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MUTUALITY OF OBLIGATION IN CONTRACT LAW

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No field of law study, certainly none in the first year curriculum, is richer in *leitmotif* than is that of contracts. Much of the challenge to the beginning student lies in untangling these recurrent themes, such as bargain, reasonable expectations and reliance, to take but a few. In the following pages I shall attempt to unravel one such theme that is of contemporary significance in the development of contract law—that of mutuality of obligation.

The principle of mutuality of obligation can be simply stated: If two parties are to be bound by an exchange of promises, neither one is bound until the other is bound. We are going to look at the erosion of this principle in modern contract law. But first, a little whimsy may provide some insight into the principle itself.

Let your imagination carry you back over a century to Friday, June 12, 1874. The scene is the railway station at Darlington in the North of England. The time is seven o'clock in the morning. Enter John Dodds, on his way to catch a train. He looks harried. For some time he has been trying to sell his estate at Croft near Darlington. Two days ago he gave a written offer to George Dickinson, the offer, "to be left over until Friday, 9 o'clock a.m." In the meantime he has succeeded in selling it to another purchaser, Thomas Allan, and has signed a contract with him. Now he is off to the train. Dodds has not yet told Dickinson of his contract with Allan. It is possible that he mistakenly thinks that he cannot revoke his offer to Dickinson. But in any case that offer is only good until nine this morning.

Lurking in the wings is Dickinson and a man named Berry. Dickinson looks worried. He would like to buy the Croft property. Yesterday afternoon he happened to hear from Berry that Dodds

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This is a footnoted and slightly edited version of a talk given to the first year contracts class at the University of Dayton School of Law at the invitation of the Student Bar Association.

had sold the property to Allan. He then tried to deliver an acceptance to Dodds at Dodds' mother-in-law's, where Dodds was staying, but failed. He and Berry have now come to the station armed with copies of Dickinson's acceptance in the hope that one of them can catch Dodds before he leaves. Enter Berry. He recognizes Dodds and hands him a copy of Dickinson's acceptance. Dodds replies that it is too late, that he has already sold the property to Allan. Dickinson himself enters, finds Dodds entering a railway carriage, hands him another copy of his acceptance, and is told he is too late. Exit Dickinson, demanding specific performance. The curtain falls.

The curtain rises on the finale. The time is 1876, two years later. Dickinson has sued Dodds and obtained a decree of specific performance. Dodds has appealed. The scene is the Chancery Division of the Court of Appeal. Enter the lord justices, James, Mellish and Baggalay. James and Mellish deliver their celebrated opinions in *Dickinson v. Dodds,*[1] unanimously overturning the decision below. Dodds had no contract with Dickinson. Dodds' offer was revoked when Dickinson learned indirectly through Berry of Dodds' sale to Allan. Music rises while the rule of indirect revocation is enshrined as "the rule of *Dickinson v. Dodds.*"[2] The curtain falls.

Now speculate on what might have happened if Dickinson rather than Berry had been the first to find Dodds at the station. Although Dodds may well have been unaware of Berry's business and surprised that he carried Dickinson's acceptance, he could scarcely have been unaware of Dickinson's reason for coming to the station at dawn. Enter Dickinson, instead of Berry. Dodds recognizes him immediately and calls out, "I have sold the estate at Croft to Thomas Allan." Dickinson then hands him a copy of his acceptance. Exit Dickinson, demanding specific performance. The curtain falls.

This time the curtain does not rise again. There is no finale. Dickinson's solicitor has explained to him that he has no case against Dodds. The Lord Justices of the Chancery Division of the Court of Appeal never hear of Dickinson, Dodds, Berry and Allan. Their names remain in oblivion. And the rule of indirect revocation—if, indeed there ever is such a rule—comes to be known by names other than those of Dickinson and Dodds. Dickinson's solicitor knows what every student of the common law knows: that if the offeror manages to blurt out a revocation even an instant before the

1. 2 Ch. 463 (1876).

2. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 42 (1973); RESTATEMENT OF CONTRACTS § 42 (1932).

offeree accepts, there is no contract. Those of us who have invested time and effort in reading the opinions of James and Mellish in *Dickinson v. Dodds* can rejoice that it was Berry and not Dickinson who first found Dodds in the Darlington Station at dawn. We may even suspect that that clever rascal, George Dickinson, also knew what every student of the common law knows and therefore had Berry approach Dodds while he, Dickinson, hid behind a railroad carriage. Should this suspicion be correct, George Dickinson well deserves the century of notoriety that he has shared with John Dodds since the encounter at the Darlington Station.

As it turned out, Dickinson's forethought in sending Berry did not win his case for him—he was done in by the indirect revocation rule of *Dickinson v. Dodds.* Had this not been so, the very outcome of the case would have turned on whether his acceptance had come an instant before or an instant after Dodds' revocation at the Darlington Station.

What sort of a system of contract law would tolerate such apparent caprice—reminiscent of a Western gun duel—in which success turns on who has not the fastest gun but the fastest tongue? There are two questions here. First, why let the offeror off scot-free if he revokes an instant before the offeree accepts? Second, why hold the offeror to a contract if the offeree accepts an instant before the offeree revokes? This second question requires us to ask why a party is liable in damages for breach of a promise on which the promisee has in no way relied, and I shall not undertake that inquiry here.[3] It is the first question that concerns us. Why is the offeror free to revoke his offer at any time until acceptance? In the context of *Dickinson v. Dodds,* why—if Dodds' offer were still in effect—should Dickinson have to make sure that his acceptance beat Dodds' revocation?

The simple answer to that question is that Dodds' offer is revocable until acceptance. But then why is that so? Why is an offer revocable until acceptance? The answer to that question is because of the principle of mutuality of obligation. Since the offeree is not bound until he makes the promise embodied in his acceptance, the offeror is not bound by the promise embodied in his offer. Until Dickinson makes his promise to buy the estate at Croft, Dodds is not bound by his promise to sell the estate and is free to revoke his offer. But what is the reason for the principle of mutuality of obligation? The answer to that question lies in the deeply rooted

3. For some answers, see Fuller and Perdue, *The Reliance Interest in Contract Damages: 1,* 46 YALE L.J. 52, 61-62 (1936).

policy of the common law against allowing one party to speculate at the expense of the other, at least where the other had not agreed to bear the risk.

If there is a period of time during which one party is bound while the other is not, the party who is not bound has in effect an option and can speculate at the expense of the party who is bound. Consider the paradigm case of an offer for the sale of goods, such as cotton, at a fixed price on a fluctuating market. If there is a period of time during which the seller is bound to sell cotton at $100,000 but the buyer is not bound to buy it, the buyer has an option to buy at $100,000 during that period. If the market price for the cotton should rise to $110,000 during the period, the buyer can take advantage of the lower price at which the seller is bound and insist that he deliver the cotton for $100,000. But if the market price should fall to $90,000 during the period, the buyer can ignore the option and take advantage of the lower market price by buying the cotton elsewhere for $90,000, leaving the seller to sell his cotton on the depressed market. The party who is not bound thus has the chance to speculate on market changes at the expense of the party who is bound. It is the supposed unfairness of giving this advantage to one of the parties, at least if the other party has not agreed to it, that leads to the traditional rule that neither party is bound until the other is bound. Traditional analysis of the agreement process attaches great importance to the principle of mutuality of obligation as a means of avoiding such opportunities for speculation. It may help to look at three examples.

A simple example is that of a late acceptance of an offer that has already lapsed. Suppose that a seller offers a buyer cotton at $100,000, the offer to lapse if he has not heard from the buyer by Monday. He does not receive the buyer's purported acceptance until Tuesday. Does the seller have a choice either to treat the acceptance as having arrived too late, or to "waive" the delay simply by disregarding it and treat the acceptance as effective to create a contract? Or is the purported acceptance a counter-offer that the offeror must in turn accept? Traditional contract law insists upon the latter solution. Since the buyer's late acceptance is a counter-offer, theoretically, it can be revoked by the buyer at any time before the seller accepts, thus preserving the principle of mutuality of obligation.[4] To allow the seller simply to "waive" the delay and insist on a contract,

4. Bridge v. O'Callahan, 118 N.Y.S. 2d 837 (Rochester City Ct. 1953)(quoting Williston, "An offeror who receives an acceptance which is too late . . . cannot at his election regard it as valid."). *See* 1 S. Williston, Contracts §§ 92, 93 (3rd ed. 1957).

would open the possibility of speculation by the seller, who might choose to "waive" the delay if the market price of cotton went down and treat the acceptance as having arrived too late if the market price went up.[5]

Another example is that of acceptance by silence of an offer that states that silence shall constitute acceptance. Suppose that a seller offers a buyer cotton at $100,000 and adds, "If I do not hear from you by Monday, I will take it that you have accepted." The buyer does not reply. Clearly the seller cannot hold him to a contract. Even as the master of his offer, the seller cannot impose on the buyer the burden of speaking if he would refuse the offer. As Karl Llewellyn expressed it, to give that effect to invited silence "in a systematics centering on overt manifestations is . . . almost lewd."[6] But if the buyer wishes, can he choose to treat his silence as an acceptance effective to bind the seller? The principle of mutuality would appear to require an answer in the negative, for otherwise the buyer could refuse to be bound if the market price of cotton went down but choose to treat his silence as an acceptance if the market price went up. But although there is some authority for this result,[7] here the answer is less clear. It is possible that the offeree may have relied on the offeror's statement inviting acceptance by silence, and, if this is the case, the policy in favor of protecting such justified reliance may overcome the principle of mutuality of obligation. You may recall that Restatement (Second) of Contracts §72(1)(b) so completely succumbs to this argument that it allows the offeree to treat his silence as acceptance if he "intends to accept the offer" even if he shows no actual reliance.[8] According to the commentary, "the offeree is entitled to rely on such a statement," and "the offeror who has invited such an acceptance cannot com-

5. *But cf.* Phillips v. Moor, 71 Me. 78 (1880). If it be conceded that the acceptance came too late, as long as the offeree "makes known his acceptance . . . within any period which he could fairly have supposed to be reasonable," the maker must promptly make known his intention "to retract on account of the delay" or "be regarded as waiving any objection." *Id.* at 80.

6. Llewellyn, *Our Case-Law of Contract: Offer and Acceptance, II*, 48 YALE L.J. 779, 801 n.35 (1939).

7. Prescott v. Jones, 69 N.H. 305, 41 A. 352 (1898). The insured claimed acceptance by silence when the insurer notified the insured that they would renew the policy unless notified to the contrary. But the insurer

> could not so frame [its offer] as to render the [insured] liable as having accepted it, merely because he did not communicate his intention not to accept it. And if the [insured] was not bound by the offer . . . , the [insurer] could not be, because "it takes two to make a bargain," and, as contracts rest on mutual promises, both parties are bound or neither is bound.

Id. at 353.

8. RESTATEMENT (SECOND) OF CONTRACTS § 72(1)(b) (1973).

plain of the resulting uncertainty."[9] One may question whether it was wise to go this far, but perhaps the matter is not of great practical importance.

A final and more complex example is one that occurs in contracts by correspondence when an offeree who has already dispatched an acceptance overtakes its acceptance by a withdrawal or rejection sent by a more rapid means of communication. Suppose that a buyer mails an acceptance of a seller's offer to sell cotton at $100,000. It then changes its mind and sends the seller a telegram saying "acceptance mailed earlier is withdrawn." If the telegram arrives before the letter, is it effective to withdraw the acceptance so that there is no contract? Traditional contract law answers no. You will recall that the "mailbox rule" of *Adams v. Lindsell*[10] deprives the offeror, the seller, of its power to revoke as soon as the offeree, the buyer, dispatches his acceptance. To allow the buyer to countermand his acceptance while it was in transit, would permit it to do so if the market price for cotton went down but to do nothing if the market price went up. The effect would be to give the offeree an option while the acceptance is in transit. Traditional contract doctrine respects the principle of mutuality of obligation by extending the "mailbox rule" so that dispatch of the acceptance not only deprives the offeror of its power to revoke its offer, but also deprives the offeree of its power to countermand its acceptance.[11] The rare case in which the countermand does not mention the acceptance can be dealt with by the notion of estoppel. If the offeree overtakes his letter of acceptance by a telegram that says simply "reject your offer," without mentioning the acceptance in transit, an offeror who has relied on the misleading telegram should be allowed to maintain that the offeree is estopped to enforce the contract.[12] The offeree, as author of the misleading telegram, can scarely complain that this rule is subject to abuse by the offeror who is minded to speculate.

Now add to the overtaking countermand of an acceptance a mistake by the offeree in accepting. The courts have traditionally taken a jaundiced view of claims to relief based on "unilateral" mistake once a contract has been formed, but this hard attitude has begun to soften,[13] and is difficult to justify if there has been no

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9. RESTATEMENT (SECOND) OF CONTRACTS § 72, Comment c (1973).

10. 1 B. & Ald. 681, 106 Eng. Rep. 250 (K.B. 1818).

11. Morrison v. Thoelke, 155 So. 2d 889 (Fla. App. 1963) (telephone call overtook letter); Postal Telegraph Co. v. Willis, 93 Miss. 540, 47 So. 380 (1908) (usage could not vary rule where telephone call overtook telegram); *see* RESTATEMENT (SECOND) OF CONTRACTS § 64 (1973).

12. *See* RESTATEMENT (SECOND) OF CONTRACTS § 64, Comment c and Illustration 7 (1973).

13. *See* RESTATEMENT (SECOND) OF CONTRACTS § 295 (1975).

reliance by the other party. The policy favoring enforcement of the expectation interests as of the instant of the bargain scarcely seems to outweigh the arguments favoring relief for mistake. And if a situation could be imagined in which no reliance by the other party were possible, the case favoring relief for mistake would be most appealing. So it was in *Dick v. United States*[14] in which the offeree erred in reading the government's offer as calling for only one set of propellors rather than two, mailed his acceptance and, on discovering his mistake, sent a telegram that overtook his acceptance. The offeror could not have relied on an acceptance of which it was still unaware. The offeree could not have used an opportunity to withdraw for the purpose of speculation. No policy argued against withdrawal on the ground of mistake. Instead of fashioning a narrow exception to the "mailbox rule" in the case of the overtaking countermand, however, the Court of Claims rejected the rule in its entirety, offending the principle of mutuality and allowing speculation in cases where no mistake is involved.

The free revocability of offers, founded on the principle of mutuality of obligation, leaves the offeree at the offeror's mercy until the offeree accepts. Although the law of restitution allows the offeree to recover any benefit that he has conferred on the offeror if the negotiations fail, this falls short of reimbursing the offeree for expenses incurred and far short of protecting his expectation interest.

But what if the offeree wants the power to speculate at the offeror's expense and the offeror is willing to grant that power? The common law required the parties to structure their transaction so that it met the requirements for enforceable agreements generally. First, the offeror had to agree to the irrevocability of his offer. Second, his agreement had to be enforceable as a promise—supported by a seal or by consideration.

The widespread abolition of the seal left the doctrine of consideration as the principal device for meeting this second requirement. If the offeree was to subject the offeror to the risk of speculation, he had to pay for an option. You will recall that John Dodds' offer was "to be left over until Friday, 9 o'clock a.m." Dickinson had paid nothing for this. Even if this were understood as an agreement by him not to revoke it before that time, rather than as merely the time when it expires if not sooner revoked, it would have been unenforceable for want of consideration.

But many offers in which the offeror agreed not to revoke differed markedly from our paradigm case of the offer to sell cotton at

14. 82 F. Supp. 326 (Ct. Cl. 1949).

$100,000. There may be no fluctuating market for the subject of the contract. The offeror may be in no hurry to have a response from the offeree. The offeree may need to spend time and effort to determine whether to accept. Where there is little chance of speculation the virtues of the symmetry produced by the principle of mutuality of obligation are less evident. The requirement of consideration began to crumble. Courts winked at the requirement of consideration. Even the smallest "peppercorn" would suffice as consideration for an option.[15] Even a false recital of a payment that had not been made might suffice, a rule now dignified, with qualification, by the Restatement (Second) of Contracts.[16] In New York the legislature dispensed with consideration where there was a signed writing stating that the offer was irrevocable.[17] The Uniform Commercial Code followed suit as to offers for the sale of goods in section 2-205.[18] And reliance as well as consideration might make an agreement not to revoke an offer enforceable. But in all of these cases the offeror had said that his offer was irrevocable, or at least acquiesced in the offeree's saying so. What if nothing was said by either party?

The first recognition that an offer might be irrevocable even when nothing was said came in another context—the "unilateral" offer where the offer invited acceptance not by a promise but by performance. If the performance took time, it was hard on the offeree to allow the offeror to revoke at any time until performance has been completed. Could the offeror, in that most notorious of hypotheticals, go scot-free if he shouted "I revoke" first before the offeree had finished crossing the Brooklyn Bridge?[19] No, said the original Restatement and later the Restatement Second.[20] The offeree should be protected by finding an "implied subsidiary promise" by the offeror not to revoke the offer while the offeree was in the course of performance. The risk that an offeree walking across the Brooklyn Bridge might, at the offeror's expense, speculate on a

15. *E.g.*, Mier v. Hadden, 148 Mich. 488, 111 N.W. 104 (1907) (one dollar was "a valuable consideration . . . paid for the contract").

16. RESTATEMENT (SECOND) OF CONTRACTS § 89B(1)(a) (1973).

17. N.Y. GEN. OBLIG. LAW § 5-1109 (McKinney 1978).

18. U.C.C. § 2-205:

> *Firm Offers.* An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

19. The hypothetical was posed in Wormser, *The True Conception of Unilateral Contracts*, 26 YALE L.J. 136-37 (1916).

20. RESTATEMENT (SECOND) OF CONTRACTS § 45 (1973); RESTATEMENT OF CONTRACTS § 45 (1932).

fluctuating market for the offeree's services (perhaps in walking across other bridges) was not to be taken seriously. That the problem continues to be discussed in the context of classroom hypotheticals and Restatement language rather than decided cases, suggests that its significance is largely academic. Practical applications of commercial significance appear to be limited to exclusive listings of real estate brokers.[21] Here, too, the risk that a broker as offeree seeking to find a purchaser under an exclusive listing might, at the expense of the owner as offeror, speculate on a fluctuating market for the broker's services is not to be taken seriously.

The most important extension of the notion that an offer might become irrevocable even when nothing was said came in the context of attempts by subcontractors to revoke their bids, usually, although not necessarily, on the ground of mistake. Let your imagination again take you back, this time to the morning of July 29, 1955. William Drennan, a general contractor, is driving to Los Angeles. Yesterday he was awarded the "Monte Vista School Job." He has stopped by the office of Star Paving to tell Star this and to say that he accepts Star's offer to do the paving as subcontractor for $7,131.60. The curtain rises on Star's office. Star's construction engineer is at his desk. He looks troubled. He has just discovered that because of an error in computation, Star's bid was less than half of what it should have been. Enter Drennan. He politely introduces himself. Before he has a chance to say more, Oppenheimer interrupts him to explain that the bid is based on a mistake and that Star cannot honor it. Exit Drennan, threatening suit. The curtain falls.

The curtain rises on the finale. The time is 1958, three years later. (Justice is not so swift this time.) Drennan has paid $10,948.60 to have another firm do the work and has sued for the difference of $3,817.00 and had a judgment for that amount. Star has appealed. The scene is the Supreme Court of California. Enter the justices. Justice Traynor delivers his celebrated opinion in *Drennan v. Star Paving*,[22] and the court unanimously affirms the decision below. There was an "implied subsidiary promise" by Star not to revoke its bid, analogous to the "implied subsidiary promise" in the Brooklyn Bridge hypothetical. That "implied subsidiary promise" became enforceable when Drennan relied on it by incorporating Star's bid when it submitted its own bid. Music rises while the holding of the *Drennan* case is enshrined as the "option contract"

21. *E.g.*, Baumgartner v. Meek, 126 Cal. App. 2d 505, 272 P.2d 552 (1954).
22. 51 Cal. 2d 409, 333 P.2d 757 (1958).

rule of section 89B(2) of the Restatement (Second) of Contracts.[23] The curtain falls.

Now speculate on what might have happened if Drennan had been less polite and had accepted before introducing himself to Oppenheimer. Enter Drennan who says, "I accept your bid of $7,131.60." Oppenheimer then explains the mistake. Exit Drennan threatening suit. The curtain falls.

This time the curtain does not rise again. There is no finale. Star's lawyer has explained to it that it is bound to do the job for Drennan under its bid. The justices of the Supreme Court of California never hear of Drennan and Star Paving. Their names remain in oblivion and the option contract rule of section 89B(2) is associated with a case bearing other names.

What is noteworthy is that Drennan prevailed on the actual facts in spite of his politeness—that Star's offer was held to be irrevocable because of Drennan's reliance on an "implied subsidiary promise" by Star not to revoke—a promise implied by analogy to the "implied subsidiary promise" in section 45 of the Restatement of Contracts.[24] Although Star had said nothing as to the irrevocability of its bid, it was bound although Drennan was not bound. What of the risk of speculation by Drennan? Perhaps the risk of market fluctuations is not great if the period of irrevocability is the relatively brief time between the moment when the general contractor submits its bid and the moment when, after award, it has had a reasonable time to accept the subcontractor's bid. The risk that the general contractor will take advantage of the irrevocability of the subcontractor's bid to engage in "bid shopping" to get a still lower bid remains, and is at the root of most of the criticism of the result in the *Drennan* case.

In any case, a prudent offeror can avoid the option contract rules of either section 45 or 89B(2) simply by providing the contrary in his offer. Would the same be true of that most recent of the major inroads on the principle of mutuality of obligation—*Hoffman v. Red Owl Stores, Inc.*?[25] You will recall that there the Supreme Court of Wisconsin allowed Hoffman, the expectant franchisee, to recover from Red Owl, the supposed franchisor, his expenditures in reliance on Red Owl's assurances that he would be given a franchise. Could Red Owl have protected itself by disclaimers of liability, made at strategic points as it led Hoffman down the garden path? Does it

23. RESTATEMENT (SECOND) OF CONTRACTS § 89B(2) (1973).
24. RESTATEMENT (SECOND) OF CONTRACTS § 45 (1973).
25. 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

make a difference whether Red Owl's liability is viewed as in contract or in tort or in some no-man's land between the two? In the dozen years since *Hoffman v. Red Owl Stores, Inc.*, courts have made no major pronouncements on questions, such as these, that it raises.

In the short run, then, the erosion of the principle of mutuality of obligation has abated. One suspects, not for long. Those of you whose practice will cover the last quarter of this century and the first quarter of the next would do well to keep your eyes on this *leitmotif* and watch for further significant inroads in this traditional doctrine.