." As was pointed out, "change orders" present an exceptionally difficult area to apply "essentiality" tests. The importance of the failure to agree depends in turn on the importance of the change. There may never be a request for change, in which case the problem will never arise. On the other hand, as in *Coleman,* the change may affect such an important specification of manufacture as to make the original price grossly inadequate.

Because of this inability to evaluate the essentiality of the change at the time of contracting, and because the parties intended a contract relationship, Justice Peters concluded that leaving the price and performance adjustments for future agreement did not prevent contract formation. Such conclusion left many other difficult problems to be decided: (1) Was Coleman entitled to stop production while the parties were

15. 65 Cal.2d at 405, 55 Cal. Rptr. at 8, 420 P.2d at 720. For this quote Justice Peters cited City of Los Angeles v. Superior Court, 51 Cal.2d at 433, 333 P.2d at 750 (1959) and Metropolitan Water Dist. of S. Calif. v. Marquardt, 59 Cal.2d at 194, 28 Cal. Rptr. at 743, 379 P.2d at 47 (1963). The same quote, oddly enough, appears in both of these cases.

16. 65 Cal.2d at 405, 55 Cal. Rptr. at 8, 420 P.2d at 720.

trying to work out the increased compensation necessitated by the change order, or must it continue to manufacture under the changed specifications? (2) If the parties failed in good faith to arrive at an agreed figure, would Coleman be entitled to receive any recovery? (3) Would the result in any way be affected by the failure of either party to negotiate in good faith? (4) Can failure to agree be classified as a "termination for convenience"?

Chief Justice Traynor in his dissenting opinion concluded that an agreement on the essential terms had not been reached, but for reasons other than the change order. He traced carefully the offer and acceptance stages of the contract formation. He found that Coleman's bid was the original offer; that on June 24, 1959, North American sent five "go ahead" telegrams informing Coleman that it was the successful bidder, but that such telegrams contained new proposals and were therefore counter-offers;[17] and that the telegrams made it clear that final arrangements were still to be made. On July 6, 1959, Coleman received the purchase orders, which stated that they became the contract only after Coleman had accepted them. On July 7, Coleman met with the North American engineers and found out for the first time that there was a misunderstanding as to payload center of gravity. On July 15, Coleman acknowledged and signed the purchase orders, but at that time both parties knew they were in disagreement as to the center of gravity and as to what should be paid if the construction was to be other than as had been originally interpreted by Coleman.

Chief Justice Traynor, therefore, concluded that neither party had a right to assume that a contract had been formed. Justice Peters, on the other hand, used the same facts to conclude that North American, by permitting acknowledgment of the purchase orders without objection, had seen fit not to withdraw its offer, that the written acknowledgment was acceptance, and that a contract had been formed.

The two justices, therefore, each used different aspects of uncertainty. Justice Peters found an intention to be bound

17. Cal. Civ. Code § 1585; American Aeronautics Corp. v. Grand Central Aircraft Co., 155 Cal. App.2d 69, 317 P. 2d 694 (1957); 1 Corbin, CONTRACTS (3rd. ed.) § 89, at 378–382 (1963).

and his only problem was whether the agreement provided a basis for the giving of an appropriate remedy. Chief Justice Traynor looked more to the other facet of uncertainty, that the parties were still trying to work out what both knew were unagreed-upon essential terms, and that the process of mutual assent had not yet been concluded.

B. Stoppage of Work

Starting with the assumption that a contract existed, receipt of a change order with no other pricing formula than mutual agreement forced Justice Peters to select from two alternatives. Did Coleman have to continue with production during the period when the parties were trying to work out the price, or might it have treated agreement on price as a condition precedent to its duty to continue? The latter alternative was held to be the law, which disposed of North American's contention that the work stoppage was a discharging breach by Coleman that freed North American from all further contractual obligations. The court admitted that if the matter involved in the change order was not an essential, then not only would the lack of a pricing formula not affect the existence of a contract, but also the manufacturer could not stop work without being in breach.

Such a rule forces the manufacturer to a difficult decision. Although this change order is not of his doing, and is in no way under his control, its presence requires him to make the essentiality decision. If it is the correct one he is in no trouble, but if he should decide that the change is essential and stop when a court, exercising hindsight, finds it unessential, he has become the breaching party. Guessing right becomes the price he pays for the privilege to stop.[18]

Chief Justice Traynor objected to the majority's approach. He felt that to find lack of agreement to an essential term was

18. This is no more unfair than rules found in other areas of contract law. For example, an innocent party whose duty of performance is subject to the other party's prior performance must decide at his peril whether he has received "substantial performance" which will mature his duty. If he makes the wrong decision whether "substantial performance" has been rendered, and refuses to perform because of it, he ends up in breach of contract.

a misuse of the essentiality test, because it resulted in making the duty to continue manufacture only conditional. In his opinion such failure to agree prevented formation rather than rendered further performance conditional.[19]

Justice Peters' decision comes very close to classifying the change provision of paragraph 9 of the contract as unessential in respect to the existence of the contract, yet essential in determining the existence of the condition precedent. Such a result is not unpalatable, however, when neither party, at the time of contracting, has any way to know what change orders may lie ahead.

C. Measure of Recovery

The determination that a fixing of a new price following the change order was a condition precedent to Coleman's duty to proceed, gave it the right to stop performance and prevented that stoppage from being the discharging breach claimed by North American. It still left, however, the perplexing problem of whether Coleman was entitled to any recovery for work to date. Having the right to stop performing does not necessarily give the right to recover for partial performance, especially when that performance has not conferred any monetary benefit on the other party. Justice Peters carefully reviewed the facts and agreed with the findings of the trial court that Coleman had acted fairly and in good faith during the negotiations for settlement of the price controversy, and that North American had not. When negotiations failed and North American terminated, in its mistaken belief that Coleman was in breach because of its decision to stop production, it was held that such termination activated the "cost to date of termination plus profit percentage" formula of Armed Services Procurement Regulation No. 8–706.

There appears to be little difference between an outright decision to terminate on the part of a buyer who decides he does not want to purchase what has been ordered, and the tactic of placing a change order and then in bad faith refusing

19. 65 Cal.2d at 411, 55 Cal. Rptr. at 11, 420 P.2d at 723 (1966).

to agree on a price for that change, however reasonable are the overtures of the manufacturer. If this activation of the voluntary termination clause is tied to a bad-faith refusal of the purchaser to negotiate, then the use of the clause seems correct.

It is far more difficult to decide what should be done when both parties, in the best of faith, make every reasonable effort to work out a price figure but cannot do so. If this is called a voluntary termination by buyer, it means the buyer is going to bear the entire contract loss when he is no more at fault than the manufacturer. Faced with this kind of risk, for all practical purposes, his change-order privileges are severely restricted. Yet to hold that good-faith negotiations by both parties eliminates any voluntary termination results in the manufacturer bearing the entire loss.

Chief Justice Traynor in his dissent found a solution in the law of restitution. He pointed out that while the parties were trying to work out the center of gravity specifications, North American requested that Coleman continue to perform. When it was finally determined that an agreement could not be reached, Chief Justice Traynor preferred the conclusion that such failure prevented contract formation but that because of the request that performance be continued during the negotiation, Coleman was entitled to the reasonable value of the services performed.

The trouble, if any, with this solution is that although Coleman's performance was requested, it did not result in any benefit being received by North American. The idea that a requested performance *resulting in benefit* can be the basis for recovery of the reasonable value of the performance is not new in California. Permitting such recovery *without benefit* is new. Such a theory has received recognition elsewhere,[20] and Chief Justice Traynor would apply that doctrine here. As the majority of the California Supreme Court were of the opinion that a contract had been formed, there is no indication how the majority would have held on this issue of recovery for

20. See Kearns v. Andree, 107 Conn. 181, 139 A. 695, 59 A.L.R. 599 (1928); Abrams v. Financial Serv. Co., 13 Utah 2d 343, 374 P.2d 309 (1962). For the proposition that the rule of recovery is based on moral obligation rather than on benefit conferred, see Note, 26 Mich. L. Rev. 942 (1928).

requested performance which resulted in no benefit to the defendant.

D. The Uniform Commercial Code

The one possibility that was not discussed in either opinion was that of implying a reasonable price to be determined by the court when the parties could not agree. The *Coleman* case was governed by the Uniform Sales Act, as all facts were prior to January 1, 1965, the effective date of the Uniform Commercial Code. Under Sales Act section 9, which was adopted in California in 1931 as Civil Code section 1729, it was provided:

> *Definition and Ascertainment of Price*—(1) The price may be fixed by the contract, or may be left to be fixed in such manner as may be agreed, or it may be determined by the course of dealing between the parties.
>
> (2) The price may be made payable in any personal property.
>
> (3) Where transferring or promising to transfer any interest in real estate constitutes the whole or part of the consideration for transferring or for promising to transfer the property in goods, this act shall not apply.
>
> (4) Where the price is not determined in accordance with the foregoing provisions the buyer must pay a reasonable price. What is a reasonable price is a question of fact dependent on the circumstances of each particular case.

Case law had determined that, under this section, specifically providing in a contract that the price was to be agreed upon by the parties did not shift the formula to reasonable price when such agreement failed.[1]

The California Commercial Code now has quite different provisions. It provides:

> *Section 2305. Open Price Term.* (1) The parties if they so intend can conclude a contract for sale even

1. See California Lettuce Growers v. Union Sugar Co., 45 Cal.2d 474, 289 P. 2d 785, 49 A.L.R.2d 496 (1955). Cf. Roberts v. Adams, 164 Cal. App.2d 312, 330 P.2d 900 (1958); Ablett v. Clauson, 43 Cal.2d 280, 272 P.2d 753 (1954).

though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

(a) Nothing is said as to price; or

(b) The price is left to be agreed by the parties and they fail to agree; or

(c) The price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

Had the Uniform Commercial Code been applicable, section 2305(1)(b) would have applied to the majority's interpretation of the *Coleman* facts. Just how it would have aided the outcome is not clear. Only the court can determine the reasonable price if the parties cannot agree. It will take time for price to be settled by litigation. The *Coleman* case makes it clear that although the manufacturer is not discharged during the price-fixing period, he can at least stop performing for that period. The next question is whether, after the price is finally fixed, the manufacturer must proceed and the buyer must accept performance. The answer to this lies with the rules applicable to temporary impossibility. In most instances, if the delay is for any appreciable time, further performance cannot be required of either party.[2]

2. See Autry v. Republic Productions, Inc., 30 Cal.2d 144, 180 P.2d 888 (1947); Restatement of Contracts § 462 and comment (a).

The manufacturer could waive the condition precedent, proceed to completion and then sue for his price to be fixed by the court in the litigation. But by so doing he could obtain nothing until judgment was rendered, and would therefore be forced to extend credit to the buyer even though the contract might have provided otherwise.

It should be noted that Commercial Code section 2305(4) recognizes that failure to agree on price can prevent formation, but does not necessarily do so. Chief Justice Traynor, had the section been applicable in *Coleman,* possibly would have considered the facts to fall under this subdivision. The case illustrates all too well how difficult is the fact-finding job when the existence of a contract rests entirely upon intention to be bound.

The Uniform Commercial Code backs to the fullest degree the position of Justice Peters; if the parties intend to be bound, the common-law niceties of offer and acceptance should not destroy a contractual relationship. Uniform Commercial Code section 2204(3) states:

> (3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

Locking the parties together by contract in *Coleman* accomplished the purposes of this section, and using the voluntary termination clause supplied a convenient "reasonably certain basis for giving an appropriate remedy."

E. Conclusion

While the foregoing has by necessity contained much conjecture, at least one thing is certain—every problem in the case could have been obviated by careful drafting. An agreement to agree or a contract to make a contract spells trouble. Many more suitable formulas are available, such as providing

The difficulty dealt with in *Autry,* of trying to apply a reasonable price formula in cases of delayed performance, may lend more credence to the theories advanced by Justice Traynor in his dissent in *Coleman.*

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for arbitration, or any number of other price-setting devices, should the parties fail to reach agreement. Perhaps Chief Justice Traynor's opinion would further the necessity for such clauses. Drafting can also settle the duty to continue performance while the price is being determined. It may well be that covering these problems originally could have held up contract formation while they were negotiated and worked out. But it is seriously doubted that, had they been carefully covered in the purchase order forms of North American, it would in any way have deterred *Coleman* in acknowledging and accepting those orders; in fact, it might have encouraged such action.