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Contracts

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CONTRACTS

by

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DURING the past year the Texas courts have decided more than the usual number of contracts cases, but most of these are not particularly noteworthy, except perhaps for unusual fact situations. Several, however, discussed herein, involve significant matters that require further consideration.

Option Contract: Counteroffer. It is common learning that a simple offer to contract is terminated by a rejection on the part of the offeree. There is a rejection when the offeree indicates to the offeror that he will not accept or that he no longer is considering the offer. By a not altogether obvious extension of this rule, a counteroffer (*i.e.*, a counter proposal of some sort or a purported acceptance which however adds new terms or imposes conditions not implicit in the original offer) is considered to be a rejection of the original offer and so a termination of the offeree's power to accept it, unless the offeree in his counteroffer makes it clear that he is still considering or willing to consider the original offer.[1] Assuming these propositions, the question arises as to their applicability to the option contract where the offeror has made an offer and, for a sufficient consideration, has contracted to keep it open for a stated time.

In *Humble Oil & Refining Co. v. Westside Investment Corp.*[2] Humble, for a consideration of $50 paid, had acquired an option to purchase certain lands from Westside. The terms of the option required Humble to give notice of its desire to purchase on or before June 4 and to pay $1,750 earnest money to a named escrow agent within ten days after the notice. Terms of the final settlement were set forth. On May 2 Humble delivered to Westside a purported acceptance which, however, added a new condition that Westside would extend all utilities to the tract prior to settlement. Westside did not assent to the modification. On May 14 Humble delivered to Westside an unconditional acceptance, instructing Westside to disregard the notice of May 2. Humble therefore had accepted the option according to its terms, unless this was made impossible by Humble's attempt on May 2 to incorporate the new terms.

When Westside refused to convey, Humble sued for specific performance, and the court of civil appeals affirmed a summary judgment for Westside on the ground that Humble's counterproposal of May 2 terminated its power of acceptance.[3] The argument was that an option, like a simple offer, creates in the offeree only an election to accept or reject,

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[1] Minneapolis & St. L. Ry. v. Columbus Rolling Mill Co., 119 U.S. 149 (1886); Quinn v. Feaheny, 252 Mich. 526, 233 N.W. 403 (1930).

[2] 428 S.W.2d 92 (Tex. 1968).

[3] 419 S.W.2d 448 (Tex. Civ. App. 1967).

and that once the election is exercised no further rights reside in the offeree. The supreme court reversed and rendered judgment for specific performance for Humble, stating that the option does not give the option-holder a mere verbal election but rather a conditional right in the property, a legally protected right to acquire ownership within the time stated, and that this right is not destroyed by the option-holder's attempt to negotiate better terms.

The court settles decisively a gray area in the law of contracts. The idea that an option is but a simple offer plus a collateral contract to keep the offer open is obsolescent. This idea was manifested in the old cases denying specific performance to the option-holder who accepted after the offeror had attempted to revoke, and relegating him to an action for damages.[4] Today specific performance in such a situation is routine.

There is still a question as to whether an unqualified rejection of the option by the offeree would prevent a later acceptance. If the offeror acts on the rejection and changes his position, as by selling to another, he would be protected by ordinary estoppel doctrine. But if there has been no change of position, and if the property is still available in the hands of the offeror, there seems to be no compelling reason for not permitting a subsequent acceptance still within the stated time limit. A new section in the proposed revision of the *Restatement of Contracts* so provides.[5]

Statute of Frauds: Contract To Make Will. Not infrequently suits to establish claimed oral contracts to make mutual wills have foundered on the Statute of Frauds where the estate involved was found to include interests in lands and where there was insufficient reference in the companion wills, each to the other, to provide the memorandum required by the statute. About all that is left to the proponent in such a case is to fall back on the doctrine of part performance frequently used in land contract cases to avoid the statute.

Such a situation was involved in *Meyer v. Texas National Bank of Commerce*.[6] In 1944, but at a six-month interval, husband and wife had executed separate wills in which each had named the other as sole beneficiary and as independent executor. When the husband died in 1962 the wife first learned that only nine weeks earlier the husband had executed a new will reducing the wife's inheritance to one-third of the estate. Four weeks later and without having changed her will, the wife died. The court of civil appeals affirmed a judgment finding a valid oral contract to make mutual wills and impressing a trust on two-thirds of the husband's estate for the benefit of the wife's heirs.[7] The supreme court reversed and rendered judgment for the husband's estate.

While the case was novel in Texas the court found its approach in the well-known case of *Hooks v. Bridgewater*[8] which declared a conservative

[4] 1 S. WILLISTON, CONTRACTS § 61C (3d ed. 1957).
[5] RESTATEMENT (SECOND) OF CONTRACTS § 35A (Tent. Draft No. 1, 1964).
[6] 424 S.W.2d 417 (Tex. 1968).
[7] 412 S.W.2d 957 (Tex. Civ. App. 1967).
[8] 111 Tex. 122, 229 S.W. 1114 (1921).

approach to the use of part performance to obviate the Statute of Frauds and stated that the doctrine is to be used only to prevent fraud. Such a case of fraud would be shown if one party to the oral agreement to make mutual wills actually inherited under the will of the other party and then changed his own will, or where he had secretly changed his own will prior to the death of the other party. In *Meyer*, however, the wrongdoing husband predeceased the wife and so took no benefits under her will. What was left was emotional shock to the wife, and this was held insufficient to make the statute inapplicable.

Accord and Satisfaction: Consideration. In *Neeley v. Southwestern Investment Co.*[9] the Neeleys were indebted to Southwestern, a loan company, on two installment notes. Payments were current, with a balance of $972.71 due on future installments. Interest had been included in the face of the notes. Mrs. Neeley inquired as to what amount would be required to pay the notes in full, and Southwestern's clerk, applying the company's formula, informed her that $837.01 would be sufficient. The details of this computation were not known to Mrs. Neeley. After further discussion, Mrs. Neeley paid the $837.01 by a "paid-in-full" check, but Southwestern did not deliver a release of the chattel mortgage on furniture securing one of the notes. Unknown to either party at this time Southwestern's books were in error in that a $62.09 payment on the furniture note had been credited twice. When Southwestern discovered the error it demanded payment of the $62.09 but the Neeleys refused. Southwestern then communicated with one Brumbelow who paid the $62.09 to Southwestern, and seized the encumbered furniture and sold it. The Neeleys sued Southwestern and Brumbelow for conversion and had judgment. The court of civil appeals reversed, holding *inter alia* that the record did not justify an issue on discharge of the note obligation.[10] The supreme court directed an affirmance of the judgment against Brumbelow and a remand of the proceedings against Southwestern so that the issue of whether Brumbelow had acted independently or as an agent of Southwestern might be determined.

In reversing the judgment against Southwestern, the court of civil appeals fell into the not uncommon error of holding that consideration for an accord and satisfaction of a liquidated demand by a money payment can be found only where there is an honest and reasonable dispute as to the validity or amount of the demand. To the contrary, while part payment of a matured, liquidated and undisputed claim will not support a settlement, the payment of a lesser sum before maturity is sufficient, and the supreme court so held.

The most interesting problem in this case is whether Southwestern should be relieved from the settlement because of the mistake made in computing the amount to be paid. This mistake was unilateral, *i.e.*, it was made by Southwestern and Mrs. Neeley had no knowledge of it. There is

[9] 430 S.W.2d 465 (Tex. 1968).
[10] 412 S.W.2d 925 (Tex. Civ. App. 1967).

a strong policy argument for holding such a mistake to be irrelevant, for enforcing the agreement.[11] However there are cases that would relieve the mistaken party upon a finding that the mistake was non-negligent and that there had been no change of position by the innocent party.[12] While this suggestion has a superficial appeal, a court attempting to follow it may become hopelessly mired in an attempt to define negligence in such a context. The Texas court demonstrated this in its opinion in the Arlington school case.[13] Negligence on the part of Southwestern would be quite difficult to assess in the case at hand. Perhaps it is significant that the court did not attempt to do so.

Tender of Performance. In *Perry v. Little*[14] the defendant had promised to purchase certain stock from the plaintiff provided the plaintiff still held the stock on a certain day. On the appointed day the plaintiff advised the defendant that he still held the stock and requested him to perform the contract to purchase. When sued for breach of contract, defendant relied on plaintiff's failure to make a formal tender of the stock certificate. It was held that the plaintiff's letter was sufficient. This is in line with a current tendency to relax the requirement of a formal tender where the promisee is able to render the return performance and states his willingness to do so, at least in cases involving something other than the payment of money.

Construction Contracts: Architect's Certificate. Almost all construction contracts of consequence contain provisions for the issuance of an architect's or engineer's certificate of compliance with the contract as a condition precedent to the final payment to the builder. While most disputes center about the claim of the builder to recover without the certificate, not a few involve defenses of improper performance made against a builder who holds such a certificate, or claims for damages against a builder who obtained such a certificate and who has been paid. The cases tend to hold that possession of the certificate does not relieve the builder of such defenses or liability, absent explicit language to that effect in the construction contract.

Many construction contracts incorporate a standard set of conditions formulated by the American Institute of Architects.[15] Article 39 of these conditions makes the architect's certificate of compliance final as to matters of artistic appearance, but subject to arbitration in other matters. Article 25 provides that no certificate shall be an acceptance of work or ma-

[11] 5 S. WILLISTON, CONTRACTS § 1579 (rev. ed. 1937); *cf.* 3 A. CORBIN, CONTRACTS § 609 (1960).

[12] St. Nicholas Church v. Kropp, 135 Minn. 115, 160 N.W. 500 (1916) and Geremia v. Boyarsky, 107 Conn. 387, 140 A. 749 (1928) are the cases usually cited for this proposition, but they are compromised by the fact that there was good reason for the other party to suspect that a mistake had occurred.

[13] James T. Taylor & Son v. Arlington Ind. School Dist., 160 Tex. 617, 335 S.W.2d 371 (1960); 15 Sw. L.J. 344 (1961).

[14] 419 S.W.2d 198 (Tex. 1967).

[15] A useful reference is W. PARKER & F. ADAMS, A.I.A. STANDARD CONTRACT FORMS AND THE LAW (1954), prepared as a handbook for architects.

terials not in accordance with the contract, but that the making and acceptance of final payment shall be a waiver of the owner's claims with certain exceptions, one such exception being "faulty work appearing after final payment or from requirement of the specifications." Article 20 provides that neither the final certificate nor payment shall relieve the contractor of responsibility for faulty materials or workmanship, and that the contractor shall remedy any defects appearing within one year after completion.

In *City of Midland v. Waller*[16] the city and the defendant builder had entered into a contract for the construction of a swimming pool. The contract incorporated the A.I.A. conditions but added other provisions, with a statement that in event of conflict the special provisions should apply. Among the special provisions was one making decisions of the architect final as to materials and manner of performance. Another provided that the final certificate should not be an acceptance of work not done in accordance with the contract, and that the contractor guaranteed all work for a period of one year from date of final acceptance.

The city of Midland brought suit for damages in 1965 alleging certain defects in the swimming pool, theretofore latent, had appeared on May 27, 1965, and that such defects indicated faulty workmanship and resulted from the defendant's failure to follow specifications. The defense was based on the fact that the architect's certificate of final acceptance had been issued on September 15, 1962, that the city had made final payment on the same day, and that the defects had not appeared within the ensuing one-year period referred to in the contract. The lower courts held that the contractor was not liable for defects first appearing after the one-year warranty period.[17] The supreme court reversed the summary judgment and remanded for trial.

The problem of course was one of interpreting the contract language. It was held that articles 20 and 25 of the A.I.A. conditions did not relieve the builder holding an architect's certificate from liability for defects appearing after the warranty period. The only time limit is the four-year statute of limitations applicable to the construction contract. This appears to be in keeping with the purpose of the document, but may be something of a surprise to the building trade. Because of the bifurcated nature of the contract with both standard and special provisions, the court had to consider also the special provision that the architect's certificate should be final as to the acceptable fulfillment of the contract and the determination of the amount and quality of the work performed and the materials furnished. While the matter is not without its difficulties, it was held that this provision made little change in the effect of the A.I.A. conditions as interpreted, although it was perhaps from this source that the court derived the requirement that, to be exempt from the one-year limitation implicit in the warranty provision, the defect had to be not only a latent one that first appeared after the year's period but also one that could not

[16] 430 S.W.2d 473 (Tex. 1968).
[17] 418 S.W.2d 915 (Tex. Civ. App. 1967).

have been discovered within that period by the exercise of ordinary care.

Loss of Contract Rights by Estoppel. In a controversial decision in 1965,[18] the Supreme Court of Texas held that a party to a contract who had systematically been underpaid moneys due him under a contract might be estopped to claim the arrearage, by reason of his negligent failure to discover the underpayments and his failure to protest when the fact of underpayment was brought, obliquely perhaps, to his attention. The facts of that case were that Champlin Oil and Refining Company was operating a processing plant removing natural hydrocarbons from natural gas. A 1948 contract with the Panola County Royalty Owners Association established a formula (the "plant formula") by which each owner would be paid. This agreement was modified slightly in 1952. After 1952 and prior to 1956 Champlin redrafted its form contract and changed the allocation formula (the "contract formula") and employed this form in negotiating agreements with additional producers and owners. Such a contract was negotiated in 1956 with one Chastain.

Despite the new contract language Champlin continued to compute its payments to all owners by the 1948 plant formula, thus underpaying Chastain and certain other holders of the later contracts. Monthly statements furnished each owner showed the arithmetical basis of the allocation, and a careful comparison with the contract would have revealed the discrepancy. No owner protested. In 1958 auditors pointed out to Champlin that it was not allocating funds as required by its contracts with 165 of its producers. On advice of counsel Champlin sent to each of its producers a not-too-revealing letter in which it disclosed that a question had arisen as to the allocation procedure, that the method used was that of the 1948 agreement as modified, that Champlin proposed to continue this method, and that Champlin would consider the addressee's failure to object within thirty days to be an assent to this procedure. Chastain did not reply. In 1961 Chastain finally was informed that he had been underpaid since the inception of the agreement and brought suit for some $118,000. Both the district court and the court of civil appeals found for Chastain.[19] The supreme court reversed.

Champlin's contention for reformation of the contract to conform to the 1948 modified plant formula failed by reason of the absence of any evidence that during the negotiations Chastain had ever agreed to anything but the formula in the 1956 contract. Any contention that Chastain's failure to reply to the 1958 letter amounted to an agreed modification of the 1956 agreement would fail, if for no other reason, for want of consideration.[20] Champlin was forced back on the contention that Chastain's failure to discover the underpayment by a careful examination of the monthly statements and his failure to protest the 1958 letter, estopped him to demand the arrearage.

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[18] Champlin Oil & Ref. Co. v. Chastain, 403 S.W.2d 376 (Tex. 1965).
[19] 379 S.W.2d 938 (Tex. Civ. App. 1964).
[20] City of Beaumont v. Fertitta, 415 S.W.2d 902 (Tex. 1967).

Champlin's position with reference to estoppel was weak. If Chastain was careless in not examining his monthly statements to discover the error, Champlin was at least equally careless in not paying according to the terms of a contract it had prepared. From 1956 Champlin knew that it was not conforming to its agreement. Nothing Chastain did or did not do led Champlin to believe that its performance was in conformity with its agreements. The most that could be said was that Chastain led Champlin to believe that Chastain would not demand the arrearages. The supreme court held that estoppel could be based on such facts, that there was evidence to support a finding that Champlin did rely and that its reliance was reasonable, and that consequent injury could be found in Champlin's overpayments to other producers who would have received less had the contract formula been applied correctly. The majority opinion met only weakly the argument that there was not a sufficient deception to bring the estoppel principle into play. The remand to the court of civil appeals was for the consideration of evidentiary matters, in view of the fact that the decision below had turned on only a balancing of the equities.

A measure of the confusion engendered by the *Champlin* decision was allayed by the 1968 decision in *Barfield v. Howard M. Smith Co.*[21] Here the parties were lessor and lessee of a store building occupied by lessee Smith under a fixed rental plus percentage of gross receipts lease. In 1958 the lessor agreed to let to Smith additional space in an adjoining building. A lease covering only the additional space provided for a fixed rental of $4,800 plus an increased percentage of gross sales over $925,000, apparently on an assumption that the added space would result in increased sales. From the outset, apparently because of an insupportable but in that case innocuous error in computing rents under the original lease, the lessee in computing his rent from year to year deducted the $4,800 fixed rent from the gross-sales percentage. Thus the lessor was underpaid by $4,800 per year until he discovered the error in 1964. Action was brought to recover the total arrearage. Since there was no fiduciary or other relation to justify disregarding the statute of limitations, the lessor was effectively limited to recovery for the four years immediately preceding the action. Relying on the *Champlin* decision, the court of civil appeals held that the lessor was estopped to recover any of the back rent and affirmed a judgment for the lessee.[22] The supreme court reversed.

Possibly this case could have been disposed of summarily for the reason that the lessee had not shown an essential element of estoppel: That there had been a change of position and a substantial and irreparable harm or injury proximately resulting from reliance on the misrepresentation of fact or intention. About all the lessee had in this connection was its contention that it had renewed the lease in 1964 and would not have done so but for the illusion of an additional $4,800 per year profit from its past operations. This would seem to fall into the category of unilateral

[21] 426 S.W.2d 834 (Tex. 1968).
[22] 415 S.W.2d 667 (Tex. Civ. App. 1967).

mistake in the inducement to the contract, clearly due to the party's own fault or neglect, for which relief will not be given.

The court's opinion gave little attention to the argument that the lessor should be estopped simply because he had the means of discovering the error but had not done so and protested. It was at this precise point that the lower courts were misled by *Champlin*. Instead the court turned to the proper starting point in an estoppel case: whether the party claiming the estoppel was actually, justifiably misled. If he was not so misled, then any discussion of the other party's "duty to speak" becomes irrelevant. The court held that the lessee, having either actual knowledge or a convenient means of acquiring knowledge of the truth, cannot properly claim to have been misled. Only fraud (*i.e.*, willful deceit by the lessor) could relieve the lessee of the burden of his own knowledge.

The court distinguished the *Champlin* case on the basis of Champlin's 1958 letter purporting to report the discrepancy in allocation methods and stating that such methods would continue. The relevance of this to *Barfield* is not clear. Had the lessee expressly informed the lessor that it was underpaying the rent by $400 per month, and had the lessor expressly agreed to this, the claimed modification of the lease would have been unenforceable for want of consideration.[23] It is baffling to consider just how one could do on a theory of estoppel based on silence what one could not do on a basis of an express agreement. It is suggested that the *Champlin* decision needs further explanation or emendation.

Third Party Beneficiary Contract. Republic National Bank agreed to make an interim construction loan to International Mortgage Company provided an acceptable commitment for long-term financing were obtained.[24] International then obtained the required long-term commitment from Interstate Life Insurance Company. Relying on this commitment letter, Republic made the loan. Subsequently National Bankers Life Insurance Company acquired Interstate and assumed its liabilities. National Bankers then refused to make the long-term loan to International, and Republic sued National Bankers for the ensuing damages. The Dallas court of civil appeals affirmed a summary judgment for National Bankers Life.[25]

An action in the nature of deceit being obviously impossible in this situation, Republic claimed, as a third party beneficiary of the contract between International and Interstate, that the purpose of the long-term loan was to repay Republic's short-term advance. This contention was rejected, the court holding that a fact issue of such a nature would be irrelevant on motion for summary judgment. Whether, assuming Republic's version of the facts to be correct, Republic could qualify as a beneficiary entitled to sue is a quite debatable issue. In a seemingly negative answer to this ques-

[23] City of Beaumont v. Fertitta, 415 S.W.2d 902 (Tex. 1967).

[24] It is common knowledge that a principal purpose of the long-term mortgage loan commitment is to assure repayment of the short-term construction lender.

[25] Republic Nat'l Bank v. National Bankers Life Ins. Co., 427 S.W.2d 76 (Tex. Civ. App. 1968), *error ref. n.r.e.*

tion, the court relied in large measure on authorities expressing the conception of section 133 of the *Restatement of Contracts* which confines such actions to beneficiaries classified as either "creditor" or "donee." When the *Restatement* was first drafted this section was criticized as too restrictive. It was urged that the basic issue was whether the promisee in the contract intended to create a right in the third person and that labels such as "donee" and "creditor" were irrelevant. A number of cases have allowed third party beneficiary actions in situations that would not meet fully the *Restatement* standard.[26] Finally, the proposed revision of the *Restatement* abandons the old terminology and the promisee's intention to give the third party the benefit of the promised performance is made the sole test.[27] Under this newer approach Republic appears to have the makings of a valid claim.

More troublesome is the court's reliance on the parol evidence rule after pointing out that Republic was neither named nor described in the commitment letter. It is true enough that evidence of custom or usage normally cannot be used to contradict an integrated contract, but it does not follow that such evidence cannot be used to establish the rights of a third person in a contract. Certainly the parol evidence rule does not prevent an undisclosed principal from suing or being sued on the integrated contract made by his agent. It is not seen that the policy of the parol evidence rule would be any different as applied to the third party beneficiary. Is it possible that we might permit a third party beneficiary to sue on an oral contract of a certain sort, and deny that right if the identical contract is reduced to writing without mention of the beneficiary?

[26] *See* Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961) (attorney liable to intended devisee where he drew will in such a way as to invalidate devise under Rule Against Perpetuities); Chatham Super Markets, Inc. v. Ajax Asphalt Paving Co., 370 Mich. 334, 121 N.W.2d 836 (1963) (owner allowed action directly against subcontractor for breach of subcontractor's contract with the general contractor); Visintine Co. v. New York, C. & St. L.R.R., 169 Ohio St. 505, 160 N.E.2d 311 (1959) (city, engaged in building railroad-highway grade separation, contracted separately with Visintine to do earth work and actual construction and with railroad to relocate trackage; contract with railroad required it to coordinate its work with that of other contractors; railroad held liable to Visintine for unnecessary obstruction of work site); *cf.* James Stewart & Co. v. Law, 149 Tex. 392, 233 S.W.2d 558 (1950).

[27] RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tent. Draft No. 4, 1968).