

Negotiation and Precontractual Obligations

Contract law is a tool for parties to bind themselves and limit their legal freedom in return for consideration. The common law and modern American law generally do not impose legal obligations or otherwise limit the freedom of the parties during negotiations until the moment of acceptance, when a contract is formed. As the California Court of Appeal famously noted: “The fact that parties commence negotiations looking to a contract . . . does not by itself impose any duty on either party not to be unreasonable or not to break off negotiations, for any reason or for no reason.” *Racine & Laramie, Ltd. v. Dep’t of Parks & Recreation*, 11 Cal. App. 4th 1026, 1034 (1992). In contrast, Civil Law countries impose a duty of good faith during contractual negotiations.

In this module, we will consider exceptions to this rule by examining situations in which legal obligations might be imposed when the parties allegedly failed to conclude their negotiation process and reach a final agreement.

A. Promissory Estoppel and Commercial Negotiation

The first three cases in this section consider whether and when promissory estoppel can be used to impose pre-contractual liability. Note that these cases are different from many of those we saw when discussing promissory estoppel. Promissory estoppel developed in cases where formal adherence to the principles of bargained-for exchange would deny enforcement of what looks like gift promises. They often involve situations in which gifts are common, such as family relationships or charitable giving.

But should promissory estoppel be extended to arm’s length transactions between business owners? Is there a place for crediting reasonable reliance instead of bargained-for exchange between sophisticated parties? Or does such a practice threaten to stretch contract law beyond its reasonable bounds?

James Baird Co. v. Gimbel Bros.

64 F.2d 344 (2d Cir. 1933)

HAND, Circuit Judge.

The plaintiff sued the defendant for breach of a contract to deliver linoleum under a contract of sale; the defendant denied the making of the contract; the parties tried the case to the judge under a written stipulation and he directed judgment for the defendant. The facts as found, bearing on the making of the contract, the only issue necessary to discuss, were as follows:

The defendant, a New York merchant, knew that the Department of Highways in Pennsylvania had asked for bids for the construction of a public building. It sent an employee to the office of a contractor in Philadelphia, who had possession of the specifications, and the employee there computed the amount of the linoleum which would be required on the job, underestimating the total yardage by about one-half the proper amount. In ignorance of this mistake, on December twenty-fourth the defendant sent to some twenty or thirty contractors, likely to bid on the job, an offer to supply all the linoleum required by the specifications at two different lump sums, depending upon the quality used. These offers concluded as follows: 'If successful in being awarded this contract, it will be absolutely guaranteed, * * * and * * * we are offering these prices for reasonable' (sic), 'prompt acceptance after the general contract has been awarded.' The plaintiff, a contractor in Washington, got one of these on the twenty-eighth, and on the same day the defendant learned its mistake and telegraphed all the contractors to whom it had sent the offer, that it withdrew it and would substitute a new one at about double the amount of the old. This withdrawal reached the plaintiff at Washington on the afternoon of the same day, but not until after it had put in a bid at Harrisburg at a lump sum, based as to linoleum upon the prices quoted by the defendant. The public authorities accepted the plaintiff's bid on December thirtieth, the defendant having meanwhile written a letter of confirmation of its withdrawal, received on the thirty-first. The plaintiff formally accepted the offer on January second, and, as the defendant persisted in declining to recognize the existence of a contract, sued it for damages on a breach.

Unless there are circumstances to take it out of the ordinary doctrine, since the offer was withdrawn before it was accepted, the acceptance was too late. Restatement of Contracts, § 35. To meet this the plaintiff argues as follows: It was a reasonable implication from the defendant's offer that it should be irrevocable in case the plaintiff acted upon it, that is to say, used the prices quoted in making its bid, thus putting itself in a position from which it could not withdraw without great loss. While it might have withdrawn its bid after receiving the revocation, the time had passed to submit another, and as the item of linoleum was a very trifling part of the cost of the whole building, it would have been an unreasonable hardship to expect it to lose the contract on that account, and probably forfeit its deposit. While it is true that the plaintiff might in advance have secured a contract conditional upon the success of its bid, this was not what the defendant suggested. It understood that the contractors would use its offer in their bids, and would thus in fact commit themselves to supplying the linoleum at the proposed prices. The inevitable implication from all this was that when the contractors acted upon it, they accepted the offer and promised to pay for the linoleum, in case their bid were accepted.

It was of course possible for the parties to make such a contract, and the question is merely as to what they meant; that is, what is to be imputed to the words they used. Whatever plausibility there is in the argument, is in the fact that the defendant must have known the predicament in which the contractors would be put if it withdrew its offer after the bids went in. However, it seems entirely clear that the contractors did not suppose that they accepted the offer merely by putting in their bids. If, for example, the successful one had repudiated the contract with the public authorities after it had been awarded to him, certainly the defendant could not have sued him for a breach. If he had become bankrupt, the defendant could not prove against his estate. It seems plain therefore that there was no contract between them. And if there be any doubt as to this, the language of the offer sets it at rest. The phrase, 'if successful in being awarded this contract,' is scarcely met by the mere use of the prices in the bids. Surely such a use was not an 'award' of the contract to the defendant. Again, the phrase, 'we are offering these prices for * * * prompt acceptance after the general contract has been awarded,' looks to the usual communication of an acceptance, and precludes the idea that the use of the offer in the bidding shall be the equivalent. It may indeed be argued that this last language contemplated no more than an early notice that the offer had been accepted, the actual acceptance being the bid, but that would wrench its natural meaning too far, especially in the light of the preceding phrase. The contractors had a ready escape from their difficulty by insisting upon a contract before they used the figures; and in commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves.

But the plaintiff says that even though no bilateral contract was made, the defendant should be held under the doctrine of 'promissory estoppel.' This is to be chiefly found in those cases where persons subscribe to a venture, usually charitable, and are held to their promises after it has been completed. It has been applied much more broadly, however, and has now been generalized in section 90, of the Restatement of Contracts. We may arguendo accept it as it there reads, for it does not apply to the case at bar. Offers are ordinarily made in exchange for a consideration, either a counter-promise or some other act which the promisor wishes to secure. In such cases they propose bargains; they presuppose that each promise or performance is an inducement to the other. *Wisconsin & M. Ry. Co. v. Powers*, 191 U. S. 379, 386, 387, 24 S. Ct. 107 (1903); *Banning Co. v. People of State of Cal.*, 240 U. S. 142, 152, 153, 36 S. Ct. 338, 60 L. Ed. 569 (1916). But a man may make a promise without expecting an equivalent; a donative promise, conditional or absolute. The common law provided for such by sealed instruments, and it is unfortunate that these are no longer generally available. The doctrine of 'promissory estoppel' is to avoid the harsh results of allowing the promisor in such

a case to repudiate, when the promisee has acted in reliance upon the promise. *Siegel v. Spear & Co.*, 234 N. Y. 479, 138 N. E. 414 (1923). *Cf. Allegheny Coll. v. Nat'l Chautauqua Cnty. Bank of Jamestown*, 246 N. Y. 369, 159 N. E. 173 (1927). But an offer for an exchange is not meant to become a promise until a consideration has been received, either a counter-promise or whatever else is stipulated. To extend it would be to hold the offeror regardless of the stipulated condition of his offer. In the case at bar the defendant offered to deliver the linoleum in exchange for the plaintiff's acceptance, not for its bid, which was a matter of indifference to it. That offer could become a promise to deliver only when the equivalent was received; that is, when the plaintiff promised to take and pay for it. There is no room in such a situation for the doctrine of 'promissory estoppel.'

Nor can the offer be regarded as of an option, giving the plaintiff the right seasonably to accept the linoleum at the quoted prices if its bid was accepted, but not binding it to take and pay, if it could get a better bargain elsewhere. There is not the least reason to suppose that the defendant meant to subject itself to such one-sided obligation. True, if so construed, the doctrine of 'promissory estoppel' might apply, the plaintiff having acted in reliance upon it, though, so far as we have found, the decisions are otherwise. *Ganss v. J.M. Guffey Petroleum Co.*, 125 A.D. 760, 110 N. Y. S. 176 (App. Div. 1908); *Comstock v. North*, 88 Miss. 754, 41 So. 374 (1906). As to that, however, we need not declare ourselves.

Judgment affirmed.

Drennan v. Star Paving Co.

333 P.2d 757 (Supreme Court of California 1958)

TRAYNOR, Justice.

Defendant appeals from a judgment for plaintiff in an action to recover damages caused by defendant's refusal to perform certain paving work according to a bid it submitted to plaintiff.

On July 28, 1955, plaintiff, a licensed general contractor, was preparing a bid on the 'Monte Vista School Job' in the Lancaster school district. Bids had to be submitted before 8:00 p. m. Plaintiff testified that it was customary in that area for general contractors to receive the bids of subcontractors by telephone on the day set for bidding and to rely on them in computing their own bids. Thus on that day plaintiff's secretary, Mrs. Johnson, received by telephone between fifty and seventy-five subcontractors' bids for various parts of the school job. As each bid came in, she wrote it on a special form, which she brought into plaintiff's office. He then posted it on a master cost sheet setting forth the names and bids of all subcontractors. His

own bid had to include the names of subcontractors who were to perform one-half of one per cent or more of the construction work, and he had also to provide a bidder's bond of ten per cent of his total bid of \$317,385 as a guarantee that he would enter the contract if awarded the work.

Late in the afternoon, Mrs. Johnson had a telephone conversation with Kenneth R. Hoon, an estimator for defendant. He gave his name and telephone number and stated that he was bidding for defendant for the paving work at the Monte Vista School according to plans and specifications and that his bid was \$7,131.60. At Mrs. Johnson's request he repeated his bid. Plaintiff listened to the bid over an extension telephone in his office and posted it on the master sheet after receiving the bid form from Mrs. Johnson. Defendant's was the lowest bid for the paving. Plaintiff computed his own bid accordingly and submitted it with the name of defendant as the subcontractor for the paving. When the bids were opened on July 28th, plaintiff's proved to be the lowest, and he was awarded the contract.

On his way to Los Angeles the next morning plaintiff stopped at defendant's office. The first person he met was defendant's construction engineer, Mr. Oppenheimer. Plaintiff testified: 'I introduced myself and he immediately told me that they had made a mistake in their bid to me the night before, they couldn't do it for the price they had bid, and I told him I would expect him to carry through with their original bid because I had used it in compiling my bid and the job was being awarded them. And I would have to go and do the job according to my bid and I would expect them to do the same.'

Defendant refused to do the paving work for less than \$15,000. Plaintiff testified that he 'got figures from other people' and after trying for several months to get as low a bid as possible engaged L & H Paving Company, a firm in Lancaster, to do the work for \$10,948.60.

The trial court found on substantial evidence that defendant made a definite offer to do the paving on the Monte Vista job according to the plans and specifications for \$7,131.60, and that plaintiff relied on defendant's bid in computing his own bid for the school job and naming defendant therein as the subcontractor for the paving work. Accordingly, it entered judgment for plaintiff in the amount of \$3,817.00 (the difference between defendant's bid and the cost of the paving to plaintiff) plus costs.

Defendant contends that there was no enforceable contract between the parties on the ground that it made a revocable offer and revoked it before plaintiff communicated his acceptance to defendant.

There is no evidence that defendant offered to make its bid irrevocable in exchange for plaintiff's use of its figures in computing his bid. Nor is there evidence that would warrant interpreting plaintiff's use of defendant's bid as the acceptance thereof, binding plaintiff, on condition he received the main contract, to award the subcontract to defendant. In sum, there was neither an option supported by consideration nor a bilateral contract binding on both parties.

Plaintiff contends, however, that he relied to his detriment on defendant's offer and that defendant must therefore answer in damages for its refusal to perform. Thus the question is squarely presented: Did plaintiff's reliance make defendant's offer irrevocable?

Section 90 of the Restatement of Contracts states: 'A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.' This rule applies in this state....

Defendant's offer constituted a promise to perform on such conditions as were stated expressly or by implication therein or annexed thereto by operation of law. (See 1 Williston, Contracts (3rd. ed.), s 24A, p. 56, s 61, p. 196.) Defendant had reason to expect that if its bid proved the lowest it would be used by plaintiff. It induced 'action * * * of a definite and substantial character on the part of the promisee.'

Had defendant's bid expressly stated or clearly implied that it was revocable at any time before acceptance we would treat it accordingly. It was silent on revocation, however, and we must therefore determine whether there are conditions to the right of revocation imposed by law or reasonably inferable in fact. In the analogous problem of an offer for a unilateral contract, the theory is now obsolete that the offer is revocable at any time before complete performance. Thus section 45 of the Restatement of Contracts provides: 'If an offer for a unilateral contract is made, and part of the consideration requested in the offer is given or tendered by the offeree in response thereto, the offeror is bound by a contract, the duty of immediate performance of which is conditional on the full consideration being given or tendered within the time stated in the offer, or, if no time is stated therein, within a reasonable time.' In explanation, comment b states that the 'main offer includes as a subsidiary promise, necessarily implied, that if part of the requested performance is given, the offeror will not revoke his offer, and that if tender is made it will be accepted. Part performance or tender may thus furnish consideration for the subsidiary promise. Moreover, merely acting in justifiable reliance on an offer may in some cases serve as sufficient reason for making a promise binding (see s 90).'

Whether implied in fact or law, the subsidiary promise serves to preclude the injustice that would result if the offer could be revoked after the offeree had acted in detrimental reliance thereon. Reasonable reliance resulting in a foreseeable prejudicial change in position affords a compelling basis also for implying a subsidiary promise not to revoke an offer for a bilateral contract.

The absence of consideration is not fatal to the enforcement of such a promise. It is true that in the case of unilateral contracts the Restatement finds consideration for the implied subsidiary promise in the part performance of the bargained-for exchange, but its reference to section 90 makes clear that consideration for such a promise is not always necessary. The very purpose of section 90 is to make a promise binding even though there was no consideration 'in the sense of something that is bargained for and given in exchange.' (See 1 Corbin, Contracts 634 et seq.) Reasonable reliance serves to hold the offeror in lieu of the consideration ordinarily required to make the offer binding. In a case involving similar facts the Supreme Court of South Dakota stated that 'we believe that reason and justice demand that the doctrine (of section 90) be applied to the present facts. We cannot believe that by accepting this doctrine as controlling in the state of facts before us we will abolish the requirement of a consideration in contract cases, in any different sense than an ordinary estoppel abolishes some legal requirement in its application. We are of the opinion, therefore, that the defendants in executing the agreement (which was not supported by consideration) made a promise which they should have reasonably expected would induce the plaintiff to submit a bid based thereon to the Government, that such promise did induce this action, and that injustice can be avoided only by enforcement of the promise.' *Northwestern Engineering Co. v. Ellerman*, 69 S.D. 397, 408, 10 N.W.2d 879, 884 (1943); see also, *Robert Gordon, Inc., v. Ingersoll-Rand Co.*, 117 F.2d 654, 661 (7th Cir. 1941); cf. *James Baird Co. v. Gimbel Bros.*, 64 F.2d 344 (2d Cir. 1933).

When plaintiff used defendant's offer in computing his own bid, he bound himself to perform in reliance on defendant's terms. Though defendant did not bargain for this use of its bid neither did defendant make it idly, indifferent to whether it would be used or not. On the contrary it is reasonable to suppose that defendant submitted its bid to obtain the subcontract. It was bound to realize the substantial possibility that its bid would be the lowest, and that it would be included by plaintiff in his bid. It was to its own interest that the contractor be awarded the general contract; the lower the subcontract bid, the lower the general contractor's bid was likely to be and the greater its chance of acceptance and hence the greater defendant's chance of getting the paving subcontract. Defendant had reason not only to expect plaintiff to rely on its bid but to want him to. Clearly defendant had a stake in plaintiff's reliance on its

bid. Given this interest and the fact that plaintiff is bound by his own bid, it is only fair that plaintiff should have at least an opportunity to accept defendant's bid after the general contract has been awarded to him.

It bears noting that a general contractor is not free to delay acceptance after he has been awarded the general contract in the hope of getting a better price. Nor can he reopen bargaining with the subcontractor and at the same time claim a continuing right to accept the original offer. See, *R. J. Daum Const. Co. v. Child*, Utah, 247 P.2d 817, 823 (1952). In the present case plaintiff promptly informed defendant that plaintiff was being awarded the job and that the subcontract was being awarded to defendant.

Defendant contends, however, that its bid was the result of mistake and that it was therefore entitled to revoke it. It relies on the rescission cases of *M. F. Kemper Const. Co. v. City of Los Angeles*, 37 Cal.2d 696, 235 P.2d 7 (1951), and *Brunzell Const. Co. v. G. J. Weisbrod, Inc.*, 134 Cal. 2d 278, 285 P.2d 989 (1955). See also, *Lemoge Electric v. San Mateo County*, 46 Cal.2d 659, 662, 297 P.2d 638. In those cases, however, the bidder's mistake was known or should have been known to the offeree, and the offeree could be placed in status quo. Of course, if plaintiff had reason to believe that defendant's bid was in error, he could not justifiably rely on it, and section 90 would afford no basis for enforcing it. *Robert Gordon, Inc., v. Ingersoll-Rand, Inc.*, 117 F.2d 654, 660 (7th Cir. 1941). Plaintiff, however, had no reason to know that defendant had made a mistake in submitting its bid, since there was usually a variance of 160 per cent between the highest and lowest bids for paving in the desert around Lancaster. He committed himself to performing the main contract in reliance on defendant's figures. Under these circumstances defendant's mistake, far from relieving it of its obligation, constitutes an additional reason for enforcing it, for it misled plaintiff as to the cost of doing the paving. Even had it been clearly understood that defendant's offer was revocable until accepted, it would not necessarily follow that defendant had no duty to exercise reasonable care in preparing its bid. It presented its bid with knowledge of the substantial possibility that it would be used by plaintiff; it could foresee the harm that would ensue from an erroneous underestimate of the cost. Moreover, it was motivated by its own business interest. Whether or not these considerations alone would justify recovery for negligence had the case been tried on that theory (see *Biakanja v. Irving*, 49 Cal. 2d 647, 650, 320 P.2d 16 (1958)), they are persuasive that defendant's mistake should not defeat recovery under the rule of section 90 of the Restatement of Contracts. As between the subcontractor who made the bid and the general contractor who reasonably relied on it, the loss resulting from the mistake should fall on the party who caused it.

Leo F. Piazzola Paving Co. v. Bebek & Brkich, 141 Cal. App. 2d 226, 296 P.2d 368, 371 (1956), and *Bard v. Kent*, 19 Cal. 2d 449, 122 P.2d 8 (1942), are not to the contrary. In the *Piazzola* case the court sustained a finding that defendants intended, not to make a firm bid, but only to give the plaintiff 'some kind of an idea to use' in making its bid; there was evidence that the defendants had told plaintiff they were unsure of the significance of the specifications. There was thus no offer, promise, or representation on which the defendants should reasonably have expected the plaintiff to rely. The *Bard* case held that an option not supported by consideration was revoked by the death of the optionor. The issue of recovery under the rule of section 90 was not pleaded at the trial, and it does not appear that the offeree's reliance was 'of a definite and substantial character' so that injustice could be avoided 'only by the enforcement of the promise.'

There is no merit in defendant's contention that plaintiff failed to state a cause of action, on the ground that the complaint failed to allege that plaintiff attempted to mitigate the damages or that they could not have been mitigated. Plaintiff alleged that after defendant's default, 'plaintiff had to procure the services of the L & H Co. to perform said asphaltic paving for the sum of \$10,948.60.' Plaintiff's uncontradicted evidence showed that he spent several months trying to get bids from other subcontractors and that he took the lowest bid. Clearly he acted reasonably to mitigate damages. In any event any uncertainty in plaintiff's allegation as to damages could have been raised by special demurrer. Code Civ.Proc. s 430, subd. 9. It was not so raised and was therefore waived. Code Civ.Proc. s 434.

The judgment is affirmed.

Notes and Questions

1. The courts in both *Drennan* and *Baird* considered two types of promises: a mere promise to keep an offer open and the promise of full performance that is part of a final bilateral agreement. Such promises can be enforceable as supported by consideration or under the promissory estoppel doctrine. Make sure you understand how each of the courts addresses each of those possibilities.
2. The facts in *Drennan* are quite similar to the facts in *Baird*. Are these cases more or less identical, or could you distinguish their holdings on the facts?

3. The courts deciding *Baird* and *Drennan* disagree as to where the risk of loss falls for the general contractor's reliance on a mistaken bid by a subcontractor. Who should bear responsibility of clarifying that a bid by a subcontractor is or is not revocable?
4. In *Drennan*, Justice Traynor noted that "a general contractor is not free to delay acceptance after he has been awarded the general contract in the hope of getting a better price." What is the base for that rule? What happens if the general contractor shops around for a better deal after being awarded?
5. The general contractor's risks are not inconsequential. In many cases, including both in *Baird* and in *Drennan*, the general contractor's bid is accompanied by a certified check or surety bond of a certain percentage of the bid amount. This upfront payment serves "as a guarantee that the bidder will enter into the proposed contract if it is awarded to him." *M. F. Kemper Const. Co. v. City of Los Angeles*, 37 Cal. 2d 696, 699, 235 P.2d 7 (1951).
6. Should a general contractor be bound to the municipality for its erroneous bid? In a case cited in *Drennan*, the California Supreme Court held that a general contractor may rescind or cancel an erroneously and clearly underpriced bid without forfeiting its bond. See *M. F. Kemper Const. Co. v. City of Los Angeles*, 37 Cal. 2d 696, 701-02, 235 P.2d 7 (1951). We further discuss the impact of such mistakes in the module concerning mistakes.
7. Restatement (Second) of Contracts § 87(2) generalized the holding of *Drennan*:

An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice

However, while many courts have adopted this rule when dealing with the relationships between general contractors and their subcontractors in the construction industry, they mostly refuse to apply it in other contexts. Why are courts reluctant to do so? Why is the construction industry different?

8. Can a contractor avoid that presumption of irrevocability with contract language? In *Fletcher-Harlee Corp. v. Pote Concrete Contractors, Inc.*, 482 F.3d 247, 249 (3d Cir. 2007), the court noted that the subcontractor's language specifying its bid was "for informational purposes only, did not constitute a 'firm offer,' and should not be relied on." In light

of these terms, the court concluded, “we cannot allow a general contractor who purports to accept such a bid to sue for breach of contract or for promissory estoppel.” The contract language eclipsed the presumption.

* * *

The *Baird* and *Drennan* courts consider whether promissory estoppel might make an offer irrevocable. But can promissory estoppel be extended even further to promises that were made during failed negotiations? Keep this question in mind as you read the following case.

Hoffman v. Red Owl Stores, Inc.

26 Wis.2d 683 (Supreme Court of Wisconsin 1965)

Action by Joseph Hoffman (hereinafter ‘Hoffman’) and wife, plaintiffs, against defendants Red Owl Stores, Inc. (hereinafter ‘Red Owl’) and Edward Lukowitz.

The complaint alleged that Lukowitz, as agent for Red Owl, represented to and agreed with plaintiffs that Red Owl would build a store building in Chilton and stock it with merchandise for Hoffman to operate in return for which plaintiffs were to put up and invest a total sum of \$18,000; that in reliance upon the above mentioned agreement and representations plaintiffs sold their bakery building and business and their grocery store and business; also in reliance on the agreement and representations Hoffman purchased the building site in Chilton and rented a residence for himself and his family in Chilton; plaintiffs’ actions in reliance on the representations and agreement disrupted their personal and business life; plaintiffs lost substantial amounts of income and expended large sums of money as expenses. Plaintiffs demanded recovery of damages for the breach of defendants’ representations and agreements.

The action was tried to a court and jury. The facts hereafter stated are taken from the evidence adduced at the trial. Where there was a conflict in the evidence the version favorable to plaintiffs has been accepted since the verdict rendered was in favor of plaintiffs.

Hoffman assisted by his wife operated a bakery at Wautoma from 1956 until sale of the building late in 1961 . . . Red Owl . . . owns and operates a number of grocery supermarket stores and also extends franchises to agency stores which are owned by individuals, partnerships and corporations. Lukowitz . . . has been divisional manager for Red Owl in a territory comprising Upper Michigan and most of Wisconsin in charge of 84 stores...

[In November 1959, Hoffman started to negotiate with Red Owl about establishing a grocery store]. Hoffman mentioned [to Lukowitz] that \$18,000 was all the capital he had available to

invest and he was repeatedly assured that this would be sufficient to set him up in business as a Red Owl store. About Christmastime, 1960, Hoffman thought it would be a good idea if he bought a small grocery store in Wautoma and operated it in order that he gain experience in the grocery business prior to operating a Red Owl store in some larger community. On February 6, 1961, on the advice of Lukowitz . . . Hoffman bought the inventory and fixtures of a small grocery store in Wautoma and leased the building in which it was operated.

After three months of operating this Wautoma store . . . the store was operating at a profit. Lukowitz advised Hoffman to sell the store . . . and assured him that Red Owl would find a larger store from him elsewhere. Acting on this advice and assurance, Hoffman sold the fixtures and inventory to his manager on June 6, 1961. Hoffman was reluctant to sell at that time because it meant losing the summer tourist business, but he sold on the assurance that he would be operating in a new location by fall and that he must sell this store if he wanted a bigger one . . . [Red Owl selected a potential site for the store in Chilton] to which plaintiff obtained an option at Red Owl's suggestion. The option stipulated a purchase price of \$6,000 with \$1,000 to be paid on election to purchase and the balance to be paid within 30 days. On Lukowitz's assurance that everything was all set plaintiff paid \$1,000 down on the lot on September 15th....

On the basis of [a meeting with representatives from the home office], Lukowitz assured Hoffman: '[E]verything is ready to go. Get your money together and we are set.' Shortly after this meeting Lukowitz told plaintiffs that they would have to sell their bakery business and bakery building, and that their retaining this property was the only 'hitch' in the entire plan. On November 6, 1961, plaintiffs sold their bakery building for \$10,000 . . .

The record contains different exhibits which were prepared in September and October, some of which were projections of the fiscal operation of the business and others were proposed building and floor plans. Red Owl was to procure some third party to buy the Chilton lot from Hoffman, construct the building, and then lease it to Hoffman. No final plans were ever made, nor were bids let or a construction contract entered. [Hoffman and Lukowitz agree that the lease will be for ten years with another optional ten years, and they agreed on the price, but some details, for example, those concerning Hoffman's ability to purchase the store after the lease expiration, were still open.]

[In a late November meeting between Lukowitz, Hoffman, and Red Owl's credit manager, a document was prepared showing] Hoffman contributing \$24,100 of cash capital of which only

\$4,600 was to be cash possessed by plaintiffs [and] \$7,500 was to be obtained on a 5 percent loan from the father-in-law. . .

A week or two after the ... meeting Lukowitz showed Hoffman a telegram from the home office to the effect that if plaintiff could get another \$2,000 for promotional purposes the deal could go through for \$26,000. Hoffman . . . met with his father-in-law, who agreed to put \$13,000 into the business provided he could come into the business as a partner. Lukowitz told Hoffman the partnership arrangement ‘sounds fine’ . . . On January 16, 1962, the Red Owl credit manager teletyped Lukowitz that the father-in-law would have to sign an agreement that the \$13,000 was either a gift or a loan subordinate to all general creditors . . . Hoffman testified that it was not until the final meeting some time between January 26th and February 2nd, 1962, that he was told that his father-in-law was expected to sign an agreement that the \$13,000 he was advancing was to be an outright gift. No mention was then made by the Red Owl representatives of the alternative of the father-in-law signing a subordination agreement.

[The negotiation collapsed when, in early February, Red Owl asked for \$34,000 from the plaintiff, including a \$13,000 gift from his father-in-law.]

[The trial court decided that the parties negotiated a franchise agreement but that they did not mutually agree on all the details “as to reach a final agreement.” The jury then decided that Red Owl made representations to Hoffman that if he fulfilled certain conditions (which he later fulfilled), he would be granted the franchise, that Hoffman should have relied on those representations “in the exercise of ordinary care,” and that he did rely on them. The jury awarded Hoffman \$16,735 for the sale of the “sale of the Wautoma store fixtures and inventory”; \$2,000 for the sale of the bakery; \$1,000 for the option on the Chilton lot; \$140 for the cost of moving his family; and \$125 for a house rental.

The trial court approved the jury verdict except for the damage in connection to the Wautoma store, for which it ordered a new trial.

Both parties appealed.]

Opinion

CURRIE, Chief Justice.

[The first question before the court is whether to adopt the doctrine of promissory estoppel in Wisconsin.]

... no other possible theory has been presented to or discovered by this court which would permit plaintiffs to recover. Of other remedies considered that of an action for fraud and deceit seemed to be the most comparable. An action at law for fraud, however, cannot be predicated on unfulfilled promises unless the promisor possessed the present intent not to perform. *Suskey v. Davidoff* (1958), 2 Wis.2d 503, 507, 87 N.W.2d 306, and cases cited. Here, there is no evidence that would support a finding that Lukowitz made any of the promises, upon which plaintiffs' complaint is predicated, in had faith with any present intent that they would not be fulfilled by Red Owl....

Many courts of other jurisdictions have seen fit over the years to adopt the principle of promissory estoppel, and the tendency in that direction continues . . .

Because we deem the doctrine of promissory estoppel, as stated in sec. 90 of Restatement, 1 Contracts, is one which supplies a needed tool which courts may employ in a proper case to prevent injustice, we endorse and adopt it.

Applicability of Doctrine to Facts of this Case

The record here discloses a number of promises and assurances given to Hoffman by Lukowitz in behalf of Red Owl upon which plaintiffs relied and acted upon to their detriment. . . . We determine that there was ample evidence to sustain the answers of the jury to the questions of the verdict with respect to the promissory representations made by Red Owl, Hoffman's reliance thereon in the exercise of ordinary care, and his fulfillment of the conditions required of him by the terms of the negotiations had with Red Owl.

There remains for consideration the question of law raised by defendants that agreement was never reached on essential factors necessary to establish a contract between Hoffman and Red Owl. Among these were the size, cost, design, and layout of the store building; and the terms of the lease with respect to rent, maintenance, renewal, and purchase options. This poses the question of whether the promise necessary to sustain a cause of action for promissory estoppel must embrace all essential details of a proposed transaction between promisor and promisee so as to be the equivalent of an offer that would result in a binding contract between the parties if the promisee were to accept the same.

Originally the doctrine of promissory estoppel was invoked as a substitute for consideration rendering a gratuitous promise enforceable as a contract. *See* Williston, Contracts (1st ed.), p. 307, sec. 139. In other words, the acts of reliance by the promisee to his detriment provided a substitute for consideration. If promissory estoppel were to be limited to only those situations

where the promise giving rise to the cause of action must be so definite with respect to all details that a contract would result were the promise supported by consideration, then the defendants' instant promises to Hoffman would not meet this test. However, sec. 90 of Restatement, 1 Contracts, does not impose the requirement that the promise giving rise to the cause of action must be so comprehensive in scope as to meet the requirements of an offer that would ripen into a contract if accepted by the promisee. Rather the conditions imposed are:

- (1) Was the promise one which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee?
- (2) Did the promise induce such action or forbearance?
- (3) Can injustice be avoided only by enforcement of the promise?

We deem it would be a mistake to regard an action grounded on promissory estoppel as the equivalent of a breach of contract action. As Dean Boyer points out, it is desirable that fluidity in the application of the concept be maintained. 98 University of Pennsylvania Law Review (1950), 459, at page 497. While the first two of the above listed three requirements of promissory estoppel present issues of fact which ordinarily will be resolved by a jury, the third requirement, that the remedy can only be invoked where necessary to avoid injustice, is one that involves a policy decision by the court. Such a policy decision necessarily embraces an element of discretion.

We conclude that injustice would result here if plaintiffs were not granted some relief because of the failure of defendants to keep their promises which induced plaintiffs to act to their detriment.

Damages

Defendants attack all the items of damages awarded by the jury.

[The court agrees with the award of (i) \$2,000 for the sale of a bakery as it was sold at a loss; (ii) the \$1,000 that Hoffman paid for the Chilton lot, which was lost when he did not purchase the property when the deal collapsed; (iii) \$125 one month's rent of a home at defendant's advice; (iv) \$140 moving costs, as Hoffman moved, at defendant suggestions, in preparation for the franchise.]

We turn now to the damage item with respect to which the trial court granted a new trial, i. e., that arising from the sale of the Wautoma grocery store fixtures and inventory for which the jury awarded \$16,735. The trial court ruled that Hoffman could not recover for any loss of future profits for the summer months following the sale on June 6, 1961, but that damages would be limited to the difference between the sales price received and fair market value of the assets sold, giving consideration to any goodwill attaching thereto by reason of the transfer of a going business. There was no direct evidence presented as to what this fair market value was on June 6, 1961. The evidence did disclose that Hoffman paid \$9,000 for the inventory, added \$1,500 to it and sold it for \$10,000 or a loss of \$500. His 1961 federal income tax return showed that the grocery equipment had been purchased for \$7,000 and sold for \$7,955.96. Plaintiffs introduced evidence of the buyer that during the first eleven weeks of operation of the grocery store his gross sales were \$44,000 and his profit was \$6,000 or roughly 15 percent. On cross-examination he admitted that this was gross and not net profit. Plaintiffs contend that in a breach of contract action damages may include loss of profits. However, this is not a breach of contract action.

The only relevancy of evidence relating to profits would be with respect to proving the element of goodwill in establishing the fair market value of the grocery inventory and fixtures sold. Therefore, evidence of profits would be admissible to afford a foundation for expert opinion as to fair market value.

Where damages are awarded in promissory estoppel instead of specifically enforcing the promisor's promise, they should be only such as in the opinion of the court are necessary to prevent injustice. Mechanical or rule of thumb approaches to the damage problem should be avoided. . . . 'The wrong is not primarily in depriving the plaintiff of the promised reward but in causing the plaintiff to change position to his detriment. It would follow that the damages should not exceed the loss caused by the change of position, which would never be more in amount, but might be less, than the promised reward.' Seavey, *Reliance on Gratuitous Promises or Other Conduct*, 64 *Harvard Law Review* (1951), 913, 926...

At the time Hoffman bought the equipment and inventory of the small grocery store at Wautoma he did so in order to gain experience in the grocery store business. At that time discussion had already been had with Red Owl representatives that Wautoma might be too small for a Red Owl operation and that a larger city might be more desirable. Thus Hoffman made this purchase more or less as a temporary experiment. Justice does not require that the damages awarded him, because of selling these assets at the behest of defendants, should

exceed any actual loss sustained measured by the difference between the sales price and the fair market value.

Since the evidence does not sustain the large award of damages arising from the sale of the Wautoma grocery business, the trial court properly ordered a new trial on this issue.

Order affirmed.

Notes and Questions

1. One of the elements of a promissory estoppel claim is that the reliance on the promisor's promise must have been reasonable. Was it reasonable for Hoffman to rely so extensively on Lukowitz's promises prior to securing a franchise agreement? Can you explain why Hoffman did so?
2. The negotiations in *Hoffman* collapsed when Red Owl asked for additional and different capital contributions, a topic on which promises were made months earlier. What would the result of the case be if the negotiations collapsed for another reason? For example, what if the parties could not have agreed on the open terms concerning the lease of the Chilton store?
3. The *Hoffman* court stressed the differences, both as a matter of liability and as a matter of remedies, between a cause of action for a breach of contract and one for promissory estoppel. Make sure you understand those differences. What additional elements did Hoffman need to prove to establish a claim for a breach of contract? What would the remedies be if he was able to do so?
4. Notice that the *Hoffman* court briefly explains that parties to a failed negotiation can sue each other for fraud, although none could have been established in this case. Indeed, while the imposition of pre-contractual liability under contract law (including under promissory estoppel) is quite controversial, the principles of tort law are applicable between negotiating parties.
5. *Hoffman* might be the high-water mark in the development of promissory estoppel, in particular in policing pre-contractual negotiations. While the case received considerable attention in the literature, its approach is not always followed. See, e.g., Alan Schwartz & Robert E. Scott, Precontractual Liability and Preliminary Agreements, 120 Harv. L.

Rev. 661, 670 (2007) (criticizing the holding and noting that the case is an “outlier” and “not been followed in its own or other jurisdictions”).

6. Now that you have read several cases concerning promises during negotiations, what are the advantages and disadvantages of applying promissory estoppel in those circumstances? How does it affect the parties’ behavior? Does it encourage or discourage negotiations and transactions?

B. Negotiation and Closure

Promissory estoppel is not the only cause of action when parties fail to conclude and perform their transaction. When that happens, the disappointed party can also claim that the transaction was already concluded, and thus, the other party’s failure to perform is simply a breach of their formed contract. As the two following cases demonstrate, while contract law places great weight on the moment of acceptance, when the contract is concluded and the parties are bound, identifying that exact moment might not be trivial.

Arnold Palmer Golf Co. v. Fuqua Industries, Inc.

541 F.2d 584 (6th Cir. 1976)

McCREE, Circuit Judge.

This is an appeal from the district court’s grant of summary judgment in favor of defendant Fuqua Industries, Inc. (Fuqua) in an action for breach of contract. The district court determined that a document captioned “Memorandum of Intent” and signed by both parties was not a contract because it evidenced the intent of the parties not to be contractually bound. We reverse and remand for trial.

Arnold Palmer Golf Company (Palmer) was incorporated under Ohio law in 1961, and has been primarily engaged in designing and marketing various lines of golf clubs, balls, bags, gloves, and other golf accessories. Palmer did none of its own manufacturing, but engaged other companies to produce its products. In the late 1960’s, Palmer’s management concluded that it was essential for future growth and profitability to acquire manufacturing facilities.

To that end, in January, 1969, Mark McCormack, Palmer’s Executive Vice-President, and E. D. Kenna, Fuqua’s President, met in New York City to consider a possible business relationship between the two corporations. The parties’ interest in establishing a business relationship continued and they held several more meetings and discussions where the general

outline of the proposed relationship was defined. In November 1969, Fuqua, with Palmer's assistance and approval, acquired Fernquest and Johnson, a California manufacturer of golf clubs. The minutes of the Fuqua Board of Directors meeting on November 3, 1969, reveal that Fuqua "proposed that this Corporation participate in the golf equipment industry in association with Arnold Palmer Golf Co. and Arnold Palmer Enterprises, Inc. The business would be conducted in two parts. One part would be composed of a corporation engaged in the manufacture and sale of golf clubs and equipment directly related to the playing of the game of golf. This Corporation would be owned to the extent of 25% by Fuqua and 75% by the Arnold Palmer interests. Fuqua would transfer the Fernquest & Johnson business to the new corporation as Fuqua's contribution."

In November and December of 1969 further discussions and negotiations occurred and revised drafts of a memorandum of intent were distributed.

The culmination of the discussions was a six page document denominated as a Memorandum of Intent. It provided in the first paragraph that:

This memorandum will serve to confirm the general understanding which has been reached regarding the acquisition of 25% of the stock of Arnold Palmer Golf Company ("Palmer") by Fuqua Industries, Inc. ("Fuqua") in exchange for all of the outstanding stock of Fernquest and Johnson Golf Company, Inc. ("F & J"), a wholly-owned California subsidiary of Fuqua, and money in the amount of \$700,000; and for the rendition of management services by Fuqua.

The Memorandum of Intent contained detailed statements concerning, inter alia, the form of the combination, the manner in which the business would be conducted, the loans that Fuqua agreed to make to Palmer, and the warranties and covenants to be contained in the definitive agreement.¹

Paragraph 10 of the Memorandum of Intent stated:

(10) Preparation of Definitive Agreement. Counsel for Palmer and counsel for Fuqua will proceed as promptly as possible to prepare an agreement acceptable to Palmer and Fuqua for the proposed combination of businesses. Such agreement will contain the representations, warranties, covenants and conditions, as generally outlined in the example submitted by Fuqua to Palmer

7. In the last paragraph of the Memorandum of Intent, the parties indicated that:

(11) Conditions. The obligations of Palmer and Fuqua shall be subject to fulfillment of the following conditions:

- (i) preparation of the definitive agreement for the proposed combination in form and content satisfactory to both parties and their respective counsel;
- (ii) approval of such definitive agreement by the Board of Directors of Fuqua;

The Memorandum of Intent was signed by Palmer and by the President of Fuqua. Fuqua had earlier released a statement to the press upon Palmer's signing that "Fuqua Industries, Inc., and The Arnold Palmer Golf Co. have agreed to cooperate in an enterprise that will serve the golfing industry, from the golfer to the greens keeper."

In February, 1970, the Chairman of Fuqua's Board of Directors, J. B. Fuqua, told Douglas Kenna, Fuqua's President, that he did not want to go through with the Palmer deal. Shortly thereafter Kenna informed one of Palmer's corporate officers that the transaction was terminated.

Palmer filed the complaint in this case on July 24, 1970. Nearly three and one-half years later, on January 14, 1974, the defendant filed a motion for summary judgment. More than one year after the briefs had been filed by the parties, on May 30, 1975, the district court granted defendant's motion.

The district court determined that "[t]he parties were not to be subject to any obligations until a definitive agreement satisfactory to the parties and their counsel had been prepared. The fact that this agreement had to be 'satisfactory' implies necessarily that such an agreement might be unsatisfactory. . . . The parties by the terms they used elected not to be bound by this memorandum and the Court finds that they were not bound."

The primary issue in this case is whether the parties intended to enter into a binding agreement when they signed the Memorandum of Intent, and the primary issue in this appeal is whether the district court erred in determining this question on a motion for summary judgment. The substantive law of Ohio applies.

We agree with the district court that both parties must have a clear understanding of the terms of an agreement and an intention to be bound by its terms before an enforceable contract is

created.² As Professor Corbin has observed “The courts are quite agreed upon general principles. The parties have power to contract as they please. They can bind themselves orally or by informal letters or telegrams if they like. On the other hand, they can maintain complete immunity from all obligation, even though they have expressed agreement orally or informally upon every detail of a complex transaction. The matter is merely one of expressed intention.”
1 Corbin on Contracts, s 30 (1963). (Footnote omitted.)

The decision whether the parties intended to enter a contract must be based upon an evaluation of the circumstances surrounding the parties’ discussions....

At bottom, the question whether the parties intended a contract is a factual one, not a legal one, and, except in the clearest cases, the question is for the finder of fact to resolve. . . .

We held in *S. J. Groves & Sons Co. v. Ohio Turnpike Comm’n*, 315 F.2d 235 (6th Cir.), also a case governed by the substantive law of Ohio, that summary judgment was inappropriate in a breach of contract case that involved “complex facts and issues.” . . .

Considering this appeal in the light of these authorities, we determine that our proper course is to remand this case to the district court for trial because we believe that the issue of the parties’ intention to be bound is a proper one for resolution by the trier of fact. Upon first blush it may appear that the Memorandum of Intent is no more than preliminary negotiation between the parties. A cursory reading of the conditions contained in paragraph 11, by

² Section 26 of the Restatement of Contracts states the general rule that Ohio follows:

Mutual manifestations of assent that are in themselves sufficient to make a contract will not be prevented from so operating by the mere fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but other facts may show that the manifestations are merely preliminary expressions as stated in Section 25.

Comment a to Section 26 of the Restatement explains the considerations that enter into a determination whether a binding contract exists:

Parties who plan to make a final written instrument as the expression of their contract, necessarily discuss the proposed terms of the contract before they enter into it and often, before the final writing is made, agree upon all the terms which they plan to incorporate therein. This they may do orally or by exchange of several writings. It is possible thus to make a contract to execute subsequently a final writing which shall contain certain provisions. If parties have definitely agreed that they will do so, and that the final writing shall contain these provisions and no others, they have then fulfilled all the requisites for the formation of a contract. On the other hand, if the preliminary agreement is incomplete, it being apparent that the determination of certain details is deferred until the writing is made out; or if an intention is manifested in any way that legal obligations between the parties shall be deferred until the writing is made, the preliminary negotiations and agreements do not constitute a contract.

themselves, may suggest that the parties did not intend to be bound by the Memorandum of Intent.

Nevertheless, the memorandum recited that a “general understanding (had) been reached.” And . . . the entire document and relevant circumstances surrounding its adoption must be considered in making a determination of the parties’ intention. In this case we find an extensive document that appears to reflect all essential terms concerning the transfer of Arnold Palmer stock to Fuqua in exchange for all outstanding stock in Fernquest and Johnson. The form of combination, the location of the principal office of Palmer, the license rights, employment contracts of Palmer personnel and the financial obligations of Fuqua are a few of the many areas covered in the Memorandum of Intent, and they are all described in unqualified terms. The Memorandum states, for instance, that “Fuqua *will* transfer all of the . . . stock,” that the “principal office of Palmer *will* be moved to Atlanta,” that “Palmer . . . *shall* possess an exclusive license,” and that “Fuqua *agrees* to advance to Palmer up to an aggregate of \$700,000” (Emphasis added.)

Paragraph 10 of the Memorandum states, also in unqualified language, that counsel for the parties “will proceed as promptly as possible to prepare an agreement acceptable to (the parties)” We believe that this paragraph may be read merely to impose an obligation upon the parties to memorialize their agreement. We do not mean to suggest that this is the correct interpretation. The provision is also susceptible to an interpretation that the parties did not intend to be bound.

As we have indicated above, it is permissible to refer to extrinsic evidence to determine whether the parties intended to be bound by the Memorandum of Intent. In this regard, we observe that Fuqua circulated a press release in January 1970 that would tend to sustain Palmer’s claim that the two parties intended to be bound by the Memorandum of Intent. Fuqua’s statement said that the two companies “have agreed to cooperate in an enterprise that will serve the golfing industry.”

Upon a review of the evidence submitted in connection with the motion for summary judgment, we believe that there is presented a factual issue whether the parties contractually obligated themselves to prepare a definitive agreement in accordance with the understanding of the parties contained in the Memorandum of Intent. Just as in *S. J. Groves*, *supra*, we believe that the parties may properly “disagree about the inferences to be drawn from (the basic facts that are not in dispute or) what the intention of the parties was as shown by the facts.” 315 F.2d at 237. Because the facts and the inferences from the facts in this case indicate that the

parties may have intended to be bound by the Memorandum of Intent, we hold that the district court erred in determining that no contract existed as a matter of law.

We reject appellee's argument that summary judgment was appropriate because the obligations of the parties were subject to an express condition that was not met. We believe a question of fact is presented whether the parties intended the conditions in paragraph 11 to operate only if the definitive agreement was not in conformity with the general understanding contained in the Memorandum of Intent. See *Frank Horton & Co. v. Cook Electric Co.*, 356 F.2d 485, 490 (7th Cir.). The parties may well have intended that there should be no binding obligation until the definitive agreement was signed, but we regard this question as one for the fact finder to determine after a consideration of the relevant evidence....

Accordingly, the judgment of the district court is reversed and the case is remanded for proceedings not inconsistent with this opinion.

Empro Mfg. Co., Inc. v. Ball-Co Mfg., Inc.

870 F.2d 423 (7th Cir. 1989)

EASTERBROOK, Circuit Judge.

We have a pattern common in commercial life. Two firms reach concord on the general terms of their transaction. They sign a document, captioned "agreement in principle" or "letter of intent", memorializing these terms but anticipating further negotiations and decisions—an appraisal of the assets, the clearing of a title, the list is endless. One of these terms proves divisive, and the deal collapses. The party that perceives itself the loser then claims that the preliminary document has legal force independent of the definitive contract. Ours is such a dispute.

Ball-Co Manufacturing, a maker of specialty valve components, floated its assets on the market. Empro Manufacturing showed interest. After some preliminary negotiations, Empro sent Ball-Co a three-page "letter of intent" to purchase the assets of Ball-Co and S.B. Leasing, a partnership holding title to the land under Ball-Co's plant. Empro proposed a price of \$2.4 million, with \$650,000 to be paid on closing and a 10-year promissory note for the remainder, the note to be secured by the "inventory and equipment of Ballco." The letter stated "[t]he general terms and conditions of such proposal (which will be subject to and incorporated in a formal, definitive Asset Purchase Agreement signed by both parties)". Just in case Ball-Co might suppose that Empro had committed itself to buy the assets, paragraph four of the letter stated that "Empro's purchase shall be subject to the satisfaction of certain conditions

precedent to closing including, but not limited to” the definitive Asset Purchase Agreement and, among five other conditions, “[t]he approval of the shareholders and board of directors of Empro”.

Although Empro left itself escape hatches, as things turned out Ball–Co was the one who balked. The parties signed the letter of intent in November 1987 and negotiated through March 1988 about many terms. Security for the note proved to be the sticking point. Ball–Co wanted a security interest in the land under the plant; Empro refused to yield.

When Empro learned that Ball–Co was negotiating with someone else, it filed this diversity suit. Contending that the letter of intent obliges Ball–Co to sell only to it, Empro asked for a temporary restraining order. The district judge set the case for a prompt hearing and, after getting a look at the letter of intent, dismissed the complaint under Fed.R.Civ.P. 12(b)(6) for failure to state a claim on which relief may be granted. Relying on *Interway, Inc. v. Alagna*, 85 Ill.App.3d 1094, 41 Ill.Dec. 117, 407 N.E.2d 615 (1st Dist.1980), the district judge concluded that the statement, appearing twice in the letter, that the agreement is “subject to” the execution of a definitive contract meant that the letter has no independent force.

Empro insists on appeal that the binding effect of a document depends on the parties’ intent, which means that the case may not be dismissed—for Empro says that the parties intended to be bound, a factual issue. Empro treats “intent to be bound” as a matter of the parties’ states of mind, but if intent were wholly subjective there would be no parol evidence rule, no contract case could be decided without a jury trial, and no one could know the effect of a commercial transaction until years after the documents were inked. That would be a devastating blow to business. Contract law gives effect to the parties’ wishes, but they must express these openly. Put differently, “intent” in contract law is objective rather than subjective—a point *Interway* makes by holding that as a matter of law parties who make their pact “subject to” a later definitive agreement have manifested an (objective) intent not to be bound, which under the parol evidence rule becomes the definitive intent even if one party later says that the true intent was different. As the Supreme Court of Illinois said in *Schek v. Chicago Transit Authority*, 42 Ill.2d 362, 364, 247 N.E.2d 886, 888 (1969), “intent must be determined solely from the language used when no ambiguity in its terms exists”. See also *Feldman v. Allegheny International, Inc.*, 850 F.2d 1217 (7th Cir.1988) (Illinois law); *Skycorp Corp. v. Telstar Corp.*, 813 F.2d 810, 814–17 (7th Cir.1987) (New York and Wisconsin law). Parties may decide for themselves whether the results of preliminary negotiations bind them, *Chicago Investment Corp. v. Dolins*, 107 Ill.2d 120, 89 Ill.Dec. 869, 871, 481 N.E.2d 712, 715 (1985), but they do this through their words.

Because letters of intent are written without the care that will be lavished on the definitive agreement, it may be a bit much to put dispositive weight on “subject to” in every case, and we do not read *Interway* as giving these the status of magic words. They might have been used carelessly, and if the full agreement showed that the formal contract was to be nothing but a memorial of an agreement already reached, the letter of intent would be enforceable. *Borg-Warner Corp. v. Anchor Coupling Co.*, 16 Ill.2d 234, 156 N.E.2d 513 (1958). Conversely, *Empro* cannot claim comfort from the fact that the letter of intent does not contain a flat disclaimer, such as the one in *Feldman* pronouncing that the letter creates no obligations at all. The text and structure of the letter—the objective manifestations of intent—might show that the parties agreed to bind themselves to some extent immediately. *Borg-Warner* is such a case. One party issued an option, which called itself “firm and binding”; the other party accepted; the court found this a binding contract even though some terms remained open. After all, an option to purchase is nothing if not binding in advance of the definitive contract. The parties to *Borg-Warner* conceded that the option and acceptance usually would bind; the only argument in the case concerned whether the open terms were so important that a contract could not arise even if the parties wished to be bound, a subject that divided the court. See 156 N.E.2d at 930–36 (Schaefer, J., dissenting).

A canvass of the terms of the letter *Empro* sent does not assist it, however. “Subject to” a definitive agreement appears twice. The letter also recites, twice, that it contains the “general terms and conditions”, implying that each side retained the right to make (and stand on) additional demands. *Empro* insulated itself from binding effect by listing, among the conditions to which the deal was “subject”, the “approval of the shareholders and board of directors of *Empro*”. The board could veto a deal negotiated by the firm’s agents for a reason such as the belief that *Ball-Co* had been offered too much (otherwise the officers, not the board, would be the firm’s final decisionmakers, yet state law vests major decisions in the board). The shareholders could decline to give their assent for any reason (such as distrust of new business ventures) and could not even be required to look at the documents, let alone consider the merits of the deal. See Earl Sneed, *The Shareholder May Vote As He Pleases: Theory and Fact*, 22 U.Pittsburgh L.Rev. 23, 31–36, 40–42 (1960) (collecting cases). *Empro* even took care to require the return of its \$5,000 in earnest money “without set off, in the event this transaction is not closed”, although the seller usually gets to keep the earnest money if the buyer changes its mind. So *Empro* made clear that it was free to walk.

Neither the text nor the structure of the letter suggests that it was to be a one-sided commitment, an option in *Empro*’s favor binding only *Ball-Co*. From the beginning *Ball-Co* assumed that it could negotiate terms in addition to, or different from, those in the letter of

intent. The cover letter from Ball–Co’s lawyer returning the signed letter of intent to Empro stated that the “terms and conditions are generally acceptable” but that “some clarifications are needed in Paragraph 3(c) (last sentence)”, the provision concerning Ball–Co’s security interest. “Some clarifications are needed” is an ominous noise in a negotiation, foreboding many a stalemate. Although we do not know what “clarifications” counsel had in mind, the specifics are not important. It is enough that even on signing the letter of intent Ball–Co proposed to change the bargain, conduct consistent with the purport of the letter’s text and structure.

The shoals that wrecked this deal are common hazards in business negotiations. Letters of intent and agreements in principle often, and here, do no more than set the stage for negotiations on details. Sometimes the details can be ironed out; sometimes they can’t. Illinois, as Chicago Investment, Interway, and Feldman show, allows parties to approach agreement in stages, without fear that by reaching a preliminary understanding they have bargained away their privilege to disagree on the specifics. Approaching agreement by stages is a valuable method of doing business. So long as Illinois preserves the availability of this device, a federal court in a diversity case must send the disappointed party home empty-handed. Empro claims that it is entitled at least to recover its “reliance expenditures”, but the only expenditures it has identified are those normally associated with pre-contractual efforts: its complaint mentions the expenses “in negotiating with defendants, in investigating and reviewing defendants’ business, and in preparing to acquire defendants’ business.” Outlays of this sort cannot bind the other side any more than paying an expert to tell you whether the painting at the auction is a genuine Rembrandt compels the auctioneer to accept your bid.

AFFIRMED.

Notes and Questions

1. There are many similarities between the facts of *Arnold Palmer* and those of *Empro*. Can you explain the different holdings?
2. Letters of Intent are common in commercial settings, but they can serve varied functions and have different legal significance. What did the parties try to achieve in drafting the letters of intent per the courts in *Arnold Palmer* and *Empro*?
3. What was the significance of the board of directors approval in *Arnold Palmer*? What was the significance in *Empro*?