

REMEDIES IN DISPUTES ARISING OUT OF AGREEMENTS TO BUY AND SELL BUSINESSES*

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I. INTRODUCTION

There are surprisingly few reported cases involving issues concerning the remedies available for breach of an agreement to buy and sell a business. No articles directly on the subject have been found, nor have any of the leading treatises on contracts or damages included even a single section specifically devoted to the area. At most, there is an occasional passing reference to a remedial problem arising out of the sale of a business, or the use of an example which happens to involve such a set of facts. In large measure, however, the principles governing the availability and scope of remedies in this situation are those generally applicable throughout the law.

While the law in this area has been developed almost entirely by the courts rather than the legislatures, no problem of remedies in connection with business purchase contracts should be deemed satisfactorily analyzed unless consideration is also given to the possible relevance of the Uniform Commercial Code. Hence, initial attention will be given to questions, still largely unresolved, concerning the extent to which the Code may affect the result. And since some of the legal rules otherwise applicable may nevertheless be subject to a contrary expression by the parties in their contract, a brief discussion of the extent to which this is so will precede a more detailed analysis of the various remedies normally available to the victim of a breach. Finally, the rights of a victim of misrepresentation will be examined, both at common law and, where applicable, pursuant to the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission.

Whenever possible, sale-of-business situations have been used as examples or illustrations of pertinent general principles; cases involving business sales have been cited in preference to those involving other factual situations.

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II. THE UNIFORM COMMERCIAL CODE AS A SOURCE OF LAW

While the direct applicability of the Uniform Commercial Code to remedial problems arising out of the sale of a business is quite limited, the Code—especially Article 2—must nevertheless be regarded as a principal source of law in this area. If applied literally, Article 2 would appear to have little relevance to cases of this kind. It expressly applies only to “transactions in goods,”¹ and “goods” are defined as “all things . . . which are movable other than . . . investment securities (Article 8) and things in action”² If, therefore, the sale is of stock, as distinguished from assets, it would be excluded from this definition.³ Although Article 8 of the Code is entitled “Investment Securities,” it does not purport to set forth the law of sales of stocks and bonds as Article 2 does with respect to the sale of goods;⁴ instead, it is more of a special negotiable instruments law parallel to Article 3 of the Code (Commercial Paper),⁵ both subjects having been previously covered in large part by the Uniform Negotiable Instruments Law.

A sale of the assets of a business will normally include at least some “goods,” for example, inventory, office supplies, raw materials, and, in some cases, machinery and equipment.⁶ Sometimes, a major fraction of the assets sold may qualify as goods; in other cases, the portion may be trivial as contrasted with the real property, leaseholds,

¹ U.C.C. § 2-102. [All citations to the Uniform Commercial Code in this article will be to the 1962 Official Text unless otherwise indicated.]

² U.C.C. § 2-105(1).

³ Stock certificates were traditionally regarded as “things in action,” and thus were held excluded from the definition of “goods” in § 76(1) of the Uniform Sales Act, which included “all chattels personal other than things in action and money.” See 3 S. Williston on Sales § 619a (rev. ed. 1948). The express exclusion of investment securities, in addition to “things in action,” in U.C.C. § 2-105(1), would thus seem to be redundant. While it might be contended that, in order to give effect to every phrase, § 2-105(1) would have to be construed to include within “goods” such stocks or bonds as did not qualify as investment securities under Article 8 (see note 4 *infra*), the draftsmen of the Code seem to have had no such intention.

⁴ U.C.C. § 8-102(1) defines “security,” for the purpose of applicability of Article 8, broadly enough to include both stocks and bonds, but limits it to “a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment.” U.C.C. § 8-102(1)(a)(ii). Thus, stock in a closely held corporation might not fall within Article 8. In any event, nowhere in Article 8 are there rules as to the measure of damages or other remedies for breaches of contract to buy or sell securities.

⁵ See Comment to U.C.C. § 8-101: “The Article . . . may be likened . . . to a negotiable instruments law dealing with securities.”

⁶ If not fixtures, machinery and equipment are clearly “goods.” Fixtures, however, if included in a sale of assets, may or may not be deemed to be “goods” under Article 2 of the Code; if they are to be severed from the realty they are included among goods, but if the sale includes the realty as well as the fixtures attached thereto, they are not. U.C.C. § 2-107(1).

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contract rights, accounts receivable, goodwill and so forth, which are being sold. Thus, several questions arise: Does Article 2 of the Code apply to the whole transaction: (a) if any part of the subject matter is goods; (b) if the principal part is goods; or (c) only if it is all goods? Or must we have two separate bodies of law applicable to a single transaction—the Code for the goods involved and the common law for the remainder? Or should there be different answers, depending upon which provisions of the Code are invoked? Unfortunately, there are no answers to these important questions either in the Code or in the official comments of the draftmen, which are, for most purposes, the nearest thing we have to a legislative history of the Code.

Thus far, there seems to be only one reported case dealing directly with this problem. In *Foster v. Colorado Radio Corp.*,⁷ a fragmented result was reached, with Article 2 applied to the goods that were to have changed hands but not to the rest of the transaction. A contract for the sale of a radio station as a going concern (including goodwill, the station's license, real estate, studios, transmission equipment, and office equipment and furnishings) was breached by the buyer. The parties stipulated the measure of damages to be the difference between the contract price and the resale price. Section 2-706(3) of the Code precludes use of that measure of damages in the case of a private resale of goods unless the defaulting buyer is given reasonable notification, which was not done in this case. No more than ten percent in value of the assets sold were goods. The court held the resale price inapplicable as to the goods but determinative as to the rest of the assets. It therefore reduced the measure of damages by ten percent.⁸

While such a divided result was manageable in this particular case, it is obvious that there are many instances in which anything other than a single rule for an entire contract would be intolerable.⁹

⁷ 381 F.2d 222 (10th Cir. 1967).

⁸ Ordinarily if the resale failed to meet the standard of U.C.C. § 2-706(3), the standard test of contract price minus market price would have been applied. U.C.C. § 2-708(1). But the court stated: "[S]ince the parties stipulated that contract price less resale price was to be the measure of damages, if any, the breach of promise to purchase the goods is unremediable." 381 F.2d at 226. It might have been more appropriate to substitute the test of the market price and allow the resale price to serve as evidence thereof. The court might also have held the stipulation to be a valid variation, by agreement, of the principles of the Code. See U.C.C. § 1-102(3).

⁹ The plaintiff in *Foster* contended that the sale of the goods was incidental to the main purpose of the transaction—the transfer of the radio station as a going concern—and that the Code should, therefore, not be applied at all, citing *Epstein v. Giannattasio*, 25 Conn. Supp. 109, 197 A.2d 342 (1963), in support of its position. 381 F.2d 222 at 226. In *Epstein*, plaintiff, a customer of a beauty parlor, was harmed by a product applied in the course of her treatment. She contended that the transaction included the sale of a good and hence brought into play the warranty provisions of the Code. The court held that there was no sale of the product, since the predominant feature of the transaction was

There are even some situations in which there would be a valid enforceable contract to the extent that Article 2 applied, but no binding agreement whatsoever as to the rest. In some other cases, the entire agreement might be effective, but the rights and duties of the parties might be different with respect to some of the assets to be sold as compared with others. And the applicable remedial provisions might vary as to goods and non-goods in circumstances much more difficult to unscramble than in the *Foster* case.

Examples of a few of the many situations in which such a split result would seem clearly to be unworkable include the following:

(a) A signed promise to keep an offer open despite lack of consideration is binding under section 2-205, but generally is revocable elsewhere in the law.

(b) An expression of acceptance stating terms additional to or different from those offered is effective as an acceptance in certain circumstances, pursuant to section 2-207, but serves merely as a rejection and counter-offer in other areas of the law.

(c) An agreement modifying a contract under Article 2 needs no consideration to be binding (section 2-209(1)); outside of Article 2 it would be ineffective in most states.

(d) The authorization to courts to refuse to enforce unconscionable contracts (section 2-302) is probably more sweeping under Article 2 than the powers granted to or asserted by courts in other situations.

the sale of services. The Tenth Circuit regarded this case as distinguishable, since in the *Foster* case some goods were clearly being sold. 381 F.2d at 222, 226.

The *Epstein* decision is consistent with a number of cases, both before and under the Code, in which a transaction involving part sale and part service, such as a blood transfusion or the provision of food in a restaurant, is treated by the courts as all sale or all service. See, e.g., *Perlmutter v. Beth David Hosp.*, 308 N.Y. 100, 123 N.E.2d 792 (1954); *Russell v. Community Blood Bank, Inc.* 185 So.2d 749 (D.C. App. Fla. 1966); *Temple v. Keeler*, 238 N.Y. 344, 144 N.E. 635 (1924); *Cheshire v. Southampton Hosp. Ass'n*, 53 Misc.2d 355, 278 N.Y.S.2d 531 (Sup. Ct. 1967). Other courts may well follow this approach in cases of the sale of businesses, allowing the predominant feature of the transaction to control in order to permit application of a single rule of law to the whole transaction. See, e.g., *Parker v. Johnston*, 244 Ark. 355, 426 S.W.2d 155 (1968), which involved the sale of a vending machine business. While the opinion is not explicit in this respect, it is probable that the transaction included not only the sale of machines but also the assignment of ongoing contracts and perhaps goodwill. The court applied U.C.C. § 2-608, providing for revocation of acceptance where the sale had been induced by misstatements as to the earnings of the business.

Nevertheless, the *Foster* case, while sharply criticized (See, R. Duesenberg & L. King, *Sales and Bulk Transfers under the Uniform Commercial Code* 3-4 (Supp. 1970)), may be influential in other courts. While ordinarily the decision of a federal court, engaging in conjecture as to the law of the state in which it sits, might not be of great weight as precedent, the command to construe and apply the Uniform Commercial Code "to make uniform the law among the various jurisdictions" (U.C.C. § 1-102(c)) may induce other courts to follow the first decision on an issue.

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(e) The parties can make a binding contract to sell goods even though the price is not settled, under section 2-305; in cases outside Article 2, an open price term generally renders the agreement unenforceable as "an agreement to agree."

(f) The preclusion of a buyer from asserting a breach, if he fails to specify it when the seller, after rejection, had demanded a full and final written statement of defects (section 2-605(1)(b)), has no counterpart outside of Article 2 of the Code. This applies not only to the use of the defect as a basis for a claim but also to its employment as a reason for the buyer to reject a tender and refuse to pay.

What may be a more attractive solution to problems of this kind is for the courts to treat the Code as a source of law by analogy and apply its principles to cases to which it is not literally applicable. Section 1-102(1) states: "This Act shall be liberally construed and applied to promote its underlying purposes and policies." Liberal construction, of course, is not the same thing as application to a situation clearly not covered. The official comment to this section, however, goes somewhat further and appears to invite the use of the statute by way of analogy.¹⁰ While such a technique has been employed more liberally in civil law jurisdictions, there has been a growing body of cases in which American courts have employed this approach,¹¹ as well as scholarly exhortations to courts to treat statutes as sources of general policy and apply that policy wherever it would be pertinent, even though the statute would not literally apply.¹²

¹⁰ U.C.C. § 1-102, Comment 1, includes the following:

Courts . . . have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520, 36 S. Ct. 194, 60 L. Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same, where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") . . . Nothing in this Act stands in the way of continuance of such action by the courts.

¹¹ For a very recent example, see the decision of the United States Supreme Court in *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375 (1970). See also *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934), referred to repeatedly in the official comments to the Code, and obviously intended by the draftsmen as a model of judicial technique. *Contra*, *Porter v. Gibson*, 25 Cal.2d 506, 154 P.2d 703 (1944).

¹² See Stone, *The Common Law in the United States*, 50 Harv. L. Rev. 4, 13 (1936): "I can find in the history and principles of the common law no adequate reason for our failure to treat a statute much more as we treat a judicial precedent, as both a declaration

This invitation to use the Code as a source of policy even where it is not literally applicable would seem to offer the courts a most convenient technique for dealing with both situations mentioned above: (a) the sale of stock; and (b) the sale of assets only a portion of which are "goods." With respect to the sale of stock, there is a further invitation to employ the Code by analogy in Comment 1 to Section 2-105 (defining "goods"):

"Investment securities" are expressly excluded from the coverage of this Article. It is not intended by this exclusion, however, to prevent the application of a particular section of this Article by analogy to securities (as was done with the Original Sales Act in *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934) when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8)).¹³

Where assets of a mixed nature are sold, the same principle would suggest that Article 2 of the Code may be applied directly with respect to the goods and by analogy with respect to the rest of the assets, so that a single, consistent legal structure can be brought into play.¹⁴

It therefore seems clear that the provisions of Article 2 of the Code are likely to be either dispositive or at least persuasive sources

and a source of law, and as a premise for legal reasoning." See also Landis, *Statutes and the Sources of the Law*, in *Harvard Legal Essays* 213 (1934); Farnsworth, *Implied Warranties of Quality in Non-Sale Cases*, 57 *Colum. L. Rev.* 653 (1957).

¹³ Article 2 has occasionally been applied in this manner by the courts. U.C.C. § 2-204(3), which states: "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," has been applied to a contract for the sale of corporate stock, in *Pennsylvania Co. v. Wilmington Trust Co.*, 39 Del. Ch. 453, 462-63, 166 A.2d 726, 731-32 (Del. Ch. 1960), appeal dismissed, 40 Del. Ch. 1, 172 A.2d 63 (Sup. Ct. Del. 1961). In a number of other cases, attempts to apply Article 2 of the Code to sales of securities have failed because the cited provisions were deemed inapposite rather than because of the refusal of the courts to apply Article 2. See *Saphier v. Devonshire Street Fund, Inc.*, 352 Mass. 683, 691-92, 227 N.E.2d 714, 720 (1967); *Wilmington Trust Co. v. Coulter*, 41 Del. Ch. 548, 570-71, 200 A.2d 441, 454 (1964); *In re Schoettle Co.*, 390 Pa. 365, 374, 134 A.2d 908, 913 (1957).

Article 2 has also been applied by analogy in other areas of the law. This has occurred especially frequently in connection with leases of personal property. See, e.g., *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, 428 S.W.2d 46 (1968).

¹⁴ It may well be that a single approach applying equally to all parts of Article 2 would not be appropriate. While those provisions dealing with formation of a contract (U.C.C. §§ 2-204-207), for example, seemingly must be applied entirely or not at all, it is less clear that provisions for the allocation of risk of loss (U.C.C. §§ 2-509, 2-510) have much relevance to immovable or intangible property, or that the Article 2 statutes of frauds (U.C.C. §2-201) or limitations (U.C.C. §2-725) should be applied to areas in which the legislature has enacted a different provision.

of authority in answering questions involving remedies for breach of a contract to buy and sell a business.

III. EFFECT OF THE CONTRACT PROVISIONS

Many of the principles of law pertaining to remedies for breach of contract are suppletive—that is, they apply only in the absence of an expression of intention by the parties and may be changed by the parties if they see fit.¹⁵ This is as true with respect to contracts providing for the sale of a business as to any other kind of contract. The principle is not, however, entirely without exception.

A contract will normally prescribe the respective performances of the parties. It follows that what is or is not a breach is also determined, at least in part, by the terms of the contract. When it comes to the consequences of a breach, however, the rules are a bit more complicated.

As will be seen below,¹⁶ in the absence of an expression by the parties, the courts will have to determine when a breach is sufficiently material to justify the innocent party in withholding his performance, and when it is sufficiently total to give him the election of terminating the contract and demanding restitution instead of suing for damages. Since the parties may, if they wish, expressly state which performances by one are conditions concurrent with or precedent to which performances by the other, these matters are generally within the range of what may be controlled by the parties themselves in their agreement.¹⁷

We must distinguish, however, between what may be called primary obligations, that is, those which the contract calls upon the parties to perform, and remedial obligations, that is, those imposed upon the parties by law if they fail to obey certain of their primary obligations. With respect to the latter, the courts have been much less

¹⁵ This principle is reasserted in U.C.C. § 1-102(3):

The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

¹⁶ See pp. 836-38, 852-53 *infra*.

¹⁷ Quite frequently the contract will explicitly state that the truth of every warranty and the performance of every covenant of one party is a condition to the other party's duty to perform. Such a provision will be upheld in instances of material breach of warranty or covenant, but there is some doubt whether courts will apply it literally where a breach is trivial. See Restatement of Contracts § 302 (1932): "A condition may be excused without other reason if its requirement (a) will involve extreme forfeiture or penalty, and (b) its existence or occurrence forms no essential part of the exchange for the promisor's performance."

permissive. A frequently encountered example of the unwillingness of courts to give the parties carte blanche power to prescribe remedies is their refusal to enforce what they deem to be penalty clauses, even if the contract expressly refers to them as "liquidated damages."¹⁸

This is not to suggest, however, that the contract may never vary the rules as to remedies that would otherwise be applied by the courts. Valid liquidated damages clauses, of course, preclude application of the measure of damages that would otherwise be applied. An agreement may, in fact, deny either or both parties any right to damages in the event of certain types of breach, or all breaches, and limit a plaintiff to a right to rescind and receive restitution of the consideration he had given. On the other hand, rescission may be barred and damages made the sole remedy.¹⁹ Nor are the parties precluded from inventing novel forms of remedy²⁰ or methods of computation so long as they are reasonable and are not regarded as unconscionable.²¹ In addition, "indemnification" clauses, frequently found in business sale contracts, may set forth some obligations not expressly contained in the listings of covenants and warranties; they may also prescribe the remedies available in various circumstances, as well as the parties in favor of and against whom such remedies are to run.

There is a limiting principle, however, that the contract may not leave a party without a reasonably effective remedy. This principle is embodied in Section 2-719 of the Code, which, while permitting "remedies in addition to or in substitution for those provided in this Article,"²² also states: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as

¹⁸ See pp. 845-49 *infra*.

¹⁹ A contract providing specifically for one remedy is not generally construed to preclude the aggrieved party from opting for another remedy unless the fact that the named remedy is intended to be exclusive is made quite clear. In *Nelson v. Spence*, 182 Cal. App.2d 493, 6 Cal. Rptr. 312 (1960), a contract for the sale of a peat moss business included warranties as to an exclusive source of supply and also provided for rescission for breach. The warranty was broken, and the court allowed the buyer to elect to sue for damages instead of rescission. This principle is carried even further in U.C.C. § 2-719(1)(b), which states that resort to the remedy provided is optional unless it is expressly agreed to be exclusive.

²⁰ A provision for forfeiture of a pound of flesh would not be recommended. Anyway, it might not be deemed "novel," as it has already been tried.

²¹ See, e.g., U.C.C. §§ 2-719, 2-302. Limitations which would otherwise be enforced will be stricken if fraudulently procured. In *Lockwood v. Christakos*, 181 F.2d 805 (D.C. Cir. 1950), there were fraudulent oral misrepresentations as to the volume of business of a sandwich shop being sold. A clause in the contract disclaimed the making of or reliance on any representations. While observing that innocent misrepresentations would be sufficient to justify rescission in such a case, the court held that the disclaimer of representations would have been given effect in the absence of fraud but in the circumstances would be stricken and the plaintiff allowed to rescind.

²² U.C.C. § 2-719(1)(a).

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provided in this Act."²³ It is also likely, although there is little case law on the subject, that a recitation in a contract that remedies at law would be inadequate, and that the parties agree that in the event of breach specific performance shall be imposed, would not be deemed binding upon the court.²⁴

IV. TYPES OF BREACH OF CONTRACT

It would be futile to try to catalogue all of the ways in which a party may breach a contract for the purchase or sale of a business. Any promise or warranty of either party may be broken.²⁵ Some of the types most frequently encountered are set forth by way of illustration, but not with a view to suggesting that such a listing is exhaustive.

Either party may, of course, refuse to close, or a buyer may refuse to pay, or a seller to convey stock or assets. Assuming that it is not justified by the other party's breach, such a refusal may be a complete repudiation of the entire contract and fully actionable; it may, on the other hand, be merely a matter of delay, with the breaching party intending, and communicating the intention, to close a short

²³ U.C.C. § 2-719(2). See also U.C.C. § 2-719, Comment 1, which states:

Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

²⁴ See, e.g., *Stokes v. Moore*, 262 Ala. 59, 77 So.2d 331 (1955), which involved an employment contract containing a covenant not to compete for a year following termination, together with clauses for liquidated damages and also a provision for a restraining order or injunction in case of violation. While holding that the injunction was expressive of the intention of the parties that the liquidated damages provision was not to be the exclusive remedy, and ordering the issuance of a temporary injunction, the court stated:

We do not wish to express the view that an agreement for the issuance of an injunction, if and when a stipulated state of facts arises in the future, is binding on the court to that extent. Such an agreement would serve to oust the inherent jurisdiction of the court to determine whether an injunction is appropriate when applied for and to require its issuance even though to do so would be contrary to the opinion of the court.

Id. at 64, 77 So.2d at 335.

²⁵ "A breach of contract is a non-performance of any contractual duty of immediate performance. A breach may be total or partial, and may take place by failure to perform acts promised, by prevention or hindrance, or by repudiation." Restatement of Contracts § 312 (1932).

time later. Depending upon the entire agreement, and perhaps the surrounding circumstances as well (and especially if time is expressly or implicitly of the essence), such a delay might nevertheless be a total breach, excusing the innocent party from further performance, and giving rise to an immediate cause of action for any of a number of remedies; it may, on the other hand, be a mere minor breach, permitting an action for the comparatively small damages flowing from the delay, but not terminating the contract as a whole; or it may, if waived or in certain other circumstances, not be actionable at all.²⁶ Refusals to perform lesser obligations due at the closing also may or may not be deemed material, depending on their nature and the terms of the contract.

Either party may be guilty of a breach of warranty in connection with a business sale. Warranties usually flow from the seller. Where a sale of stock is involved, there may be warranties of title, warranties as to balance sheets, profit and loss statements, and other aspects of the business being sold. Where assets are sold, any or all of these warranties may also be present.

There are fewer things a buyer is likely to warrant (as distinguished from promise), but if the business is sold for shares of stock in the buyer's company, warranties concerning that stock or the buying corporation itself are usually included and, in turn, may, therefore, be breached.²⁷ Quite frequently, the agreement contains promises to be performed after the closing. The purchase price, for example, may be payable in installments, with the latter either fixed in time and amount or variable depending on the level of post-closing earnings. The agreement may also call for payment of certain or all creditors by the seller; conversely, however, in some contracts the buyer promises the seller that he will assume such obligations. A breach of such a clause by either party may, therefore, give rise to a cause of action by the other party, as well as a possible claim by the creditor as a third party beneficiary.

As part of the sale of a business there is often a collateral contract providing for the employment of certain principal officials of the selling company by the buyer. A breach by either employer or employee may be actionable; if the seller itself promises that certain of its personnel

²⁶ Restatement of Contracts § 275 (1932) sets forth general rules for determining when a breach is material, and § 276 contains specific guidelines where the breach takes the form of delay. If a breach is "material," it excuses the counter-performance of the other party; in addition, it permits him to treat the contract as totally breached and to sue for whatever remedies for breach of the entire contract are appropriate. Restatement of Contracts §§ 313, 317, 327 (1932).

²⁷ Forms frequently employed for business sale agreements convert pre-closing promises and conditions into warranties at the closing, which survive the closing and may be breached at a later time.

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will enter into employment arrangements with the buyer, the seller may be guilty of a breach of contract if they refuse.

A type of breach peculiar to the seller's side would be that of a covenant not to compete. Individual sellers so covenanting may commit a breach and, if a seller covenants that certain of its employees will not compete, their violation may make the seller guilty of a breach.

At this point, a distinction should be noted between promises and conditions. Performance of a promise by one party may be a condition to part or all of the performance of the other, and failure by the one may suspend or excuse the obligation of the other. There are instances, however, where either because of provisions of the contract or, in their absence, a decision that the law treats the performances as independent, a party may be obliged to continue his performance despite the other's breach.²⁸

Conversely, certain events may be conditions to a party's duty to perform, while their breach gives rise to no cause of action. For example, a contract may provide that a buyer is free to cancel if the seller's profits for a given period—for example, the period between the contract date and the closing date—fail to attain a designated level; this is to be distinguished from a case in which the seller warrants that level of profits. Also distinguished from that case would be a provision making the payment of post-closing installments of the purchase price dependent upon the level of earnings attained.

Similarly, the failure of the seller to induce a principal employee to enter into an employment contract with the buyer may, if the contract so provides, excuse the buyer from proceeding with the purchase, even if the seller does not promise that the employee will do so and, thus, has committed no breach. The first place to look to determine what events are promised, which are conditions, and which are both, is the contract itself; in the absence of a clear expression by the parties, the courts will fill the interstices as best they can.²⁹

For almost every one of the aforementioned types of actual breach, there may potentially be a corresponding repudiation, also often referred to as an "anticipatory breach," in which the intention

²⁸ Rules applied by the courts, in a wide range of situations in which the question arises of whether performances are conditional or independent and the issue is not expressly resolved by the contract, are set forth in Restatement of Contracts §§ 266-90 (1932).

²⁹ Some principles of interpretation, helpful in this respect, are set forth in Restatement of Contracts §§ 260-63 (1932).

With respect to the sale of goods, the Uniform Commercial Code provides that in the absence of agreement to the contrary, tender of delivery is a condition to the buyer's duty to accept and pay for the goods, and tender of payment is a condition to the seller's duty to tender and complete any delivery. U.C.C. §§ 2-507(1), 2-511(1).

in manifested not to render a performance due at a future time, or the inability so to perform is communicated to the other party. Such an anticipatory breach is itself actionable in roughly the same fashion as a completed breach,⁸⁰ except for the possibility of retraction of the repudiation before a change of position by the other party.⁸¹

V. REMEDIES FOR BREACH OF CONTRACT

The principal remedies for breach of contract (including breaches of warranty)⁸² are damages, restitution and specific performance.

⁸⁰ Restatement of Contracts § 318 (1932). With respect to the sale of goods, U.C.C. § 2-610 sets forth the following rule:

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

- (a) for a commercially reasonable time await performance by the repudiating party; or
- (b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and urged retraction; and
- (c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

⁸¹ Restatement of Contracts § 319 (1932); U.C.C. § 2-611.

⁸² A breach of one or more of the warranties in a business sale contract should be regarded generally as giving rise to the same range of consequences as a breach of one of the explicitly promissory clauses of the contract. In many instances, the breach will not go to the heart of the contract and, therefore, will not constitute a "material" or "total" breach; but this may also be true in many instances of breach of a promise.

One difference in the treatment of warranties may be in the imposition of a higher standard of promptness in asserting a breach of warranty. While delay for the full period of the statute of limitations would not bar a damage claim for breach of a promise (although its credibility might be seriously weakened thereby), there is authority that a lapse of years from the time a buyer of all the stock of a corporation had reason to know of a breach of financial warranties until he asserted the claim was sufficient to bar his claim for damages. *Franck v. J. J. Sugarman-Rudolph Co.*, 40 Cal.2d 81, 251 P.2d 949 (1952).

Since restitution must always be demanded promptly (see pp. 853-54 *infra*), cases asserting the same principle as a bar to restitution by the buyer may be less significant than damages cases in demonstrating that a prompt demand is required if breach of warranty is to be claimed. See *Royal Hair Pin Corp. v. Rieser Co.*, 18 App. Div.2d 925, 238 N.Y.S.2d 310 (2d Dep't 1963), appeal dismissed, 13 N.Y.2d 1044, 195 N.E.2d 317, 245 N.Y.S.2d 610 (1963); *Sy-Jo Luncheonette, Inc. v. Marsav Distribs., Inc.*, 279 App. Div. 715, 108 N.Y.S.2d 349 (1st Dep't 1951), *aff'd*, 304 N.Y. 747, 108 N.E.2d 614 (1952).

There is also authority that for a breach of warranty to be actionable, the aggrieved party must have relied on it. In *Sy-Jo supra*, the court held that a failure to show reliance, as well as the lapse of time, barred buyer's claim for rescission.

Some, but not all, of these rules are effective where Article 2 of the Code applies. The requirement of promptness in claiming breach of warranty in purchased goods is continued, with somewhat greater specificity. The buyer is obliged "within a reasonable time after he discovers or should have discovered any breach [to] notify the seller of breach or be barred from any remedy. . . ." U.C.C. § 2-607(3)(a).

It should be noted that where the goods have been accepted, the buyer need not

Each will be discussed below at some length. There are, in addition, a number of miscellaneous responses to breach available to the aggrieved party, which should also be mentioned.

A. *Non-Performance by the Aggrieved Party*

In some circumstances, upon a breach by one party, the other party has the privilege of suspending his own performance, either permanently or until such time as the breach is cured. Failure to render a performance which is a condition precedent to or concurrent with the aggrieved party's counter-performance will generally at least permit the latter to withhold his performance; if the breach may properly be characterized as "material," he may also treat the contract as terminated and pursue his other remedies.⁸³ No all-inclusive statement can set forth the circumstances that make a breach "material," but a helpful catalogue of factors bearing upon that conclusion may be found in the Restatement of Contracts Sections, 275 *et seq.*⁸⁴ It should be noted in this connection that for a breach to excuse the innocent party from further performance, it must be concluded that the performance which was not rendered was a condition precedent to or concurrent with the performance of the innocent party which is excused. As pointed out above,⁸⁵ the parties may specify in their contract what performances by each of them are to be deemed precedent to or concurrent with what performances by the other, and thus may themselves write their own body of law as to which breaches may be deemed material and which may not. In the sale of a business, however, there is likely to be a fairly lengthy catalogue of obligations imposed, partic-

"include a clear statement of all the objections that will be relied on by the buyer," and his notification "need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched." U.C.C. § 2-607, Comment 4. Where the goods are being rejected, on the other hand, the buyer loses his rights unless he states the particular defect he is relying upon if either (a) the seller could have cured it if it had been stated seasonably, or (b) between merchants, after rejection, the seller has made a written demand for a full and final statement of all defects. U.C.C. § 2-605(1).

Reliance upon express warranties may not be absolutely necessary under the Code. Section 2-313(1)(a), (b) and (c) require only that the warranty be "part of the basis of the bargain," a standard probably easier to meet.

Under the Code, as in other areas of law, the measure of damages for breach of warranty is the difference "between the value of the goods accepted and the value they would have had if they had been as warranted. . . ." § 2-714(2).

⁸³ See Restatement of Contracts §§ 266 *et seq.* (1932).

⁸⁴ The test by which it is determined whether a breach is sufficiently "material" to justify the other party, not only in suspending his performance, but also in refusing to proceed further and to treat the contract as terminated, is quite similar to the standard of "total breach" which is a prerequisite to the right to demand restitution. Cf. pp. 852-53 *infra*; Restatement of Contracts §§ 275, 313 *et seq.*, 347 (1932). A non-material breach may be a "total" breach if it is accompanied by a repudiation by the party in default. Restatement of Contracts §§ 317, 318 (1932).

⁸⁵ See pp. 831-33 *supra*.

ularly upon the seller, but sometimes upon the buyer as well, with the result that it is unlikely that every permutation and combination of circumstances can be provided for in the contract.³⁶ Where no such provision is made, the answers must be found in the generally applicable principles of law, and in many circumstances, predictions cannot be made with a high degree of confidence.

B. Assurance of Performance

Another remedy, also not directly enforced in a legal action, is the right to demand assurance of performance where a party has reasonable grounds for insecurity. This right had found some expression even before adoption of the Uniform Commercial Code. However, Section 2-609 of the Code codifies it with some specificity, and although it applies literally only to the sale of goods, the principle asserted would seem appropriate for adoption by way of analogy to a wide range of contractual situations. In connection with the sale of a business, a demand for assurance of performance might well be appropriate where, for example: either party indicated doubt as to whether he was going to complete the transaction; a buyer's financial situation appeared to be deteriorating, thus giving rise to reasonable apprehension as to his ability to pay; either party might have entered into discussions with a third party for a purchase or sale inconsistent with the contract already entered into; a key employee, who was to have entered into an employment contract, might be bargaining for a long-term contract with another employer; information might come to light suggesting that promises as to the performance of the seller's business prior to closing will not be met. The common denominator in these examples is that even though neither party may have yet committed an actionable wrong, each party is entitled not only to ultimate performance, but also to a measure of security that such performance will in fact be rendered. As stated in Section 2-609(1) of the Code: "A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired."³⁷

³⁶ Contracts for the sale of a business frequently provide, however, that performance of each warranty and covenant is a condition to the other party's duty to perform. See note 16 supra.

³⁷ See also U.C.C. § 2-609, Comment 1:

The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contract and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky

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Under the Code provision, where a party has reasonable grounds to regard himself as insecure in any of these respects, he may demand adequate assurances of due performance from the other party and suspend his own performance until such assurances are received. What types of assurance may reasonably be demanded will depend upon all of the circumstances, especially the basis for the insecurity. For example, indications that the buyer has serious financial problems might in some instances be satisfactorily disposed of by a mere explanation. If, on the basis of all the facts, there is greater reason for apprehension, a new certified balance sheet might suffice. In extreme cases, it might be proper to insist upon a performance bond, a deposit of cash in escrow, or even an advance payment of cash otherwise not due until later. If adequate assurances are not forthcoming within a reasonable time, the apprehensive party may treat the contract as repudiated.³⁸

C. *Declaratory Judgments*

Another remedy, not discussed elsewhere herein, is the declaratory judgment. It may occasionally happen in the course of performance of a business purchase contract that a party's needs will be satisfied by a judicial declaration on a disputed issue pertaining to his rights against the other party. More typically, however, if a disagreement cannot be resolved informally, the pressures of time are likely to be such that one party or the other will want a more direct remedy—either equitable relief (specific performance or an injunction) or a legal remedy such as damages or restitution.³⁹

D. *Damages*

1. *The Basic Standard: To Give the Plaintiff the Benefit of His Bargain*

The most frequently applied remedy for breach of contract is an award of damages. "Damages," in contract actions, does not have the normal meaning it would have in other areas of the law, for example, in a tort case—namely, that the aggrieved party be put back in his previous position. Contract damages are intended, instead, to put the

buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

³⁸ U.C.C. § 2-609(4).

³⁹ Although arbitration may be regarded as a remedial device which may be employed as an alternative to adjudication, it will not be discussed herein.

plaintiff in the position he would have been in financially if the contract had been performed.

While simple enough to state, this principle is not easy to apply in business purchase cases. In a sale involving goods which are bought and sold on an available market, damages are readily computed. If the contract price is \$10 and the market value is \$11 and the seller defaults, the buyer is entitled to \$1 in damages.⁴⁰ Correspondingly, if the contract price is \$11 and the market value is \$10, an aggrieved seller is entitled to \$1 in damages.⁴¹ There is, however, normally no such ready market for businesses. It would generally be quite difficult for a buyer who has contracted to purchase a business for \$1,000,000 to prove that its value was really \$1,100,000.⁴² Such proof is not necessarily impossible, however, and the courts have become increasingly permissive in allowing expert testimony as to valuations of this kind. Such formulae as multiples of earnings and the like may be employed. Devices for determining valuation for other purposes—for example, just compensation in cases of condemnation—presumably may be used. At best, however, the task is a difficult one.

The use of market value as the yardstick was formerly not only permissible, but generally mandatory in cases involving the sale of goods, except where there was no market or the market value test did not provide adequate compensation.⁴³ If, for example, after default by the buyer, the seller resold the goods, the resale price was at most merely rebuttable evidence of the market value of the goods. The Uniform Commercial Code, however, has developed a pair of alternative remedies for buyers and sellers which will sometimes achieve a more just result. An aggrieved seller may resell the goods to another party, and, if the sale is made under commercially reasonable circumstances and otherwise meets the statutory requirements, the resale price fixes the measure of damages.⁴⁴ The aggrieved buyer has an analogous remedy under the Code known as "cover," whereby the buyer replaces the goods he should have received from the seller. If

⁴⁰ U.C.C. § 2-713.

⁴¹ U.C.C. § 2-708. In both cases, the measure of damages expressed assumes an entirely executory contract; where there has been part or full performance by the plaintiff, the damage would be increased accordingly. For example, if the buyer in the example given above had paid the \$10 price, his damages would be \$11. Also in both cases, appropriate incidental and consequential damages may be recovered in addition to the standard measure. U.C.C. §§ 2-710, 2-715.

⁴² The test is often stated as that of value to the plaintiff, rather than in the abstract, provided the defendant was aware at the time of entering into the contract of any special factors in the plaintiff's situation that made his performance especially valuable to the plaintiff. See 11 S. Williston on Contracts § 1343 (3d ed. 1968) [hereinafter cited as Williston].

⁴³ Uniform Sales Act, §§ 64(3), 67(3).

⁴⁴ U.C.C. § 2-706.

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he does this in a commercially reasonable fashion, the purchase price establishes his measure of damages⁴⁵ rather than being merely evidence of value. Finally, it should be noted that there is no obligation under the Code for the aggrieved seller to resell or the aggrieved buyer to cover. These are merely alternative devices for establishing damages, which the parties are free to employ or forego. Since no two businesses are alike, cover is unlikely to be of much use in business purchase cases. The resale option offered by the Code, however, may often be attractive to the seller, and even though the sale may be one of stock, or of assets only a small part of which are goods, there may be reason to expect that courts may be persuaded to apply the resale provisions of the Code by way of analogy.⁴⁶

Since a breach of warranty is a type of breach of contract, damages are predicated upon the same basis, namely, that the plaintiff be put in the same position he would have been in if the warranty had been adhered to.⁴⁷ In business purchase cases, it may not always be easy to determine the difference in value between the business with the warranty true and the warranty false. Breaches of warranty may pertain to one non-repeating item, such as a lack of good title to a single piece of property. In such cases, the diminution of value of that property by reason of the defect might be the measure of damages. In other cases, however, a breach of warranty might reflect a long-term repeating phenomenon, which should be capitalized; for example, if net profits for the last full year were overstated by \$10,000, and the

⁴⁵ U.C.C. § 2-712.

⁴⁶ But cf. *Foster v. Colorado Radio Corp.*, 381 F.2d 222 (10th Cir. 1967), discussed at p. 827 *supra*. Even if the resale price is not accepted as conclusive upon the measure of damages, it may still serve as persuasive and frequently decisive evidence of the market value of the business and thus, indirectly, have the same effect. The seller of a business recovered upon this basis from a defaulting buyer in *Pacific Odorite Corp. v. Gersh*, 94 Cal. App.2d 174, 210 P.2d 318 (1949). While the converse—a buyer procuring the same business from someone else—must be quite rare, an analogy may be found in the case of a buyer who has a contract in hand to resell the business which the seller wrongfully fails to sell to him. In *Delvitto v. Schiavo*, 164 Pa. Super. 338, 64 A.2d 496 (1949), the buyer of a hotel was permitted to recover the difference between the contract price and the price for which he could have resold it. The court stressed the fact that the seller knew of the resale contract at the time of the breach as a reason for allowing the resale price to determine the measure of damages. Under the foreseeability test as generally applied (see p. 842 *infra*), however, the critical time for knowledge or reason to know is that of the making of the contract rather than that of the breach. Compare *Amsterdam v. Marmor*, 125 Misc. 865, 212 N.Y.S. 300 (App. Term, 1st Dep't 1925), rejecting, as incompetent, evidence of a resale contract.

⁴⁷ As to sales of goods, this rule is set forth in U.C.C. § 2-714(2). A measure of damages analogous to this was applied in a case of breach of a covenant not to compete incident to the sale of a business. The court computed damages on the basis of the difference between the value of the business with and without the seller's competition. *Amsterdam v. Marmor*, 125 Misc. 865, 212 N.Y.S. 300 (App. Term, 1st Dep't 1925).

purchase price was based in large part on a formula of five times the earnings, a claim for damages of \$50,000 might be upheld.⁴⁸

2. *Consequential Damages: Foreseeability*

A plaintiff will often lose more from a breach than the mere benefit of his bargain. The buyer, for instance, may have planned to use the business to be acquired as an assured source of supply of materials needed for a business already owned, and may be obliged to curtail operations of the latter if the seller defaults. Similarly, a buyer's default may deprive a seller of an opportunity to use the money to take advantage of an exceptional investment opportunity. In either situation, such consequential damages are recoverable only if losses of that character could reasonably have been foreseen by the defendant at the time the contract was made. This foreseeability doctrine, which arose in the renowned English case of *Hadley v. Baxendale*,⁴⁹ is still applied by modern courts,⁵⁰ and has been reaffirmed in the Uniform Commercial Code.⁵¹

If the parties to the agreement can anticipate consequences of breach which would not normally follow in the absence of special circumstances, but which would be likely to occur in their situation, these consequences can be communicated at or before the signing of the contract, or better still, recited in the contract itself. Human foresight is limited, however, and since the only thing that can be expected with confidence is the unexpected, situations are bound to arise in which various types of consequential damages must be regarded as too remote to meet the test of foreseeability.

⁴⁸ Damages based upon breach of a warranty as to the seller's net income might over-compensate the buyer if a tax refund or other tax saving resulted therefrom. Conversely, a breach of warranty caused by the government's assertion of a tax deficiency not scheduled by the seller might reflect a higher level of profits, increasing the value of the company to the buyer. In such case, an award of damages to the buyer in the amount of the tax deficiency might give him an unjustified windfall. Courts are slow to take account of such tax considerations in determining the measure of damages, and express provision for such contingencies should be included in the contract.

⁴⁹ 9 Ex. 341 (1854).

⁵⁰ See, e.g., 5 A. Corbin on Contracts §§ 1007 et seq. (1964) [hereinafter cited as Corbin].

⁵¹ U.C.C. § 2-715(2)(a) allows the buyer consequential damages resulting from the seller's breach including "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise." There is no comparable provision as to seller's damages, presumably because of the comparative rarity of cases in which the seller of goods suffers any indirect losses from the temporary withholding from him of the sales price. In that situation, consequential damages are usually restricted to interest on the money withheld. 11 Williston, *supra* note 42, at § 1410.

3. *Avoidable Consequences*

Another limitation upon the scope of damages is that a party may not recover for consequences which he reasonably could have avoided. The buyer of a business, for example, who, after receiving notice of repudiation by the seller continues to enter into leases, have stationery printed, engage employees and otherwise take steps which will be of use only if and when the contract is performed, is likely to find that the courts will deny him recovery for losses so incurred.

In addition to refraining from taking affirmative steps to increase damages, the aggrieved party may not remain passive when positive action, not involving undue expense or risk, reasonably could be expected to limit his losses. If he fails to take such action, he may not recover for the consequences which could have been avoided.⁶² If, for example, the seller of a business delivers equipment warranted to be functioning, but in fact in need of minor repairs, the buyer may not include in his damages losses resulting from the defect which could have been avoided if timely repairs had been made. Similarly, if employment contracts executed by specified employees have been promised by the seller, but are not forthcoming, the buyer will not be allowed to recover for the consequences of allowing the business to collapse for lack of their services if competent substitutes could readily have been hired; his damages would be limited to the losses that would have been incurred through having had to employ substitutes.

4. *Certainty*

Another requirement of contract damages is that proof of damages must rest on something more than mere guesswork. If the amount of the damage claim is based entirely upon conjecture, a court will not permit a recovery of damages as such (although specific performance or restitution may be awarded in appropriate cases). The requirement of certainty is often stated to be less rigid when the issue is the measure of damages rather than whether there is a loss at all.⁶³ Also, distinctions

⁶² See Restatement of Contracts § 336(1) (1932). The denial of consequential damages to a buyer who fails to cover, contained in U.C.C. § 2-715(2)(a), should be regarded as a statutory application of the doctrine of avoidable consequences.

⁶³ See *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562-63 (1931); *Allen v. Gardner*, 126 Cal. App.2d 335, 340, 272 P.2d 99, 102 (1954). Cf. U.C.C. § 1-106(1) (liberal administration of remedies), and Comment 1 thereto: "[A] purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more." See also U.C.C. § 2-715, Comment 4. Where defendant's breach has prevented use of a method of valuation prescribed by the contract, the plaintiff is permitted to prove value

are sometimes drawn between a going business and one merely about to be launched.⁵⁴ Nevertheless, some degree of reasonable estimation, as distinguished from sheer conjecture, is necessary.⁵⁵

Problems of proof of damages obviously cannot be discussed in detail in this article. The practitioner might be advised not to limit his research to contract cases but to consider approaches employed in other types of litigation. In business sale cases, the most troublesome obstacle in establishing damages is likely to be proving the value of the business being sold. Counsel should consider techniques used in determining the valuation of a business in other situations such as condemnation, dissolution of a partnership, appraisal of the interest of a minority stockholder, civil antitrust actions, and cases involving the tort of interfering with business relationships.⁵⁶

In some instances, when a plaintiff's case for damages will otherwise fail because of lack of certainty, another approach may be adopted to give some measure of relief, even if not a completely satisfactory one. For example, where the profits from a piece of property cannot be computed, a court may award instead its rental value or interest on the value of the property.⁵⁷ For example, in one action by the buyer for specific performance of a contract to sell a business, the court, in determining damages for the period until compliance, used as a measure the difference between the rental cost of the property to be conveyed and its value as a motion picture theatre.⁵⁸

Another substitute measure of damages where the value of defendant's performance is too speculative for determination is the loss incurred by the plaintiff. For example, where the plaintiff sold a going business to order to move to another state to become half owner of the defendant's business, the defendant breached, and the profits of the business to be acquired were regarded as not sufficiently ascertainable to establish a measure of recovery, the court allowed as damages the loss incurred by the plaintiff in disposing of his previous business.⁵⁹

by other means. Cf. *E. I. Du Pont de Nemours Powder Co. v. Schlottman*, 218 F. 353, 355 (2d Cir. 1914).

⁵⁴ See *Evergreen Amusement Corp. v. Milstead*, 206 Md. 610, 618-19, 112 A.2d 901, 904-05 (1955); 5 Corbin, *supra* note 50, at § 1023.

⁵⁵ Restatement of Contracts § 331(1) (1932). "It is not merely milkmaids who have rosy dreams as to the large gains to be made by selling the chickens to be hatched from the eggs to be bought with the price of the milk that was spilled by the defendant." 5 Corbin, *supra* note 50, at § 1022.

⁵⁶ For suggested methods for proving lost profits, see 11 Williston, *supra* note 42, § 1346A.

⁵⁷ Restatement of Contracts § 331(2) (1932).

⁵⁸ *Loomis v. Hailston*, 183 N.Y.S. 705 (Sup. Ct. Sp. Term 1920).

⁵⁹ *Overstreet v. Merritt*, 186 Cal. 494, 200 P. 11 (1921).

5. *Preparation Expenses*

Courts will also award, as part of a damage remedy, the expenditures incurred by the plaintiff in preparation for, or in part performance of, the contract.⁶⁰ Such awards are subject to the limitations that they must not give rise to duplications and that the relationship between the expenditures and the contract is sufficiently close that they might truly be taken into account in computing the profits from the contract, rather than being regarded as expenditures for the general purposes of the plaintiff's business.⁶¹

6. *Lawyers' Fees*

While broad statements may often be encountered to the effect that lawyers' fees are never included as part of damages unless specifically agreed upon in the contract itself,⁶² the general rule is subject to some necessary qualification. The expenses incurred by a plaintiff in suing a defendant for breach of contract normally are not recoverable in American law unless expressly provided for in the contract.⁶³ Lawyers' fees may be incurred for other purposes, however. If, for example, there is a warranty that the business being sold has no outstanding debts or taxes against it, and if the buyer is presented with such a claim and has to defend it, reasonable legal expenses incident to the defense may well be appropriate for inclusion in the measure of damages along with the amount actually paid to the creditor.⁶⁴ Depending upon the language of the warranty, however, the plaintiff may not be free to engage his own attorney for this purpose without first serving upon the defendant a demand that the defendant undertake the defense of the case.⁶⁵

7. *Liquidated Damages*

Quite frequently in contracts for the sale of a business, the parties provide for liquidated damages in the event of certain breaches. Such provisions, where valid, are applied to fix the measure of damages, replacing the elements that would otherwise go into the court's determination of the amount of recovery.

Despite the lip-service generally accorded the notion of freedom of contract, reflected in a tendency to permit parties of comparatively

⁶⁰ See *Lieberman v. Templar Motor Co.*, 236 N.Y. 139, 149, 140 N.E. 222, 225 (1923); *Overstreet v. Merritt*, 186 Cal. 494, 200 P. 11 (1921).

⁶¹ See 5 Corbin, *supra* note 50, at § 1031.

⁶² See, e.g., 22 Am. Jur.2d Damages § 165 (1965).

⁶³ This is subject to an exception, of course, for taxable costs.

⁶⁴ *Verhagen v. Platt*, 1 N.J. 85, 61 A.2d 892 (1948); see also 5 Corbin, *supra* note 50, at § 1037; Restatement of Contracts § 334 (1932).

⁶⁵ See 5 Corbin, *supra* note 50, at § 1037; Restatement of Contracts § 334 (1932).

equal bargaining power to make almost any sort of agreement they choose, liquidated damages clauses are closely weighed and often found wanting. Courts must satisfy themselves that the clause in question is a genuine effort to establish a fair measure of damages, rather than an attempt to coerce performance through the threat of a crippling liability.⁶⁶ Where the clause is sustained the courts will call it a "liquidated damages" provision, and when it is voided they will refer to it as a "penalty," but these labels are no more than expressions of the conclusions reached.

In this area, as in so many others, there is no precise formula by which to identify the clause which will be upheld as distinguished from the one which will be stricken. Militating in favor of upholding a provision will be such factors as a measure of recovery within the general range of the damages which might be anticipated, the fact that computation or proof of the precise damage would probably be difficult, and the lack of any indication of intention to coerce performance through imposition of disproportionately harsh damages. A penalty would be characterized by the reverse of some or all of these elements.

In addition, where a contract provides for the same measure of liquidated damages for any breach, whether trivial or substantial,⁶⁷ courts frequently seize upon this fact as evidence of a lack of genuine intention to liquidate the damages, and will either void the entire clause or, in some cases, construe it as applicable only to the more serious breaches.⁶⁸ Thus, if a contract for the sale of a business for \$1,000,000 provided for liquidated damages in the amount of \$500,000 in the event of the buyer's total breach, this sum would appear to be on the high side, although one could not tell for certain that it was out of line without further information as to the availability of buyers, fluctuations in the selling price of similar businesses, probable difficulties in determining or proving damages, and so forth. If, however, the clause also provided for the same \$500,000 sum regardless of whether the breach were a total repudiation of the agreement or the delay of one day in readiness to close, a strong case for invalidation as a penalty would be made.⁶⁹

⁶⁶ See generally Restatement of Contracts § 339 (1932); 5 Corbin, *supra* note 50, at §§ 1054-075.

⁶⁷ Such provisions are sometimes referred to as "blunderbuss" or "shotgun" clauses, depending upon the ballistic preferences of the writer.

⁶⁸ In *Hackenheimer v. Kurtzmann*, 235 N.Y. 57, 138 N.E. 735 (1923), liquidated damages of \$50,000 for any breach of a contract to sell a business for \$130,000 were upheld where the breach was one of a covenant by the seller not to compete and the court construed the clause as applicable only to serious breaches.

⁶⁹ A provision for damages of \$6,200 for a breach at any time of a covenant not to compete, where the purchase price of the business was \$12,500, was held invalid on this theory, since the contract prescribed the same measure of damages regardless of

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Section 2-718(1) of the Uniform Commercial Code has made a minor modification in the common law rules concerning liquidated damages. It requires that the amount be "reasonable in the light of the anticipated *or actual* harm caused by the breach. . . ." (Emphasis added.) Prior to adoption of the Code, the usual rule was to evaluate the liquidated damages clause only in the light of circumstances known at the time of entering into the contract. It remains to be seen whether the courts will apply the more permissive standard enunciated in the Code by analogy to cases other than those involving the sale of goods.⁷⁰

In view of the difficulties frequently encountered in establishing actual damages,⁷¹ as well as uncertainty as to the availability of specific performance,⁷² liquidated damages clauses, if carefully drawn, can be extremely useful to either or both of the parties to a business sale agreement. If the reported cases are an indication, however, such clauses are most frequently used in business sale cases in connection with a covenant by the seller or its principals not to compete with the business being sold.⁷³ It may be noted that most of the liquidated damages cases cited above arose out of violations of covenants of this sort.⁷⁴

Other uses of liquidated damages clauses in connection with ancillary aspects of the sale of a business include their application to a covenant not to reveal trade secrets or to use trademarks or trade names of the business being sold.⁷⁵

A related question arises in what might be called "underliquidated damages." If the agreement provides a measure of damages grossly

when the competition occurred. *Mount Airy Milling & Grain Co. v. Runkles*, 118 Md. 371, 84 A. 533 (1912). But cf. *Robbins v. Plant*, 174 Ark. 639, 297 S.W. 1027 (1927), upholding liquidated damages of \$10,000 for entry within 20 years into competition with a business sold for only \$10,000. And in *Buckhout v. Witwer*, 157 Mich. 406, 122 N.W. 184 (1909), damages set at a fixed amount per year of competition were nevertheless held to be a penalty, and were thus not a bar to a suit for specific performance of the contract.

⁷⁰ See pp. 828-29 *supra*.

⁷¹ See pp. 839-44 *supra*.

⁷² See pp. 856-61 *infra*.

⁷³ Discussed generally in 5 Corbin, *supra* note 50, at § 1071. Such clauses must be drafted to comply with the general principles as to the validity of liquidated damages clauses; covenants not to compete must also limit the range of the restriction, in both space and time, to what is reasonably necessary to assure the purchaser that he will in fact acquire the goodwill for which he is bargaining. If a covenant is unreasonably broad, a court might strike it down as against public policy, perhaps labeling it an unreasonable restraint of trade, or it might uphold it *pro tanto*. 2 Restatement of Contracts §§ 515-16 (1932); cf. *Bradshaw v. Millikin*, 173 N.C. 432, 92 S.E. 161 (1917) (sale of barbershop; agreement not to compete for two years upheld against contention it was unreasonable restraint of competition). This is an application of a common law principle antedating the antitrust laws but reflecting related concepts of public policy.

⁷⁴ See notes 67-68 *supra*.

⁷⁵ E.g., *Tode v. Gross*, 127 N.Y. 480, 28 N.E. 469 (1891).

inadequate to compensate the aggrieved party, there may be questions of public policy as to whether it should be applied,⁷⁶ but the problem is a different one from that of the "penalty," since the purpose of the clause cannot be to coerce performance. Comment 1 to Section 2-718 of the Code states:

A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

It is not at all clear that the comment is correct in stating that the unreasonably small amount would be subject to "*similar criticism*," but an argument that the clause is suspect nevertheless may well be persuasive. In addition to the section on unconscionability (2-302) referred to, a party seeking to void an "underliquidated damages" clause might find support in section 2-719(2), which reads: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."

Still another variation of the liquidated-damages-versus-penalty problem is the question whether a defaulting buyer would forfeit any payments he had already made (or the rarer case of a forfeiture of initial installments of stock or assets delivered by a subsequently defaulting seller). There was a substantial body of law in the last century, vestiges of which still remain, to the effect that a defaulting party to a contract would lose whatever part performance he had rendered—in particular, part payment of the price by a buyer.⁷⁷

Despite the obvious similarity between permitting forfeiture of part payments on the one hand and enforcement of penalty clauses on the other, there was, for a considerable time, little attention paid by the courts to their inconsistency in treatment of the two situations. Part payments were held forfeited even though there was no reference to such a consequence in the agreement, and regardless of whether the amount of the forfeiture, if specifically included in the agreement as an attempt at liquidating damages, would clearly have been regarded as a penalty.

This doctrine of forfeiture has been whittled away both by statute

⁷⁶ Corbin regards such clauses as generally valid, on the ground that they serve as a legitimate limitation upon the risk assumed by a party to a contract, except in cases of disparate bargaining power. 5 Corbin, *supra* note 50, § 1068.

⁷⁷ E.g., *Lawrence v. Miller*, 86 N.Y. 131 (1881); see 5 Corbin, *supra* note 50, at § 1075 and cases cited therein.

and judicial decision,⁷⁸ but in many states it is not yet completely eradicated. At least with respect to the sale of goods, New York changed the rule in 1952, providing that upon the buyer's default the seller could retain either such amount as was provided for by a valid liquidated damages clause, or in the absence thereof, twenty percent of the value of the total performance.⁷⁹ This provision has now been superseded by Section 2-718(2) of the Uniform Commercial Code, which is modeled upon the New York statute but establishes a ceiling of twenty percent or \$500, whichever is less.⁸⁰ This clearly changes the old rule, where it still existed, with respect to transactions in goods, but whether it will be applied by the courts by way of analogy to other cases remains to be seen. Certainly, more clearly than many other more technical provisions of Article 2 of the Code, this change seems to evidence a legislative policy which should commend itself to the courts in situations to which it is not literally applicable. However, since part payments by buyers before closing are fairly rare, this particular problem may not arise frequently in business sale cases.

8. *Miscellaneous*

Where the buyer has a claim for damages—for example, for breach of warranty—and there remain unpaid installments of the purchase price, the buyer may assert his claim by way of recoupment or as a counterclaim to reduce the installment payments due or to recover for any excess.⁸¹

Punitive damages are normally not awarded in any case involving mere breach of contract⁸² in the absence of fraud.

Where the plaintiff has established the fact of breach but cannot substantiate the amount of injury, courts will usually award nominal damages, sometimes as a basis for the award of costs.⁸³

⁷⁸ See the interesting discussion of this problem by Judge Clark in *Amtorg Trading Corp. v. Miehle Printing Press & Mfg. Co.*, 206 F.2d 103 (2d Cir. 1953).

⁷⁹ Upon the recommendation of the Law Revision Commission, Section 145-a was inserted in the N.Y. Personal Property Law, following Section 145, which corresponded to Section 64 of the Uniform Sales Act. N.Y. Pers. Prop. Law § 145, 145-a (McKinney 1962).

⁸⁰ So small a forfeiture would be virtually meaningless in a typical business sale case, but it must be remembered that all of the other remedies for breach of contract, including any valid liquidated damages clause agreed upon by the parties, would still be available.

⁸¹ Where the seller of a "camp" (consisting of cabins, a cafe, a garage, boats, and so forth) had misstated earnings, the Supreme Court of Arkansas stated that the buyer had a choice of (1) "rescinding" and by returning or offering to return the business to the seller, recovering what he has paid on the contract, (2) retaining the business and suing for damages, or (3) pleading the breach, when sued for unpaid installments, as a deduction from the amount due. The choice by the buyer of the last of these alternatives was upheld in *Kotz v. Rush*, 218 Ark. 692, 238 S.W.2d 634 (1951).

⁸² Restatement of Contracts § 342 (1932).

⁸³ Restatement of Contracts § 328 (1932).

E. *Restitution*1. *Generally*

Restitution, an alternative remedy for breach of contract, may be sought instead of damages. While the purpose of awarding damages is to put the aggrieved party as nearly as possible in the position he would have been in if the contract had been performed, restitution is intended, instead, to restore the plaintiff, as far as can be done, to his position before he started performance.⁸⁴ The prevailing plaintiff is normally given back whatever performance of his obligations under the contract he had rendered, either in kind or by way of monetary equivalent. Thus, restitution would have no place in a contract that was entirely executory; only those plaintiffs who had paid, or transferred, or done something in performance would even consider weighing the possible advantages of restitution against damages, as a remedy for breach.

In business sale cases, restitution might take any of several forms. Upon the seller's material breach—for example, his breach of an important warranty—a buyer who had paid part or all of the purchase price could offer back anything he had received from the seller and demand the return of what he had paid.⁸⁵ If the seller had transferred assets of the business to the buyer, who then was in serious default in making payments, the seller could offer back any payments he had received and demand return of such assets as could be conveyed back readily and the cash equivalent of those that could not.

2. *Rescission*

Confusion often arises from the use of the word "rescission" to designate the remedy just described; this use of the word alone would be harmless, resulting only in a choice of two words for one concept.⁸⁶ Unfortunately, "rescission" is also the term used to denote the complete cancellation of the contract by agreement of the parties, with all claims under it extinguished. When rescission is used in this manner, whatever rights either party might have to recover for his own performance necessarily would depend on the terms of the rescission agreement.⁸⁷ When rescission is used as a synonym for the remedy of restitution,

⁸⁴ Restatement of Contracts § 347, Comment b (1932).

⁸⁵ E.g., where payment for a business had been made in promissory notes rather than cash, and they had not been negotiated to a holder in due course, the seller was ordered to return the notes for cancellation. *Giotis v. Lampkin*, 145 A.2d 779 (D.C. Mun. Ct. App. 1958).

⁸⁶ Cf. note 67 *supra*.

⁸⁷ Where a down payment had been made on the purchase of a retail store, and the parties later mutually agreed to rescind without specifically referring to repayment, it was held that the buyer was not entitled to restitution of what he had paid. *McKinney v. Jones*, 210 Ark. 912, 198 S.W.2d 415 (1946).

however, the rights generated are not dependent upon agreement between the parties, but devolve upon the injured party by operation of law.⁸⁸

These semantic difficulties are largely avoided in the Uniform Commercial Code. For example, instead of "rescinding," a buyer "rejects"⁸⁹ or "revokes acceptance."⁹⁰ In addition, parties are saved from the pitfalls arising from improvident use of terms like "rescission" by a provision that such terms generally shall not be construed to constitute a renunciation of rights.⁹¹ While the Restatement⁹² and Corbin⁹³ call the remedy "restitution," and Williston⁹⁴ refers to "rescission and restitution," it is still frequently referred to as "rescission" by the courts.⁹⁵

3. *Restitution Cannot Be Combined With Damages or Specific Performance*

Since restitution is intended to nullify the effect of the contract as far as possible, while both damages and specific performances are remedies predicated upon the notion of giving to the contract as nearly as possible its intended full effect, it is generally said that the plaintiff cannot recover for both restitution and damages or both restitution and specific performance.⁹⁶

Here, too, confusion may arise from semantic difficulties. If, because of a breach of warranty, a buyer of a business suffers losses in trying to operate it, he may sue for restitution, tendering back the business and recovering his purchase price, and also receive compensation for his losses.⁹⁷ The latter element in his recovery is often referred to as "damages," and the erroneous conclusion has been drawn, therefore, that a party may obtain both restitution and damages. It should be noted, however, that the so-called "damages" in this instance are part of the process of putting the plaintiff in the financial position he had been in prior to the contract; they are not true "damages,"

⁸⁸ See 5 Corbin, *supra* note 50, at § 1105; cf. 5A Corbin § 1131.

⁸⁹ U.C.C. § 2-601.

⁹⁰ U.C.C. § 2-608.

⁹¹ U.C.C. § 2-720.

⁹² Restatement of Contracts §§ 347-57 (1932).

⁹³ 5, 5A Corbin, *supra* note 50, at chs. 61-62.

⁹⁴ 12 Williston on Contracts ch. 44 (3d ed. 1968) [hereinafter cited as Williston].

⁹⁵ It is sometimes sought to justify the use of the word "rescission" in this context on the basis that a default sufficiently vital to justify restitution will also permit the innocent party to stop performing and treat the contract as totally halted. This still does not justify using "rescission" to describe the remedy of restitution, since the plaintiff may in such circumstances nevertheless elect to sue for damages instead.

⁹⁶ See 12 Williston, *supra* note 94, at § 1464; 5A Corbin, *supra* note 50, at §§ 1223-224; *Nelson v. Spence*, 182 Cal. App.2d 493, 498, 6 Cal. Rptr. 312, 315 (1960).

⁹⁷ *Hirshon v. Whelan*, 122 A.2d 114 (D.C. Mun. Ct. App. 1956).

intended to put him in the position he would have been in if the contract had been performed.⁹⁸

While the inconsistency between restitution and specific performance seems inescapable,⁹⁹ the objection to awarding both damages and restitution—once the possibility of double recovery for the same wrong is eliminated—seems largely conceptualistic.¹⁰⁰ That this asserted mutual exclusivity is not inevitable may be seen in certain of the provisions of the Uniform Commercial Code allowing the buyer of goods both remedies.¹⁰¹ If the buyer had paid part or all of the price, and the seller either fails to deliver or the goods are not in conformity with the contract (for example, because of a breach of warranty) so as to permit rejection or revocation of acceptance, the buyer may recover both the amount he has paid and damages for his lost bargain.¹⁰² Whether these provisions will be influential in cases not involving the sale of goods remains to be seen.

4. *Restitution Is Available Only for "Total" Breach*

Damages, in some amount, are normally appropriate for any breach. Even if the breach is a trivial one, the innocent party nevertheless has a cause of action if he cares to pursue it, and may recover damages in an appropriate amount for his consequent loss. For example, where time is not of the essence, and the seller of a business is one week late in being ready to close, the buyer may, if he can show consequent loss, be awarded damages for the delay, even though the

⁹⁸ Thus, in *Hirshon v. Whelan*, 122 A.2d 114 (D.C. Mun. Ct. App. 1956), a claimed item for lost profits was not allowed. See also *Mahurin v. Schmeck*, 95 Ariz. 333, 342, 390 P.2d 576, 582 (1964). Where the seller failed to disclose the interest of a third party, which materially impaired the goodwill of the business, and also failed to deliver important records, the buyer was permitted to rescind the purchase, return the business to the seller, get back the purchase price, and also be paid for services rendered to the business during her management of it, but was not awarded damages for her lost bargain.

⁹⁹ See 5A Corbin, *supra* note 50, at § 1224.

¹⁰⁰ Compare 5A Corbin, *supra* note 50, at § 1223 with 12 Willison, *supra* note 94, at § 1464.

¹⁰¹ The seller of goods is almost never entitled to restitution. Since the seller's performance normally takes the form of delivery, a breach by the buyer before the seller delivers entitles the seller to either damages (U.C.C. §§ 2-706, 2-708) or, in an appropriate case, the price (U.C.C. § 2-709), but there has been no performance at that point for which the seller is entitled to restitution. Once the goods are delivered, as a matter of substantive law, the seller is not permitted to reclaim them, except in such limited situations as stoppage in transit (U.C.C. § 2-702), and where agreed between the parties as in a conditional sale.

¹⁰² U.C.C. §§ 2-711(1), 2-712, 2-713. These provisions reverse the rule under § 69 of the Uniform Sales Act, which provided that where the buyer "rescinded" a purchase of goods for breach of warranty, he was denied all other remedies. New York had modified this provision in 1948 to allow damages in just such a situation, in the revised N.Y. Prop. Law § 150(1)(d) (McKinney 1962), now superseded in turn by the Uniform Commercial Code. See also U.C.C. § 2-721.

contract as a whole is not destroyed. Restitution, on the other hand, is permitted only in the case of total breach.¹⁰³ "Total breach," however, is a phrase of art and does not necessarily mean that the breaching party has failed to render even the slightest portion of his agreed performance.¹⁰⁴ For example, even though the business has been transferred, a breach of a material warranty may be sufficient to justify the buyer in returning the business and recovering the consideration which he had paid.¹⁰⁵

5. *Timeliness of Demand*

A limitation upon the availability of restitution is that unlike damages, which normally can be sought at any time until the statute of limitations has run, restitution must be demanded with reasonable promptness. Even though restitution is not purely of equitable origin,¹⁰⁶ a doctrine akin to laches is generally invoked to deny this remedy to one who has not moved with reasonable promptness.¹⁰⁷

A delay occasioned by reasonable reliance upon reassurances given by the other party, however, will not bar restitution. Thus, the

¹⁰³ Restatement of Contracts § 347, Comment e (1932); *Long v. Long*, 121 S.W.2d 800 (Mo. 1938) (buyer of warehouse business failed to make a small part of the payments called for by the contract of sale; held insufficient ground for seller to treat contract as terminated and insist on restitution). See also *Royal Hair Pin Corp. v. Rieser Co.*, 18 App. Div.2d 925, 238 N.Y.S.2d 310 (2d Dep't 1963), appeal dismissed, 13 N.Y.2d 1044, 195 N.E.2d 317 (1963) (minor failure as to record keeping alternative ground for refusal to permit restitution).

¹⁰⁴ See Restatement of Contracts §§ 275, 276, 313 (1932). Compare the test for determining the right of the aggrieved party to refuse to perform. See pp. 837-38 *supra*.

¹⁰⁵ E.g., *Mahurin v. Schmeck*, 95 Ariz. 333, 390 P.2d 576 (1964), discussed at note 98 *supra*; *Campbell v. Pollack*, 101 R.I. 223, 221 A.2d 615 (1966) (breach of warranty of title as to about 10% of assets of car wash business sold, held sufficient to justify revocation of acceptance under U.C.C. § 2-608; *Giotis v. Lampkin*, 145 A.2d 779 (D.C. Mun. Ct. App. 1958) (breach of covenant not to compete held ground for restitution in contract for sale of business); *Lockwood v. Christakos*, 181 F.2d 805, 807 (D.C. Cir. 1950) (dictum to the effect that even innocent breach of warranty as to gross receipts of sandwich shop would be sufficient for restitution).

¹⁰⁶ See 5 Corbin on Contracts § 1103 (1964) [hereinafter cited as Corbin].

¹⁰⁷ *Williston*, *supra* note 94, at § 1469; *Royal Hair Pin Corp. v. Rieser Co.*, 38 App. Div.2d 925, 238 N.Y.S.2d 310 (2d Dep't 1963), appeal dismissed, 13 N.Y.2d 1044, 195 N.E.2d 317 (1963) (lapse of five and one-half years and intervening demand by plaintiff for arbitration were bar to obtaining rescission); *Sy-Jo Luncheonette, Inc. v. Marsav Distribs. Inc.*, 279 App. Div. 715, 108 N.Y.S.2d 349 (1st Dep't 1951), *aff'd*, 304 N.Y. 747, 108 N.E.2d 614 (1952) (operation of business by buyer for two months after he learned of asserted misrepresentations barred rescission). This principle is illustrated rather dramatically in the recent case of *American Container Corp. v. Hanley Trucking Corp.*, 7 U.C.C. Rep. 1301 (N.J. Super. 1970). *A* sold a semi-trailer to *B*, erroneously believing that he had good title to it. *B* sold it to *C*. The true owner then laid claim to the semi-trailer, and it was seized by the police. *C* promptly notified *B*, but *B* failed to give prompt notification to *A*. All three parties were before the court. It was held that *C* was entitled to restitution from *B* in the amount of the purchase price less the value of its use while he had possession. It was also held, however, that *B*'s delay in informing *A* precluded restitution, thus limiting *B* to a cause of action for damages.

buyer of a vending machine business was held entitled to revoke the transaction and recover his payments because of misstatements as to the earnings of the business, even though he had continued to make installment payments after knowledge of the discrepancy. The decisive factor in the decision was the buyer's reliance upon explanations given him by the seller when the inaccuracies were pointed out.¹⁰⁸

6. *Measure of Recovery*

If the plaintiff's performance has taken the form of a payment of money—which is frequently the situation where a business buyer seeks restitution for the seller's breach—it is fairly easy to compute the amount of the recovery on the basis of money paid plus interest. When the plaintiff's performance is of a non-pecuniary nature, however, complications arise. For example, an aggrieved seller demanding return of assets, part of which had been consumed or sold (for example, raw materials and inventory) might encounter problems of valuation not unlike those faced in proving damages.¹⁰⁹ Similarly, where restitution is sought by a buyer which has paid for a business in its own corporate stock, mere redelivery of the stock may not be a proper remedy because the value of the stock, and sometimes the structure of the issuing corporation, may have changed greatly in the interim.

7. *Plaintiff's Obligation To Restore Consideration Received by Him*

To be entitled to restitution, a plaintiff usually must offer to return whatever he has received from the defendant,¹¹⁰ or its pecuniary value if it cannot be returned in kind or if interim changes would render its return unfair to either party. Thus, a seller of a business who has received part or all of the price (whether in money or in stock) from the buyer who later breaches, must offer to return it (or, in appropriate cases, credit it against what is claimed from the buyer).¹¹¹ Also, an aggrieved buyer who demands restitution of the part of the price he has paid must offer to return the business property that had been transferred to him, and furthermore, must offer to credit the seller with profits made from the business while it was in the buyer's hands.¹¹²

¹⁰⁸ *Parker v. Johnston*, 244 Ark. 355, 426 S.W.2d 155 (1968).

¹⁰⁹ See 5 Corbin, *supra* note 106, at § 1112.

¹¹⁰ 2 Restatement of Contracts § 349 (1932).

¹¹¹ Cf. 2 Restatement of Contracts § 349(2)(c) (1932).

¹¹² See 5 Corbin, *supra* note 106, at § 1115; *Mahurin v. Schmeck*, 95 Ariz. 333, 390 P.2d 576 (1964). Against these profits, buyer can claim compensation for his services. *Id.* at 582. The same case also holds that a formal tender of the property is not required, and that the offer to return it may be conditional upon return by the defendant of plaintiff's consideration. *Id.* at 581. Accord, Restatement of Contracts § 349(3) (1932).

However, where the reason for restitution also prevents return of the property received, and either destroys its value or otherwise renders it inequitable to require return of the equivalent in money, neither return of the property nor payment to the defendant of its value will be required.¹¹³

8. *Specific Restitution*

Where property has been delivered which may have a value to the plaintiff not readily translatable into money, and where it may be returned without destroying it, the plaintiff may demand specific restitution—an order requiring redelivery in kind.¹¹⁴ This is an equitable remedy comparable to specific performance, except that here the contract is sought to be terminated, rather than enforced. Thus, if a buyer makes part payment for the seller's business in the buyer's own stock, the seller then defaults, and the stock is not readily available on the market, or is of a quantity too large to be acquired without distorting the market price, or is important for the buyer's control of the corporation, a decree for specific restitution might be appropriate.

9. *Choice of Restitution or Damages*

In electing whether he stands to gain more from damages on the one hand or restitution on the other, the aggrieved party must consider a number of factors. Since most contracts are entered into on the supposition that they will prove to be profitable, there will undoubtedly be many cases in which the plaintiff would have gained a substantial benefit from the bargain and would presumptively do better by seeking damages.¹¹⁵ Therefore, a decisive factor in such cases would probably be whether the plaintiff can meet the necessary level of certainty in establishing his damages.¹¹⁶ If damages are likely to be of a highly speculative nature, so that there would be a substantial danger of inadequate recompense on a damage theory, and if all of the requirements for restitution can readily be met, prudence may dictate that the plaintiff pursue restitution instead, and accept the next best remedy—the restoration to his position before he entered into the contract.

¹¹³ An example would be the breach of warranty of title as to goods sold; where the goods are seized by the true owner, the plaintiff is entitled to restitution of his payments, less the value of their use while he had them, with no obligation to return either the goods or their value. *American Container Corp. v. Hanley Trucking Corp.*, 7 U.C.C. Rep. 1301 (N.J. Super. 1970).

¹¹⁴ Restatement of Contracts § 354 (1932).

¹¹⁵ Unless the requirement of foreseeability limited the measure of damages. See p. 842 *supra*.

¹¹⁶ See pp. 843-44 *supra*.

F. *Specific Performance*1. *Generally*

As stated above,¹¹⁷ specific performance and restitution appear to be mutually exclusive. In some circumstances, however, damages may accompany specific performance. Although one cannot receive damages for that portion of a breach which a specific performance decree prevents from happening,¹¹⁸ in most cases there will be a period of breach until the decree is issued, and for that period damages may also be recovered.¹¹⁹ For example, where a party breaks a covenant not to compete and the covenant is specifically enforced, the plaintiff may recover damages for the prohibited competition from the time of its commencement until it was brought to a halt.¹²⁰

2. *Adequacy of Remedy at Law*

In Anglo-American law, specific performance is an exceptional, rather than ordinary, remedy. It is granted only when the remedy at law is not adequate. But each business is unique in many respects, and where there is a wrongful refusal to close, a business buyer should normally have a strong argument that a mere monetary award is not the equivalent of specific relief. The seller's position is somewhat weaker at least where the consideration to be paid to him is only money, but still, unless at least one substitute buyer is available, the seller can argue persuasively that mere damages are not likely to serve as an adequate replacement for his lost sale.¹²¹ Traditionally, specific performance has always been available to either party to a contract to sell real estate,¹²² and if a major part of the property being sold in a sale-of-

¹¹⁷ See p. 851 *supra*.

¹¹⁸ See *Bradshaw v. Millikin*, 173 N.C. 432, 92 S.E. 161 (1917) (specific performance of breach of covenant not to compete granted, liquidated damages not awarded in addition).

¹¹⁹ See Annot., *Awarding Damages for Delay, in Addition to Specific Performance, of Contract for Sale of Corporate Stock*, 28 A.L.R.3d 1401 (1969).

¹²⁰ *Loomis v. Hailston*, 183 N.Y.S. 705 (Sup. Ct. Sp. Term 1920).

¹²¹ A rough analogy may be found in U.C.C. § 2-709(1)(b), which permits the seller to sue for the price of goods (as distinguished from mere damages) "if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing." The uncertainties as to the measure of damages so likely in many business sale cases (see pp. 839-44 *supra*) would seem to make the argument for specific enforcement in such cases even stronger than that in most situations involving the sale of goods.

¹²² See 5A Corbin, *supra* note 106, at §§ 1143, 1145. The rule as to land contracts is probably based upon the uniqueness of any parcel of land as well as the special importance of land in the English economy during the formative period of equity. This may explain the right of the purchaser to specific performance, but does not completely

assets transaction is real property, specific performance will probably be granted at the instance of either party in the event of a breach by the other. Where the sale is one of stock, there is a general rule that specific performance will not be granted, at least if there is a ready market for the stock.¹²³ For the purposes of this article, however, we are considering by hypothesis a sale of all of a corporation's stock, or at least a sale of enough shares to ensure corporate control; in such a case, an exception to the general rule would be invoked.¹²⁴

3. *Doctrines of Equity*

Specific performance, an equitable remedy, is of course subject to all of the usual equitable doctrines, such as the requirement that the plaintiff come in with clean hands. Unfairness and overreaching may induce a court to refuse to award specific performance even if the activities involved are not sufficiently extreme to prevent imposition of remedies at law.¹²⁵ In addition, if a defaulting seller has sold the same business to a bona fide purchaser for value, the latter's equities would be sufficiently strong to prevent the buyer from obtaining specific performance, and he would be relegated to his legal remedies.¹²⁶

4. *Specific Relief at Law*

There are certain circumstances in which specific relief, comparable to specific performance but rendered at law, may be available. Before the Uniform Commercial Code, a seller of goods could obtain the price of the goods (as distinguished from damages) if the property interest in the goods had passed to the buyer.¹²⁷ While this rule has been abandoned by the Code, it has been replaced by authorization for recovery of the price if the goods have been accepted by the buyer or if the seller is unable to resell them at a reasonable price.¹²⁸ Thus, if the seller has delivered and the buyer has not paid, the right of the

account for the fact that this remedy is also available to the vendor, who might be expected to be adequately compensated by damages.

A notion of "affirmative mutuality"—that if one party would be entitled to specific performance, the other also is, even though nothing in the circumstances would otherwise call for it—has fallen into disrepute; the case of the vendor of land may be its last surviving application. See 2 Restatement of Contracts § 372(2) (1932).

¹²³ See 5A Corbin, *supra* note 106, at § 1148.

¹²⁴ *Armstrong v. Stiffler*, 189 Md. 630, 56 A.2d 808 (1948); see also 5A Corbin, *supra* note 106, at § 1148 and cases cited therein.

¹²⁵ See 5A Corbin, *supra* note 106, at §§ 1164-165.

¹²⁶ See 5A Corbin, *supra* note 106, at § 1169. For an interesting catalogue of reasons for refusing specific performance, see 5A Corbin ch. 64.

¹²⁷ Uniform Sales Act § 63(1).

¹²⁸ U.C.C. § 2-709.

seller to damages in the amount of the agreed price is the equivalent of specific performance. Similarly, the buyer, who under prior law could replevy the goods from the seller if the property had passed to him,¹²⁹ may now do so if he is unable to effect cover for the goods.¹³⁰

In business sale situations, in which a party would have been able to obtain specific relief at law if the sale had been one of goods, a court might be persuaded to apply the Uniform Commercial Code by analogy.¹³¹ At least, it would seem worthwhile for counsel to try the argument, as a second string to his bow, where his right to specific performance in equity seems uncertain.

5. *Effect of a Liquidated Damages Clause*

The question sometimes arises as to whether specific performance is appropriate where there is a liquidated damages clause. The argument may be made that the parties have determined for themselves an appropriate remedy for breach, that by virtue of their agreement this is an adequate remedy, and that, therefore, specific performance is not appropriate.

This argument has found little favor with the courts in recent years. It is rebutted by the analysis that, in liquidating damages, the parties have attempted to produce a fairer and more readily administered measure of damages than the courts would be able to devise, but still not one that purported to give the parties the equivalent of actual performance.¹³² While the courts generally reach this conclusion without help from the contract language, a provision expressly stating that the liquidated damages clause was not intended to bar specific performance might insure this result.

As pointed out above,¹³³ there are a number of business sale cases involving covenants not to compete, with liquidated damages clauses incidental thereto. Provided the other requirements for equitable relief are met, specific performance is normally appropriate in such a case.¹³⁴ It might be added that if the liquidated damages clause is invalid as a penalty, the case for specific performance is even stronger, since the argument that a liquidated damages clause precludes specific performance, weak enough if the clause is valid, would seem hopeless if the clause is voided.¹³⁵

¹²⁹ Uniform Sales Act § 66.

¹³⁰ U.C.C. § 2-716(3).

¹³¹ See pp. 828-31 *supra*.

¹³² See 2 Restatement of Contracts § 378 (1932); 5A Corbin, *supra* note 106, at § 1213.

¹³³ See p. 847 *supra*.

¹³⁴ Bradshaw v. Millikin, 173 N.C. 432, 92 S.E. 161 (1917).

¹³⁵ Buckhout v. Witwer, 157 Mich. 406, 122 N.W. 184 (1909). In *Bauer v. Sawyer*,

Occasionally, whether as the result of deliberate intention or poor draftsmanship, what appears at first glance to be a liquidated damages clause is in fact an alternate promise.¹³⁶ For example, instead of the seller agreeing to pay \$1,000 a month in liquidated damages if he re-enters the business, the seller promises in the alternative either to refrain from competing or pay \$1,000 per month. If the agreement is construed to bear the latter meaning, specific performance in the form of an injunction against competition would of course be inappropriate.¹³⁷

The emphasis in the foregoing discussion upon liquidated damages clauses bolstering covenants not to compete is not to suggest that they do not arise elsewhere in agreements to sell businesses. In view of the difficulty of proving damages in many situations, a liquidated damages clause may be a useful device, and if properly drawn will be upheld against the claim that it is a penalty. Where specific performance is otherwise appropriate, a liquidated damages clause will not serve to bar that remedy.¹³⁸

6. *Injunctive Relief*

Although a decree for specific performance is generally expressed in affirmative terms, directing the defendant to abide by the contract, it will frequently contain some negative commands, and in some cases may be entirely negative in form. For example, where a covenant not to compete or not to reveal trade secrets is specifically enforced, the decree of the court is normally in the form of an injunction against committing the forbidden conduct. While a decree may be expressed in terms of a prohibition, and properly labeled an "injunction," the applicable doctrines are not changed by virtue of that fact.¹³⁹

There are also distinguishable situations in which injunctive relief is granted, not as the direct means of enforcing the contract provision,

8 Ill.2d 351, 134 N.E.2d 329 (1956) (not a case involving sale of a business), the presence of a liquidated damages clause incident to a covenant not to compete was held not to bar specific performance, but the court went on to bolster its conclusion by demonstrating the invalidity of the liquidated damages clause. Interestingly, the plaintiffs, in seeking an injunction against the forbidden competition, challenged the validity of the clause, while the defendants sought to uphold it.

¹³⁶ See Holmes, J., in *Smith v. Bergengren*, 153 Mass. 236, 237-38, 26 N.E. 690, 691 (1891).

¹³⁷ Cf. *Rigs v. Sokol*, 318 Mass. 337, 343, 61 N.E.2d 538, 541 (1945) (provision for payment of \$500 in event either party did not perform was construed as liquidated damages clause rather than option to perform or pay, and held no bar to specific performance). Accord, *Franko v. Olszewski*, 316 Mich. 485, 490, 25 N.W.2d 593, 595 (1947).

¹³⁸ Specific performance was awarded in at least two business sale cases in which there was a liquidated damages clause applicable not to a breach of a covenant to refrain from competing but to a breach of the sale contract itself: *Armstrong v. Stiffler*, 189 Md. 630, 56 A.2d 808 (1948); *Franko v. Olszewski*, 316 Mich. 485, 25 N.W.2d 593, 595 (1947).

¹³⁹ See 5A Corbin, *supra* note 106, at § 1138.

but either to preserve the status quo and safeguard the jurisdiction of the court, or as the next best alternative where affirmative enforcement is not possible.¹⁴⁰ Thus, it has been held appropriate, where a buyer was granted specific performance, to include an injunction against the seller disposing of the business to another;¹⁴¹ in fact, if the buyer shows some likelihood of such a sale being made, and if there is otherwise some merit to his case, he can probably obtain a temporary order to that effect even before the specific performance demand is adjudicated.

7. *Miscellaneous*

Where part of a promised performance cannot be rendered because of impossibility or other legal excuse, or where part of the performance cannot be specifically enforced because of a legal obstacle such as the difficulty of judicial supervision of enforcement, the remainder may nevertheless be specifically enforced, with appropriate compensation to the plaintiff for the balance.¹⁴² For example, where a substantial part of "Luna Park," an amusement area on Coney Island, had been destroyed by fire, and the risk of loss had remained on the seller, specific performance of the sale contract was ordered at the instance of the buyer, with abatement of an appropriate portion of the purchase price.¹⁴³

The fact that certain situations are mentioned herein, in which demands for specific performance arise with comparative frequency, should not be taken to negate the possibility of a wide range of other possible types of breaches for which specific performance might also be appropriate. There are a large number of collateral obligations often assumed by parties to a business sale agreement, breach of which would normally give rise to a persuasive case for specific performance. Typical of these would be the promise of the seller to change its corporate name so as to enable the buyer to enjoy its use.

It is interesting to note that there appear to be comparatively few reported cases involving specific performance of an entire contract to buy or sell a business,¹⁴⁴ as distinguished from such collateral aspects

¹⁴⁰ Thus an employment contract ancillary to the sale of a business would normally not be specifically enforceable (Restatement of Contracts § 379 (1932)), but in appropriate cases a court might enjoin the employee from working for a competitor (id. § 380). Cf. the classic case in which such relief was granted against a repudiating concert singer, *Lumley v. Wagner*, 1 De G.M. & G. 604 (1852).

¹⁴¹ *Loomis v. Hailston*, 183 N.Y.S. 705 (Sup. Ct. Sp. Term 1920).

¹⁴² Restatement of Contracts § 365 (1932).

¹⁴³ *World Exhibit Corp. v. City Bank Farmers Trust Co.*, 186 Misc. 420, 59 N.Y.S. 2d 648 (Sup. Ct. 1945), aff'd, 270 App. Div. 654, 61 N.Y.S.2d 889 (2d Dep't), aff'd, 296 N.Y. 586, 68 N.E.2d 876 (1946).

¹⁴⁴ Even though in appropriate cases either a buyer or a seller could obtain specific performance, the remedy is less likely to be sought by a seller, who may be completely satisfied by an award of damages.

thereof, such as a covenant not to compete. A partial explanation may lie in the fact that in a substantial portion of these transactions the agreement calls for an employment contract whereby one or more principals of the seller are engaged for a period of time by the buyer. Such an arrangement is sometimes a form of "sweetening" the deal for the employees; it also may be essential, however, to the buyer to insure continuity of management and retention of trade contacts. In any event, once the parties have reached the stage of disagreement that brings them into court, the likelihood of such an employment relationship being tolerable to either is rather slim. This in turn may sour the entire transaction to the point where the aggrieved party would prefer to seek either damages or restitution rather than insist upon performance.

G. Effect of Closing on Availability of Remedies for Breach of Contract

The closing of a business sale contract, as with any transaction, is a watershed event, at which point the rights of the parties may undergo substantial change. While almost nothing has been written with respect to the effect of a closing in the case of a sale of a business, a body of law has developed in connection with real estate closings which may offer helpful analogies.¹⁴⁵

Where a closing is total, with all of the purchase price passing to the seller and all of the stock or assets to the buyer, the only kinds of claims that would generally survive might be those for breaches of warranty, which will be discussed below,¹⁴⁶ and those for breaches of collateral agreements such as employment contracts and covenants not to compete. Where the closing is equally inclusive, but part or all of the purchase price or the property is placed in escrow pending resolution of various matters, whatever additional rights and remedies might accrue would depend upon the terms of the escrow agreement.¹⁴⁷ Since these terms may vary so greatly, any attempt here at enumeration of possibilities would be fruitless.

Where the closing is less than total, additional possibilities arise. If, for example, part of the purchase price is to be paid in later installments, the seller would have a cause of action for their payment should the buyer default. This would be in the form of an action at law for

¹⁴⁵ See 6 Corbin, *supra* note 106, at § 1319; Restatement of Contracts § 413 (1932). For more general statements of the problem of excuse of conditions by acceptance or retention of defective performance, see 5A Corbin, *supra* note 106, at § 1245; Restatement of Contracts § 298 (1932).

¹⁴⁶ See pp. 862-63 *infra*.

¹⁴⁷ There may, of course, be other surviving rights of either party not covered by the escrow agreement.

damages, with the measure of damages being the unpaid portion of the price, but the result could as readily be regarded as the equivalent of specific performance at law.

A more difficult question, however, is whether a seller who would prefer to escape from the contract can, even at this late stage, seize upon the buyer's breach as an excuse to demand restitution, recovering the property or stock conveyed and returning the payments he had received. A post-closing attempt to obtain restitution might encounter two obstacles related to the factor of its timing.

First of all, as pointed out above, restitution is appropriate only in instances of "total breach"¹⁴⁸—unlikely to occur if a substantial part of the defendant's performance has already occurred. Usually, the performances of both parties are likely to be almost complete at the time of closing, although an obvious exception could arise out of a contract calling for post-closing installment payments by the buyer. However, even if the breach is less than material, where it is accompanied by a repudiation, the standard for "total breach" may still be met, and restitution might be possible.¹⁴⁹ Even in such instances, however, there is an exception which may bar the seller from securing restitution where he has performed fully and the buyer's only remaining obligation is to pay money; in such instances, perhaps for historical rather than practical reasons, the seller is limited to suing for damages—in this case the unpaid price—and may not opt for restitution.¹⁵⁰

Secondly, it will be recalled that restitution is available only to a party who has moved promptly following a breach.¹⁵¹ While the fact of closing may not itself prove decisive, lapse of time following knowledge of a breach may prove fatal.

There is a greater possibility of serious post-closing breaches arising out of non-performance of a warranty, generally on the part of the seller. In some cases the warranty is not breached until after the closing; in others, the breach may have occurred earlier but comes to light only after the closing, as in the case of accounting data.¹⁵² The question may be viewed, in part, as one concerning the extent to which the provisions of the contract, including the warranties, are merged into the actual sale and do not survive the closing.

Here again, the starting point is the language of the contract,

¹⁴⁸ See pp. 852-53 *supra*.

¹⁴⁹ 5 Corbin, *supra* note 106, at § 1104; Restatement of Contracts § 317 (1932).

¹⁵⁰ 5 Corbin, *supra* note 106, at § 1110; Restatement of Contracts § 350 (1932). If the buyer were insolvent, however, the argument for granting the seller restitution might be stronger.

¹⁵¹ See pp. 853-54 *supra*. Compare also the requirements of prompt notification of breaches of contracts for the sale of goods. U.C.C. §§ 2-602, 2-605, 2-606, 2-607, 2-608.

¹⁵² See *Franck v. J.J. Sugarman-Rudolph Co.*, 40 Cal.2d 81, 251 P.2d 949 (1952).

and, in the absence of fraud, it is within the power of the parties to write their own law as to what will and will not survive the closing.¹⁵³ In the absence of such an expression, however, ordinary principles of construction would have to be applied; it would be obvious, for example, that warranties as to sales or profits for a period up to, or past, the date of closing would rarely be deemed to be cancelled by the closing, and the case would be even clearer as to warranties as to how the business would perform for the buyer after the closing.¹⁵⁴

Even where the case for survival of the warranty is less obvious, any breaches which the aggrieved party did not know of and which he could not have reasonably discovered at the time of the closing will normally survive. Execution of an instrument at the closing, whereby a party relinquishes any such claims, may achieve its purpose in some cases, but is likely to be strictly construed by the courts and may also be held ineffective upon a showing of fraud, mistake, or even over-reaching.¹⁵⁵

There is a separate question as to how long the parties may contract for the survival of their warranties after closing. Normally, a claim for breach of warranty must be asserted promptly or be lost.¹⁵⁶ The time for such communication, however, runs from discovery (or when a reasonable person would have discovered) rather than from the time of the contract or of the closing. Another temporal restraint on the assertion of warranty claims is found in statutes of limitations, which apply to the commencement of suit rather than the communication of the grievance. The parties thus may normally modify the limitation period by agreement, but there are some statutory restrictions upon freedom of contract in this respect.¹⁵⁷

¹⁵³ See, e.g., *Johnson v. Grapentien*, 357 Mich. 420, 98 N.W.2d 547 (1959).

¹⁵⁴ See *Lockwood v. Christakos*, 181 F.2d 805 (D.C. Cir. 1950).

¹⁵⁵ Cf. 5A *Corbin*, supra note 106, at § 1245; *Cawley v. Weiner*, 236 N.Y. 357, 140 N.E. 724 (1923) (purchase of house).

¹⁵⁶ See note 32 supra; *Franck v. J.J. Sugarman-Rudolph Co.*, 40 Cal.2d 81, 251 P.2d 949 (1952).

¹⁵⁷ With respect to the sale of goods, U.C.C. § 2-725 prescribes a four-year statute of limitations. This applies as well to actions for breach of warranty in connection with such sales, but in that respect, U.C.C. § 2-725(2) states: "A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered." U.C.C. § 2-725 further provides that the parties by their original agreement may reduce the period of limitation, but to no less than one year, and may not extend it beyond four years. Whether a court would apply any part of these limitation provisions to a contract for the sale of stock or a contract for the sale of assets of which only a portion are goods, is problematical.

If following closing there is a merger of the acquired corporation, either with the buying company or with a subsidiary, additional complexities will arise in the pursuit of remedies for breach of the original contract. There is authority that in some circum-

H. *Election of Remedies*

At earlier stages of our jurisprudence, an elaborate body of law developed concerning the extent to which a party choosing one of the three principal contractual remedies—damages, specific performance, or restitution—might be precluded from asking for one of the others. Along with reforms in pleading and practice, the law has moved away from creating such pitfalls for unwary lawyers and their clients. Generally speaking, alternative and even inconsistent demands may be made in a single complaint, and an irrevocable election occurs only if and when the other party would be prejudiced by a change of demand.¹⁵⁸

I. *Parties to the Action*

Who the parties will be in an action for breach of a business sale contract will depend largely upon the contract itself. The agreement will designate the seller or sellers and the buyer or buyers, who, in the absence of anything to the contrary, will normally be the parties to the contract and the parties in any ensuing litigation. The extent of the obligations of each of the defendants and the rights of each of the plaintiffs may depend upon whether they are designated in the agreement as joint, several, or joint and several parties.¹⁵⁹

If one party undertakes to secure the performance of someone else, such as when a corporation promises to obtain a covenant from its officers not to compete, or a principal stockholder promises to obtain a tender of stock from minority stockholders, the party making

stances former stockholders of a merged-in corporation might bring a derivative action against the successor corporation, with the proceeds going to those stockholders. *Miller v. Steinbach*, 268 F. Supp. 255, 269 (S.D.N.Y. 1967). Where the attack is on the merger itself, based upon misrepresentations in the proxy materials in violation of § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1964), aggrieved stockholders have a cause of action for "all necessary remedial relief" under § 27 of the Act, 15 U.S.C. § 78aa (1964). *J. I. Case Co. v. Borak*, 377 U.S. 426, 433-35 (1964). Whether damages, restitution, or unwinding of the merger is appropriate depends upon the facts of the case; whether the merger should be set aside, for example, "must hinge on whether [it] would be in the best interests of the shareholders as a whole." *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388 (1970). Jurisdiction for such actions may also be found under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. See *SEC v. National Securities, Inc.*, 393 U.S. 453, 468-69 (1969); see also pp. 869-71 *infra*.

¹⁵⁸ See Restatement of Contracts §§ 381-84 (1932).

¹⁵⁹ The applicable law is set out in considerable detail in Restatement of Contracts ch. 5 (1932). The principles there set forth, however, should be regarded only as guidelines for construction of the contract language, and any clear expression by the parties would be decisive. In the commonly encountered situation in which each of the stockholders of the selling corporation simply promises to sell his shares, the agreement may well be construed to treat their obligations as several but not joint, and if one of them failed to perform, the others might not be held liable for breach. If it is intended that each selling stockholder should assume responsibility that all tender their shares, this should be made clear in the agreement.

REMEDIES FOR BREACH OF BUSINESS SALE AGREEMENTS

the promise will of course be responsible for its performance.¹⁶⁰ Generally speaking, if one person promises that another will act or forbear in a specified fashion, the promisor assumes responsibility for that performance.¹⁶¹

There may be instances in which rights may accrue to a non-party, either on a third party beneficiary theory, or otherwise. For example, where the transaction is in the form of the sale of stock, the corporation involved may have certain rights against the seller if benefits which the seller has promised to confer upon the corporation being sold are not given in fact. Similarly, where, as part of the agreement, either party promises to pay debts owed to creditors of the business, the latter may enforce that promise as third party beneficiaries.¹⁶²

Apart from the parties to the agreement, other persons associated with them (particularly with the seller), may be subjected to possible tort liability in certain instances. Attorneys and accountants participating in misrepresentations may themselves be liable for common law fraud, negligent misrepresentation,¹⁶³ or violation of the securities laws.¹⁶⁴

VI. REMEDIES FOR MISREPRESENTATION

A. *Restitution*

Where a party has been induced to enter into a contract through the material misrepresentation of the other party or his agent, the contract is voidable and the deceived party may call it off, obtaining restitution of any consideration already paid.¹⁶⁵ This rule applies to business purchase contracts as well as to any other contract.¹⁶⁶ The right to restitution for misrepresentation is closely parallel to the right to the same remedy for "total breach" of contract,¹⁶⁷ and similar

¹⁶⁰ This would, of course, not apply if the promise were merely one to use best efforts. Whether failure in such case, even if not actionable, might excuse further performance by the other party would depend upon the express provisions, or in their absence, the construction of the contract as a whole.

¹⁶¹ Guarantees may be terminated by cancellation of the basic agreement. Thus, in *Koch v. Han-Shire Invs. Inc.*, 273 Minn. 155, 140 N.W.2d 55 (1966), when the seller of a business pursued its right under the terms of the agreement to rescind the transaction for non-payment of installments by the buying corporation, guarantees by the buyer's principal stockholder were held terminated, and stock pledged to secure his performance was ordered returned to him.

¹⁶² Restatement of Contracts §§ 136, 141 (1932).

¹⁶³ But see *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931).

¹⁶⁴ See pp. 869-71 *infra*. Derivative actions, brought by stockholders on behalf of the corporation against its fiduciaries, are another possibility.

¹⁶⁵ Restatement of Contracts § 476 (1932); 12 Williston on Contracts §§ 1523, 1525 (3d ed. 1968) [hereinafter cited as Williston].

¹⁶⁶ *Hirshon v. Whelan*, 113 A.2d 484, 485 (D.C. Mun. Ct. App. 1955); *Springer v. Korotki*, 215 Md. 310, 137 A.2d 655 (1958).

¹⁶⁷ See pp. 852-53 *supra*; compare Restatement of Contracts §§ 347-57 with §§ 470-91 (1932).

requirements of prompt assertion of rights are imposed.¹⁶⁸ Neither willfulness, scienter, nor even negligence is a necessary element of a cause of action for restitution; mere innocent misrepresentation of a material fact is sufficient.¹⁶⁹

It is quite common in contracts for the sale of a business to classify as "warranties" only representations of present fact, and to label commitments as to future events as "covenants" or "promises." If this nomenclature is employed, "breaches of warranty" and "misrepresentations" become synonymous.¹⁷⁰ For purposes of this article, however, "warranty" will be used in its normal sense—broad enough to include, for example, a promise that an appliance will perform satisfactorily for a year. In this sense, breaches of warranty may or may not involve misrepresentation. Where the warranty consists of a statement of present fact and the statement turns out to be incorrect, it may be deemed to be a misrepresentation, whether or not intentional. Warranties directed to future events, however—such as those pertaining to the contents of a balance sheet or profit-and-loss statement to be drawn up in the future—even if untrue would not normally be regarded as misrepresentations unless the party making them implies the existence of present facts which are not true.¹⁷¹

Since restitution is available for breaches of warranty regardless of the presence or absence of misrepresentation, in most instances nothing is added to the plaintiff's case by proof of misrepresentation. One important point, however, is that restitution for breach is permitted only if the breach may be characterized as "total";¹⁷² on the other hand, restitution for innocent misrepresentation will be granted if the misrepresentation was "material,"¹⁷³ while *any* fraudulent misrepresentation will be sufficient.¹⁷⁴

¹⁶⁸ See Restatement of Contracts §§ 480, 482-84 (1932); *Sy-Jo Luncheonette, Inc. v. Marsav Distributions, Inc.*, 279 App. Div. 715, 108 N.Y.S.2d 349 (1st Dep't 1951), *aff'd*, 304 N.Y. 747, 108 N.E.2d 614 (1952).

¹⁶⁹ Restatement of Contracts §§ 470, 476 (1932); see *Lockwood v. Christakos*, 181 F.2d 805, 807 (D.C. Cir. 1950).

¹⁷⁰ Quite frequently in business sale contracts, these provisions denominated as "covenants" and "conditions" in the contract, become "warranties" at the closing, and as such are specifically stated to survive the closing and to be actionable if breached thereafter.

¹⁷¹ "A promissory statement or even a prediction may involve by necessary implication an assertion that other facts than a state of mind exist, from which the promised or predicted consequences will follow, and there is, therefore, in such case a representation as to those other facts." Restatement of Contracts § 473, Comment c (1932).

¹⁷² See pp. 852-53 *supra*. It will be recalled that a "total" breach may be something less than complete failure on the part of the defendant to render any performance.

¹⁷³ Restatement of Contracts § 476 (1932). A "material" misrepresentation, in this context, would seem to be something less than a "material" breach, as described in Restatement of Contracts § 275 (1932), which is one of the tests of a "total" breach required for restitution in Restatement of Contracts § 347 (1932).

¹⁷⁴ Restatement of Contracts § 476, Comment b (1932). Another consequence of

B. *Damages*

As an alternative to restitution, the aggrieved party in the case of misrepresentation may keep the contract in force and sue for damages for misrepresentation. Whether the cause of action is characterized as one in tort or contract is becoming increasingly unimportant under modern "one form of action" procedural codes, but it may still make a difference in some jurisdictions what theory is asserted.

Where the misrepresentation takes the form of a breach of warranty, the plaintiff can ignore the tort, if any, and sue on a contract theory, with his measure of damages reflecting the difference between the value of what he received and what he was promised that he would receive.¹⁷⁵ In case of a profitable contract, this measure of damages is likely to be greater than the traditional tort measure of putting him in a position financially equivalent to the position he had been in before entering into the transaction.¹⁷⁶ Moreover, warranty liability, like all contract liability, is in a sense a form of strict or absolute liability, not dependent upon any showing of fault.

There are many other types of misrepresentation, however, that do not involve warranties or breaches of contract, where it would be difficult to spell out a theory for a contractual cause of action. In such cases, it would be necessary instead to bring a tort action for deceit.¹⁷⁷ Moreover, even if a contract action is available, a plaintiff may deliberately or unwittingly couch his claim in terms of an action for deceit.

The question of the measure of damages for deceit is not entirely settled. There are competing analogies—on the one hand, the general approach in tort law of putting the plaintiff in *statu quo ante*; on the

fraudulent, as distinguished from innocent, misrepresentations may be to avoid those clauses in a contract to which they were addressed. Thus, in an action for restitution in a contract for the purchase of a sandwich shop, in which the buyer alleged fraudulent misrepresentations as to volume of business, but the contract included a disclaimer of any representations, the court allowed restitution because of the fraud, but indicated that if the misrepresentations had been innocent the disclaimer clause would have barred relief. *Lockwood v. Christakos*, 181 F.2d 805 (D.C. Cir. 1950).

¹⁷⁵ See pp. 839-42 *supra*.

¹⁷⁶ On the other hand, the possibility of punitive damages, available in tort cases, would be barred in a contract action.

¹⁷⁷ Just as an action for damages is not subject to the same requirements of promptness as in an action for restitution, a tort action for deceit may be brought after the time for demanding restitution for misrepresentations has long since passed. See *Sy-Jo Luncheonette, Inc., v. Marsav Distribs., Inc.*, 279 App. Div. 715, 108 N.Y.S.2d 349 (1st Dep't 1951), *aff'd*, 304 N.Y. 747, 108 N.E.2d 614 (1952). And where restitution in a business purchase contract may not be granted because of lack of jurisdiction over indispensable parties, a tort action for deceit against parties before the court who have made representations to the plaintiff is permissible. See *Ward v. Deavers*, 203 F.2d 72, 75-76 (D.C. Cir. 1953).

other, the argument that the victim of a fraudulent breach should surely not recover less than the victim of an innocent one.

For a long time, the tort approach was dominant, and if an action was brought for deceit the successful plaintiff was restored to his situation before the transaction.¹⁷⁸ Thus, in a contract for the sale of a business for \$1,000,000, where the value of the business was \$1,100,000, if the seller fraudulently warranted certain assets to be worth \$150,000 more than they actually were, the buyer could recover \$150,000 for breach of warranty; if he sued for deceit, however, he would be awarded only \$50,000.

In recent years, there has been a trend away from this limitation on damages for deceit. While the Restatement of Torts followed the *statu quo ante* rule,¹⁷⁹ the Tentative Draft of the Restatement Second¹⁸⁰ adds a subsection stating: "The recipient of a fraudulent misrepresentation in a business transaction is also entitled to recover damages sufficient to give him the benefit of his contract with the maker, if such damages are proved with reasonable certainty."¹⁸¹ And the Council's notes point out that the benefit-of-the-bargain rule is now followed in a large majority of the states.¹⁸² Finally, with respect to the sale of goods, the Uniform Commercial Code has also reached the same result; Section 2-721 provides: "Remedies for material misrepresentation or fraud include all remedies available under this Article for nonfraudulent breach. . . ."¹⁸³

The other principal shortcoming of the tort remedy for misrepresentation, as compared with the contractual remedy, has been the requirement of fraud, or at least negligence, as a necessary element in plaintiff's case.¹⁸⁴ Here too, the standards are changing, although less rapidly,¹⁸⁵ and Prosser reports that a substantial minority of states

¹⁷⁸ The leading case was *Reno v. Bull*, 226 N.Y. 546, 124 N.E. 144 (1919).

¹⁷⁹ Restatement of Torts § 549 (1938).

¹⁸⁰ Restatement (Second) of Torts (Tent. Draft No. 10, 1964).

¹⁸¹ *Id.* § 549(2).

¹⁸² *Id.* Comment 2.

¹⁸³ The official Comment states as the purpose of U.C.C. § 2-721, "[t]o correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus, the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. . . ."

¹⁸⁴ Restatement of Torts § 525 (1938) requires fraud for a cause of action for deceit. *Id.* § 552 allows a cause of action in certain circumstances for negligent misrepresentation; although the emphasis of the text, comment and illustrations is on negligence of a third person rather than of a party to the contract, the latter would seem to be an *a fortiori* case.

¹⁸⁵ The tentative drafts of the Restatement (Second) of Torts do not propose changing the rule in this respect.

now allow an action for deceit to be based upon innocent misrepresentations.¹⁸⁶

C. Reformation

Where the fraud of one party and the mistake of the other, or the mutual mistake of both, cause a written contract to fail to express the intention of both, a court of equity will generally reform the contract to reflect their actual agreement.¹⁸⁷ But this remedy is not available in the more common case of an agreement induced by fraud or mistake which accurately reflected what the parties meant.¹⁸⁸

D. Constructive Trust

One who induces a transfer of property through fraud may be obliged to hold it in constructive trust for the transferor, and will be required to account to him for any profits made from it or for the proceeds if he has disposed of it.¹⁸⁹

E. Rule 10b-5

While there are several provisions in the federal securities laws expressly or impliedly authorizing civil actions for various types of wrongdoing, by far the most widely used basis for such statutory causes of action is Securities and Exchange Commission Rule 10b-5.¹⁹⁰

For 10b-5 to be applicable at all, the transaction has to involve "securities." This includes a sale of the stock of a company but—although "security" is construed fairly broadly in this area—probably not a sale of assets for cash unless the assets were themselves peculiarly of a type employed for investment or speculation.¹⁹¹ However, if the assets were sold for stock in the buying company, Rule 10b-5 would, of course, be applicable.

¹⁸⁶ See W. Prosser, *The Law of Torts* 724-29 (3d ed. 1964).

¹⁸⁷ Restatement of Contracts §§ 491, 504 (1932).

¹⁸⁸ See 12 Williston, *supra* note 165, § 1525A.

¹⁸⁹ Restatement of Restitution § 166 (1936); see text at note 209 *infra*.

¹⁹⁰ 17 C.F.R. § 240.10b-5 (1970):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

¹⁹¹ See 12 Williston, *supra* note 165, § 1516A at 503 et seq.

Another jurisdictional requirement, reflecting statutory and ultimately constitutional limitations, is that either interstate commerce, the mails or a national securities exchange be employed. Where a transaction is peculiarly local and the mails are avoided, but intrastate telephone calls are made, there is a split of authority as to whether the use of the telephone within one state is to be deemed a use of a portion of the interstate telephone network and, therefore, sufficient to bring the Rule into play.¹⁹²

The law as to the remedies available for 10b-5 violations is still in a formative stage, and most of the decisions thus far are on the pleadings rather than on the merits. Certain principles seem to be evolving, however. Less seems to be required for a 10b-5 cause of action than for common law deceit, at least in most jurisdictions; willfulness or intent to deceive are not required, and non-disclosure of material information, where "the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact,"¹⁹³ is in itself sufficient for a cause of action.¹⁹⁴

Either a buyer or a seller may sue for a violation of Rule 10b-5,¹⁹⁵ and sales of one hundred percent of the stock of closely held corporations are not excluded.¹⁹⁶ Moreover, misstatements in connection with mergers have been held by the Supreme Court to fall within Rule 10b-5, the term "purchase or sale" as used in both the statute¹⁹⁷ and the Rule¹⁹⁸ being construed sufficiently broadly to apply.¹⁹⁹ In addition, the fact that the misstatements were contained in a proxy statement (which is likely to be true in many instances of complaints arising out of mergers), and that false statements in proxy solicitations are specifically covered by a different section of the statute²⁰⁰ and a different SEC Rule,²⁰¹ were held not to exclude Rule 10b-5 coverage.²⁰²

¹⁹² Compare *Myzel v. Fields*, 386 F.2d 718, 727-28 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968), with *Burke v. Triple A Machine Shop, Inc.*, Current Fed. Sec. L. Rep. ¶ 92,949 (C.A. 9, Feb. 9, 1971).

¹⁹³ *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965), cert. denied, 382 U.S. 811 (1965). The court rejected the contention that it was not necessary to show any degree of reliance upon the misrepresentation.

¹⁹⁴ A. Bromberg, *Securities Law: Fraud: SEC Rule 10b-5 §§ 8.2, 8.4 and cases cited therein* (1967) [hereinafter cited as Bromberg]; cf. *Restatement of Torts* §§ 525, 529 (1938).

¹⁹⁵ Bromberg, *supra* note 194, at § 8.8.

¹⁹⁶ *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir. 1960), cert. denied, 365 U.S. 870 (1961); *Dauphin Corp. v. Davis*, 201 F. Supp. 470 (D. Del. 1962).

¹⁹⁷ Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1964).

¹⁹⁸ See note 190 *supra*.

¹⁹⁹ *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969).

²⁰⁰ Section 14 of the Securities Exchange Act of 1934, 15 U.S.C. § 78n (1964).

²⁰¹ SEC Rule 14a-9(a), 17 C.F.R. 240.14a-9(a) (1970); see *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964).

²⁰² *SEC v. National Securities, Inc.*, 393 U.S. 453, 468-69 (1969); see also Brom-

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The types of remedy thus far allowed under Rule 10b-5 follow rather closely those available for common law causes of action. Aggrieved buyers may demand return of the purchase price,²⁰³ and the sellers' stock must be returned. This is, of course, the equivalent of common law restitution.²⁰⁴ Alternatively, the buyer may keep the stock and sue for damages, but there is some doubt as to whether the measure of damages is the expected profit rather than merely the out-of-pocket loss.²⁰⁵

An aggrieved seller may secure the difference between the price paid him and true value,²⁰⁶ which is analogous to common law damages,²⁰⁷ or may presumably obtain restitution if the stock is still in the hands of the buyer.²⁰⁸ If it has been sold, he can pursue a constructive trust theory and recover the buyer's profits.²⁰⁹

Relief under Rule 10b-5 is not limited to actions for damages or rescission; criminal sanctions, administrative proceedings and injunctions have also been pursued. There have been indications that injunctive relief may be more readily obtained than damages.²¹⁰

Rule 10b-5 remedies are not limited to actions between buyers and sellers, but may in appropriate cases be asserted against other persons committing misrepresentations or otherwise violating the Rule, such as broker-dealers²¹¹ and accountants.²¹²

As in the case of contract actions, but unlike the tort analogy, punitive damages are apparently not allowed in 10b-5 actions.²¹³

berg, *supra* note 194, at § 6.5. Non-statutory remedies may also be available where grievances arise out of a merger. In *Miller v. Steinbach*, 268 F. Supp. 255, 268-69 (S.D.N.Y. 1967), it was held that the shareholder of a corporation merged into another could still bring a derivative action, with the recovery going to the stockholders of the merged-in corporation.

²⁰³ Bromberg, *supra* note 194, at § 9.1 and cases cited therein.

²⁰⁴ See pp. 854-55 *supra*.

²⁰⁵ Bromberg, *supra* note 194, at § 9.1; compare *Estate Counseling Serv., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962), with pp. 867-68 *supra*.

²⁰⁶ Bromberg, *supra* note 194, at § 9.1.

²⁰⁷ See pp. 839-43 *supra*.

²⁰⁸ See W. Cary, *Cases and Materials on Corporations* 790-91 (4th ed. 1969); Ruder, *Texas Gulf Sulphur—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases*, 63 *Nw. U.L. Rev.* 423, 427 (1968).

²⁰⁹ Bromberg, *supra* note 194, at § 9.1; cf. *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969); 83 *Harv. L. Rev.* 1421 (1970).

²¹⁰ See *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967); Friendly, J., concurring, in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 866-68 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

²¹¹ See Bromberg, *supra* note 194, ch. 5.

²¹² See *Drake v. Thor Power Tool Co.*, 282 F. Supp. 94, 104-05 (N.D. Ill. 1967); *Fischer v. Kletz*, 266 F. Supp. 180, 186-87 (S.D.N.Y. 1967); Bromberg, *supra* note 194, at § 7.4(2).

²¹³ *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968), cert. denied, 395 U.S. 977 (1969); Bromberg, *supra* note 194, at § 9.1 n.20; 12 *Williston*, *supra* note 165, at

CONCLUSION

There is remarkably little law specifically addressed to questions of remedies for grievances arising out of agreements to buy and sell businesses. Principles of general application, however, will be found to be relevant in most situations and dispositive in many. Finally, the Uniform Commercial Code—whether actually controlling or applied by way of analogy—must be regarded as a major source of law in this area.

§ 1516c at 533 et seq.; cf. *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1283 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970).