

**Fact Pattern:**

Larry Waters has had a stock brokerage account with Chuck Securities since 1997. Lawrence is not a big stock trader, but instead makes a few trades every year. Unlike its competitors, when Larry opened his account, Chuck Securities did not require its customers to submit their disputes to binding arbitration. However, a few months ago, Chuck Securities hired a new President/CEO named Schwab. Schwab happened to be an attorney from a major New York law firm and he found it preposterous that in this day and age there would be a brokerage house that did not require its customers to submit their disputes to binding arbitration. Accordingly, Schwab had his legal department come up with a solution. It was decided that Chuck Securities would insert the following statement with the monthly statements that it mailed to its customers, including Larry:

To our value friends and customers: Any disputes between you (customer) and us (Chuck Securities, Inc.) that arise after January 1, 2005 must be submitted to binding arbitration before a tri-panel of NASD arbitrators. Thank you for your continued business.

Larry did not respond to this notice. In February of 2005, Larry telephoned Chuck Securities and placed an order to buy "100 shares of Dow Chemical at the market." The stock symbol of Dow Chemical was "DOWC." However, the registered representative that took the order mistakenly thought that Larry wanted to purchase 100 shares of Dow Industries. The stock symbol of Dow Industries was "DOWI." Coincidentally, both Dow Chemical and Dow Industries were trading at a price of \$34.00 per share.

Larry did not become aware of this discrepancy until he received Chuck Securities' written confirmation of the purchase through the mail two days later. By the time he received his trade confirmation, Dow Industries had fallen to \$27.00 per share, whereas Dow Chemical had risen to \$45.00 per share. Although Larry immediately repudiated the Dow Industries transaction, Chuck Securities chose to wait until the trade settled (i.e., 3 business days after the transaction) before selling Dow Industries for a then current market price of \$25.00 per share. Chuck Securities also charged Larry's account for the loss, plus commissions for the buy and sale of \$50.00 each. By settlement day, Dow Chemical had returned to \$34.00 per share. Larry had to see a heart specialist because of the immense physical and emotional pressure he felt. His doctor bills totaled \$2,000.00.

**Questions:**

What are Larry's contractual rights and remedies to recover damages considering he has incurred substantial medical bills because of the stress associated with the transaction?

### **Example Answer:**

#### 1. Existing Contract / Applicable Law

A contract is a legally enforceable agreement. The first question you must ask in the analysis of any contracts questions is the applicable law. The answer will be either the Uniform Commercial Code (UCC) Article 2 or the common law (C/L). The UCC applies to contracts involving the sale of goods. § 2-102. The Common Law applies to all other contracts, for example service contracts. Here, Larry has a brokerage account with Chuck Securities, Inc, through which it purchases stock on his behalf. Their agreement constitutes a contract for stock brokerage services. Accordingly, the UCC does not apply.

#### 2. Common Law Contract Modification

There are notable differences between the C/L and the UCC. For example, under C/L, contracts cannot be modified without consideration. The UCC allows modifications sought in good faith without consideration.

The facts indicate that Chuck Securities has attempted to modify the existing contract with Larry by sending an arbitration clause insert to its clients with their monthly statement. To modify a contract, there must be mutual assent, i.e., an offer to modify, acceptance of that offer and consideration.

##### A. Offer.

An offer is the manifestation of willingness to enter into a bargain, made in such a way as to justify the offeree's understanding that assent to the bargain is invited and will form a contract. By sending the arbitration insert, Chuck Securities is offering to change the current contract to require its clients to agree to arbitration.

##### B. Acceptance.

Acceptance of an offer is the offeree's manifestation of assent to the offeror's terms in a manner invited or required by the offer. Apparently, Larry did not respond to the arbitration insert. Whether Larry's silence is sufficient to constitute accept is determine by the reason person standard, i.e., whether a reasonable person would think there has been an acceptance under the circumstances.

The arbitration insert was included with Larry's monthly account statement. Nothing more is known about the insert. For example, was the insert conspicuous enough to alert Larry. Without notice of the insert, Larry's silence cannot reasonably be construed as assent to Chuck Securities' terms. Chuck

Securities is likely to argue that Larry accepted by not canceling his account and by making a subsequent stock purchase. However, without proof of notice, mutual assent does not appear to be present.

#### C. Consideration

As indicated above, under the C/L contract modifications require new consideration. Consideration is generally bargained-for legal detriment (i.e., giving up something of value or limit liberty to act or refrain from acting in a certain way). Here, Chuck Securities does not appear to have provided any consideration.

#### D. Unconscionability

Even if a Court finds an offer, acceptance, and consideration, Larry may still defend arguing that the modification was unconscionable. A contract may be voidable where the clauses are so one-sided as to be unconscionable. Larry is likely to argue that in light of the industry standard, adding a term such as arbitration without meaningful choice is unconscionable.

### 3. Contract to Purchase Dow Chemical

In order for there to be a valid contract, there must be: (1) mutual assent, i.e., offer and acceptance; (2) consideration or a substitute; and (3) no defenses to formation.

Here, Larry ordered shares in Dow Chemical. However, Chuck Securities mistakenly thought that Larry wanted to purchase Dow Industries.

#### A. Mutual Mistake

Mutual mistake is generally a defense to a contract. However, (1) the mistake must concern a basic assumption on which the contract was formed; (2) the mistake must have a material effect on the agreed exchange of performances; and (3) the party adversely affected by the mistake must not have borne the risk of the mistake.

Chuck Securities is likely to have known that there is a difference between Dow Chemical and Dow Industries. In light of the professional status of Chuck Securities, the risk of mistake is borne by it.

Notwithstanding the mistake, the contract will be enforced according to Larry's intention, i.e., 100 shares of Dow Chemical at \$34.00 per share.

### 4. Remedies/Damages

The primary objective of contract damages is to put the nonbreaching party in the same position that she would have been in had the contract been performed. Also known as expectancy damages or benefit of the bargain.

A.      Compensatory Damages

Larry can recover as compensatory damages the \$900.00 that was debited from his account when Dow Industries was eventually sold. Larry can also recover the two commissions that he paid, if he is being returned to his pre-contractual position, or is receiving damages for the potential profit loss from Dow Chemical. Otherwise, Larry would have been charged with one commission had he received the benefit of the bargain and still hold 100 shares of Dow Chemical.

B.      Consequential Damages

Consequential damages are those damages or those losses which arise not from the immediate act of the party, but in consequence of such act. In order to recover consequential damages, they must be reasonably foreseeable at the time of contract formation. Here, Larry's loss of opportunity in being able to purchase Dow Chemical and then selling for a quick profit is likely to be considered too speculative. Larry is not an active trader, but instead makes a few trades every year; therefore it was likely unforeseeable that Larry would have sold Dow Chemical at a quick profit.

C.      Emotional Distress Damages

Damages for breach of contract do not include emotional distress. Although contract damages are not available for emotional distress, Larry may have a potential under a tort theory of liability.