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Contracts--Consideration--Mutuality of Obligation

John T. Bondurant
University of Kentucky

Recent Cases

CONTRACTS—CONSIDERATION—MUTUALITY OF OBLIGATION—The plaintiffs, partners d/b/a Jacks Creek Mining Company, entered into an agreement with the defendants, partners d/b/a Virgie Coal Company, on March 29, 1949, whereby the defendants promised to sell and deliver to the plaintiffs all the coal mined from a particular mine in Pike County. The plaintiffs agreed to accept "all coal which their equipment would permit them to process at the best advantage" and which "market conditions will permit them to handle," at $4.50 a ton, subject to revision by mutual consent. The plaintiffs further agreed to attempt to find a market for the coal they were unable to handle, in order that the defendants might maintain a weekly operation of five days, with the understanding that the defendants were free to sell their coal to others only if the plaintiffs were unsuccessful in their effort to find a buyer and could not accept the coal themselves. Moreover, the plaintiffs were given the right to reject any coal or cancel the agreement if in their opinion the coal was not "clean and merchantable." Unless cancellation was made, the agreement was to remain in force for a term of one year. The parties operated under this agreement until February 11, 1950, after which the defendants refused to deliver any more coal. The plaintiffs brought this action to recover the amount of profits which they alleged would have been made by them had the coal been delivered as promised under the contract. The case was referred to a special commissioner who ruled that the contract was unenforceable on the theory that it was unilateral, and therefore lacked mutuality of obligation. Exceptions entered to the report when filed were overruled by the Circuit Court of Pike County and the complaint was dismissed. On appeal, *held*: Affirmed. The contract constituted nothing more than a continuing offer to sell by the defendants which could be revoked at any time. *Baber v. Lay*, 305 S.W. 2d 912 (Ky. 1957).

Mutuality of obligation and consideration are often confused.[1] While consideration is essential to any contract, mutuality of obligation is not, unless the want of mutuality would leave one party without

[1] "In the opinion of this and other courts, there is frequently a misuse of legal terminology in the discussion of . . . mutuality. It is sometimes said that a contract is unenforceable because it . . . lacks mutuality, when what is meant is that it is unenforceable because of want of consideration." Jackson v. Pepper Gas Co., 280 Ky. 226, 229, 133 S.W. 2d 91, 93 (1939).

a valid or available consideration for his promise. Since in a bilateral contract the mutual promises of the parties constitute the consideration, these promises must be binding on both parties, or the contract fails for want of consideration. In a unilateral contract, where the performance of one party constitutes the consideration for the promise of the other, mutuality of obligation is not essential, and the agreement is enforceable, despite a lack of mutuality.[2]

The doctrine of mutuality of obligation appears therefore merely to be one aspect of the rule that mutual promises may constitute consideration for each other, a means of expressing the idea that each party to a bilateral contract is under a legal duty to the other; each has made a promise and each is an obligor.[3]

Consideration is something which has value in the eyes of the law. As a practical matter, a promise does not have value in the eyes of the law unless two things are true: (1) the promised performance has legal value; and (2) the promise itself is legally binding on the promisor.[4] To say that a bilateral agreement is unenforceable for want of mutuality is, therefore, to say that the promise of at least one of the parties lacks one of the essential elements for it to provide sufficient consideration for the promise of the other party. In a majority of instances, the question is whether the promise is legally binding, rather than whether the promised performance has legal value.

There are several reasons why a promisor may not be bound to perform. Not all of these should form the ground on which an agreement can properly be held unenforceable for want of mutuality.[5] However, there are many instances where the promisor is not legally bound by his promise which the Kentucky Court has long recognized, and rightly so, as within the scope of the doctrine of mutuality.[6]

[2] Meurer Steel Barrel Co. v. Martin, 1 F. 2d 687, 688 (3rd Cir. 1924); Armstrong Paint & Varnish Works v. Continental Can Co., 301 Ill. 102, 108, 133 N.E. 711, 714 (1921).

[3] 1 Corbin, Contracts sec. 152 (1950).

[4] Williston, "Effect of One Void Promise in a Bilateral Agreement," 25 Colum. L. Rev. 857, 864, 866.

[5] An outstanding example of a situation outside the scope of mutuality is that which occurred in Venters v. Stewart, 261 S.W. 2d 444 (Ky. 1953), cited in the principle case. There a "promise" to fill an order for goods was made by a salesman subject to the approval of the head office. Since what was purported to be the promise was made in response to an offer prior to an effective act of acceptance by the person to be bound thereby, no contract had yet come into existence, and there was no need to inquire into the lack of consideration. However, although the court held that such an arrangement failed for want of an effective acceptance, it gave as an additional reason for its decision that the contract was unenforceable for lack of mutuality.

[6] For example, where a married woman entered into a contract for the sale of her land without her husband joining therein, as was required by statute,

Where the terms of the agreement give one or both parties the absolute power, either express or implied, to reject or withhold performance, or to terminate the contract, there is no mutuality of obligation which will uphold the agreement insofar as it remains executory. The right of cancellation without cause in effect relieves the party retaining such right of its legal obligation to perform its promise, and renders such a promise insufficient consideration for the return promise of the other.[7]

However, this result does not follow where the power to reject performance or to terminate the agreement is subject to conditions or to the exercise of reasonable discretion. For instance, the right of one party to reject goods tendered which fail to meet stated specifications, where such right cannot be arbitrarily exercised, does not render the contract unenforceable for want of mutuality. The person with such power is still bound to perform his promise and is excused by the unsatisfactory performance of the other party, as determined by a fixed or reasonable standard.[8]

In the agreement with which the court was concerned in the principal case, the plaintiffs were given the right to reject any coal or cancel the agreement if in their opinion the coal was not "clean and merchantable." A fair interpretation of this provision would determine that it granted a conditional power of rejection or termination subject to the exercise of reasonable discretion, and in and of itself was not enough to render the contract unenforceable for want of mutuality of obligation. However, the court declined to discuss this point, as it found another basis on which to decide the issue—neither promise was binding on the party who made it, and therefore neither could constitute sufficient consideration for the promise of the other.

The court first considered the promise of the defendant coal company to sell and deliver to the plaintiff all coal which was mined

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the court held that the agreement was void and unenforceable for lack of mutuality, even after she had obtained a divorce. Brown v. Allen, 204 Ky. 76, 263 S.W. 717 (1924). She was not legally bound to carry out her promise to sell, and her promise was not sufficient consideration for the return promise of the prospective purchaser.

[7] Combs v. Hazard Ice & Storage Co., 218 Ky. 29, 290 S.W. 1035 (1927); Daniel Boone Coal Co. v. Miller, 186 Ky. 561, 217 S.W. 666 (1920); Second National Bank of Ashland v. Rouse, 142 Ky. 612, 134 S.W. 1121 (1911); Lowe v. Ayer-Lord Tie Co., 29 Ky. L. Rep. 1302, 95 S.W. 383 (1906).

[8] City of Bowling Green v. Knight, 216 Ky. 838, 840-41, 288 S.W. 741, 742 (1926). See also Jay Dreker Corp. v. Delco Appliance Corp., 93 F. 2d 275 (2nd Cir. 1937); Marrinan Medical Supply, Inc. v. Fort Dodge Serum Co., 47 F. 2d 458 (8th Cir. 1931); Hunt v. Stimson, 23 F. 2d 447 (6th Cir. 1928); The Fair v. Estate Stove Co., 246 Ill. App. 558 (1927); 17 C.J.S., Contracts sec. 100(d) at 451-452 (1939).

from a particular mine. It came to the "inescapable conclusion" that this promise did not create any legal obligation on the defendants since they could at their whim cause production to cease without incurring any liability to the plaintiffs. This was true because they failed to commit themselves to mine, or to continue to operate for the duration of the agreement, and, moreover, because no penalty was provided for a failure to deliver the amount of coal which the plaintiffs could profitably handle.

This raises the question whether a promise by a producer to sell to another his total output is legally binding on the promisor, and, when given for valuable consideration, creates a binding contract. The weight of authority would support an affirmative answer. Some of the authorities supporting this position hold that such a promise is not illusory, but binds the promisor not to sell any of his output to a third party. The producer is limited to the option between selling to the promisee or not selling at all. Even though the promisor does not in addition agree to maintain his production at a stated level, but retains the privilege of closing down the works and producing nothing, he has given sufficient consideration in promising to sell his entire output, whatever it may be, to the promisee and none others. He may relieve himself of any performance and still keep his promise, but only by doing something in itself a legal detriment—going out of business.[9]

Other courts have used another interpretation to hold that a promise to sell total output is legally binding on the promisor. From the business situation and the conduct of the parties, they have implied an obligation to continue production in good faith in the manner anticipated, realizing that the producer may for reasonable cause cease to maintain his output.[10]

Following this line of reasoning, the Kentucky Court has heretofore consistently enforced contracts wherein one party promised to

[9] 1 Corbin, Contracts sec. 158 at 524 (1950); 1 Williston, Contracts sec. 104A at 355 (rev. ed. 1936). See also Ramey Lumber Co. v. John Schroeder Lumber Co., 237 F. 39 (7th Cir. 1916); Allen v. Field, 130 F. 641 (2nd Cir. 1094); Kentucky Tobacco Products Co. v. Lucas, 5 F. 2d 723 (W.D. Ky. 1925); Green v. Lovejoy, 155 Minn. 241, 193 N.W. 173 (1923); Walker v. Mason, 272 Pa. 315, 116 A. 305 (1922). Cf. Hollandsworth v. William Mead Tie Co., 26 F. 2d 33 (6th Cir. 1928); Texas Co. v. Pensacola Maritime Corp., 279 F. 19, 24 (5th Cir. 1922).

[10] 1 Williston, Contracts sec. 104A at 357 (rev. ed. 1936). In Fayette-Kanawha Coal Co. v. Lake & Export Coal Corp., 91 W.Va. 132, 112 S.E. 222, 225 (1922), the court used this principle to uphold a contract whereby one party promised to deliver to another all coal mined from given mines, saying: "The plaintiff was obliged to operate its mines during the term provided by the contract in the usual and ordinary way in good faith, and was required to deliver to the defendant the coal produced by such operation."

deliver to a tie company all the railroad ties which the promisor could produce (total output) from his timber lands, or from those of a given area, and the tie company promised to receive and pay for all ties delivered. In *Mitchell-Taylor Tie Co. v. Whitaker,*[11] the court found that a fair interpretation of the contract bound the plaintiff to exercise "reasonable diligence" under the circumstances to produce ties and deliver them to the defendant. If he declined to do so, or furnished a lesser number than he should have by exercising reasonable diligence, there was no doubt in the mind of the court that the company would have a cause against him for breach of contract. "In other words," the court said, "this contract was mutually binding upon both of the parties and . . . each of them was obliged to perform it in a reasonable manner."[12]

Conceivably, there is no vast difference between coal-mining and tie-making which would prevent the application of the principle laid down in these cases to a promise to sell and deliver total output of a coal mine. Yet the Court of Appeals has *supposedly* declined to do so. In *Springton Coal Co. v. Bowling,*[13] the court held that a contract whereby the defendant agreed to pay the plaintiffs 77½c per ton for each and every ton of coal they removed out of two entries to the defendant's mine, was unilateral (in the sense that it bound only one party) and therefore unenforceable.

In the principal case, the court stated that the *Springton* case dealt with a total output contract, and that, as such, the ruling of the court presented there had been criticized as inconsistent with the weight of authority. However, it attempted to distinguish the two cases on the grounds that the present case was not a total output case.[14]

[11] 158 Ky. 651, 166 S.W. 193 (1914).

[12] Id. at 653, 166 S.W. at 194. Cf. Ayer & Lord Tie Co. v. O. T. O'Bannon & Co., 164 Ky. 34, 174 S.W. 783 (1915); Louisville & Nashville Ry. Co. v. Coyle, 123 Ky. 859, 99 S.W. (1907) (opinion on rehearing), original opinion 123 Ky. 854, 97 S.W. 772 (1906): "The contract bound Coyle to deliver as many ties as he could get out by ordinary care and diligence in the time fixed and was not lacking in mutuality."

[13] 228 Ky. 317, 14 S.W. 2d 1082 (1929).

[14] A better way in which the court might have distinguished the Springton case from the Baber case, and also the tie company cases, would have been to recognize that the former in effect dealt with a contract for the employment of the plaintiffs to work the defendant's mine for an indeterminate period, payment for which was to be made on a piece-work basis—per ton of coal delivered at the portal. As such, it was not a true total output contract—there was not the same legal detriment to be incurred by ceasing to "produce", for there would be other employment the plaintiffs would be free to engage in. What is more important, there was no definite or determinable period during which the plaintiffs were bound to perform their promised work. An analysis of the language of the agreement reveals no obligation on the part of the plaintiffs to mine any specified quantity of coal, or to take all the coal from any specified area of the mine, nor to work for any given length of time. Rather, they could cease mining at any time they saw fit without incurring any liability to the other party.

While the plaintiff did not promise to buy the total output, one must admit that the promise of the defendant was a promise to sell and deliver his total output for a specific term. If given in return for valuable consideration, it should have been sufficient to constitute a legally enforceable obligation on the producer. Then the crucial question would have been whether there were any promises or performances moving from the plaintiffs to the defendants which could have been deemed sufficient consideration for the promise of the defendants.

The most likely consideration for a promise of this type, and the one that the court has been most ready to hold sufficient, is a return promise to receive and pay for the total output of the producer on given terms at a set or determinable rate.[15] The court in the present case recognized, however, that the absence of a return promise of this kind does not automatically render the agreement unenforceable, if another promise of valuable performance legally binding upon the promisor be given in its stead. It even suggested a type of promise which would meet this requirement: "[A] promise to buy total needs or requirements of a business from a producer is by the weight of authority a valid promise and constitutes sufficient consideration for a return promise, . . ."[16] At the same time, the court recognized a qualification which, in light of its interpretation of the plaintiffs' promises, prevented it from using this doctrine to uphold the enforceability of the contract. It stated: "[Y]et, where the determination of the amount needed or required is left entirely up to the will of the purchaser, such an amount must be considered too indefinite to enable enforcement of the contract."[17]

The keystone of the court's reasoning was that the plaintiffs had not bound themselves to buy only from the defendants, but that they were at liberty under the arrangement to purchase freely from other producers. This being the case, the amount of coal the plain-

[15] Ayer-Lord Tie Co. v. O. T. O'Bannon & Co., 164 Ky. 34, 174 S.W. 783 (1915); Mitchell-Taylor Tie Co. v. Whitaker, 158 Ky. 651, 166 S.W. 193 (1914). See also Fayette-Kanawha Coal Co. v. Lake & Export Coal Corp., 91 W. Va. 132, 112 S.E. 222 (1922).

[16] Baber v. Lay, 305 S.W. 2d 912, 914. See also Heidelberg Brewing Co. v. E. F. Pritchard Co., 297 Ky. 788, 180 S.W. 2d 849 (1944). This is especially true where the nature of the purchaser's business is such as to make the quantity subject to reasonably accurate estimate. Fowler's Bootery v. Selby Shoe Co.,: 273 Ky. 670, 117 S.W. 2d 931 (1938) (dictum).

[17] Baber v. Lay, supra, note 16 at 914; 1 Corbin, Contracts sec. 156 at 509 (1950). Cf. Rehm-Zeiher Co. v. F. G. Walker Co., 156 Ky. 6, 160 S.W. 777 (1913); Fowler's Bootery v. Selby Shoe Co., supra note 16. The same principle applies in a contract of employment, where the employer is bound to retain the services of an employee only so long as it desires to keep goods on the market in a certain district. Stanley v. Kentucky Utilities Co., 223 Ky. 688, 4 S.W. 2d 732 (1928).

tiffs might need or require would be conditioned not only by the fluctuations in the market, but also by their purchases from other companies. The decision to buy from the defendants would be governed to a large extent by the subjective will of the plaintiffs and might even approach the vanishing point. The court felt that under this arrangement the plaintiffs bound themselves only to the extent they desired to be bound. The promise made by them was at most an illusory promise to purchase, and it was not sufficient consideration for the defendant's promise to sell all coal mined by them to the plaintiffs. The promise of the defendants, not binding upon them for lack of consideration, became a standing offer to sell. Acceptance of each delivery by the plaintiffs created a series of separate obligations, but the offer nevertheless remained open to revocation by the defendants.[18]

On the facts, this decision insofar as it holds that the plaintiffs' promise was not legally binding on them represents an instance where an agreement was held unenforceable for lack of mutuality of obligation in a case where the doctrine was designed to apply. However, in reaching its decision, the court gave an indication that it still regards a promise to sell total output for a determinable period as not legally binding upon the promisor, and therefore incapable of forming the basis of a bilateral contract. Such a position is contrary to the weight of authority, and contrary to previous decisions of the court (excluding the *Springton* case, which, it is submitted, was right in its result but wrong in its reasons).[19]

If in the principal case, the plaintiffs had promised to deal entirely with the defendants, a strong case could have been made out that this promise bound the plaintiffs either to buy all the coal they could profitably handle from the defendants, the quantity to be determined objectively by market conditions, or to accept the alternative of handling none and going out of business. Moreover, they might have been said to have been expected to continue operations in good faith in much the same way as in the total output cases previously mentioned.[20] However, here the plaintiffs did not bind themselves to deal exclusively with the defendants, and therefore their promise to take all the coal that they could reasonably handle, even when taken together with the somewhat indefinite proposal to "attempt" to find other markets for any coal they could not handle, did not bind the plaintiffs to performance. Therefore it was not

[18] See 1 Corbin, Contracts sec. 157 (1950).
[19] See note 14 supra.
[20] 1 Williston, Contracts sec. 104A (rev. ed. 1936).

sufficient consideration for the return promise of the defendants to sell and deliver the total output of their mines.

It is a matter for conjecture what the attitude of the court will be in future cases involving a promise to sell total output. It is to be hoped that the court will bend to the dictates of business convenience and hold enforceable an agreement wherein such a promise is given in consideration for a return promise to buy the entire output or the total needs of the purchaser.

John T. Bondurant

CONTRACTS—QUASI-CONTRACT—RIGHT OF TOBACCO BOARD OF TRADE TO REGULATE NON-MEMBER WAREHOUSES—Congress, under its power to regulate interstate commerce, enacted the Tobacco Inspection Act[1] to provide for a uniform system of classification and inspection of tobacco to be sold at auction markets.[2] Pursuant to this Act no tobacco may be sold on a designated market until it has been inspected by an authorized representative of the Secretary of Agriculture.[3] Lexington is a designated market. To assist in carrying out the purpose of the Act the Secretary is authorized, under the Act, to cooperate with local organizations, such as boards of trade.[4] The Secretary has been cooperating with the Lexington Tobacco Board of Trade, which is an association of warehouse organizations[5] and persons engaged in the same general business acting together for their mutual benefit in the sale and purchase of tobacco. Of the twenty-eight tobacco warehouses located in Lexington, the owners of twenty-one are members of this association. Appellants are owners and operators of four of the non-member warehouses. The Board adopted regulations prescribing the order in whcih the sets of buyers of the tobacco would visit the Lexington warehouses, allotting selling time to each warehouse, prescribing the amount of space allowed per basket of tobacco, and prohibiting selling of tobacco in driveways. The appellants, in a declaratory judgment action, challenged the right of the Board to exercise such control over them, as non-members of the Board. The lower court held that the Board could exercise such control over non-member warehouses so long as it did not do so in a "discriminatory, unreasonable, arbitrary, or capricious manner." Upon

[1] 49 Stat. 735 (1935), 7 U.S.C. sec. 511 (1952).
[2] Id. sec. 511a.
[3] Id. sec. 511d.
[4] Id. sec. 511m.
[5] Not organized under statutory authority as in some states. E.g., see Co-operative Warehouse, Inc. v. Lumberton Tobacco Board of Trade, Inc., 242 N.C. 123, 87 S.E. 2d 25 (1955).