Memorandum

To: Remedies Class Spring 2005

From: Mike Allen

Date: May 2005

Subject: Final Exam

I have set out in this memorandum my thoughts about the essay questions on the final examination. To be sure, this answer is not comprehensive. That is, students will no doubt have given responses that I have not included in my discussion. If those responses were appropriate, you can be sure I gave you credit. By the same token, this answer is certainly more detailed than the ones produced by students. Remember, I had unlimited time and was dealing with questions that I had drafted.

Question 1

This question primarily, although not exclusively, addressed remedial defenses. The Association has sued Todd for breach of contract, covenant #1. The Association is seeking only specific performance of the covenant. Your first and principal task was to advise Todd about his responses to the lawsuit assuming that he had no defense on the merits.

There were six defensive points I would have mentioned, although not all of them would likely be successful from Todd's perspective. You should have noted that even though the question indicated that Todd had not defenses *on the merits*, he still had strong defenses overall. The reason is that the remedial defenses we discussed in class are not related to the merits of the underlying dispute. I will discuss each possible defense in turn below.

Statute of Limitations

Stetson statute #3 provides that the statute of limitations for a breach of contract is three years from the date of the breach. Todd was in breach of covenant #1 as written as soon as he moved in 4-5 years ago. The statute of limitations applies here even though the Association is seeking only an equitable remedy. This is so because the cause of action (breach of contract) can lead to both legal and equitable remedies. Thus, it would seem that the Association's claim would be barred by the statute of limitations.

However, Todd's activity is a continuing violation with each new day constituting a separate breach of the covenant. As such, the Association's suit is not barred by the statute of limitations. Since the Association is not seeking damages in the case you would not need to deal with which portion of any damages the Association might have suffered as a result of the breach are now recoverable. If you did need to address this issue it would likely be three years back from the filing of the lawsuit.

Laches

Under the doctrine of laches, a party is not entitled to equitable relief if the court determines that (1) it waited for an unreasonable length of time to assert the claim for relief at issue and (2) the other party (here Todd) has been prejudiced by the unreasonable delay. The doctrine of laches is potentially applicable here because the Association is seeking an equitable remedy. Thus, it is possible for the claim for an equitable remedy to be barred on something less than the statute of limitations applicable to the claim in general.

In this case, one can make the argument that the Association has waited too long to file suit. Four years have passed during which time Todd has conducted tennis lessons on his Darbyville property. Todd's lessons were open and obvious and the Association either knew or should have known that they were being conducted. Moreover, the fact that the membership on Association's board has changed does not alter these facts. The Association and its Board are legal entities that would be the proper point for analysis.

The unreasonable delay of the board is only a part of the analysis. Todd must also have been prejudiced by the Association's delay. The facts are not nearly as clear about prejudice to Todd flowing from the Association's *delay in filing suit.* There is no indication that Todd rejected offers to teach elsewhere after moving in. Nor is there any evidence that Todd invested in new structures in reliance on the Association's actions. However, one could argue that Todd built up his business in reliance on the Association's delay in bringing suit. In sum, it is possible to argue that the delay cause Todd some harm. Your answer should have depended on your analysis.

Equitable estoppel

The third possible defense is equitable estoppel and it is likely to be more successful for Todd. The elements of equitable estoppel using the relevant actors in this question are: (1) an act or conduct by the Association and its board that is inconsistent with the relief it now seeks against Todd, (2) Todd's reasonable reliance on those actions, and (3) injury to Todd flowing from that reliance.

The Association is now seeking specific performance of covenant #1 prohibiting Todd from conducting a business for profit on his property. That request for relief is directly at odds with the express statements of the Association's board four years ago that it would not enforce the covenant against Todd. Thus, the first element of equitable estoppel is satisfied.

The second element is also satisfied. There is no question under these facts that Todd relied on the board's assurance when he decided to move into Darbyville fours years ago.

Finally, Todd was harmed as a result of his reliance. According to the facts, Todd rejected another possible living arrangement that would have allowed him to have the tennis business. He did so expressly based on Darbyville's assurances. The bottom line is that the defense of equitable estoppel is likely to be successful.

Waiver

The next defensive possibility for Todd is waiver. Waiver is the intentional relinquishment of a known right or conduct inconsistent with the later assertion of that right. In this case, the board's oral assurances to Todd that it would not enforce covenant #1 against him would certainly qualify as the intentional relinquishment of a known right. It would also serve as conduct that is inconsistent with later assertion of the right. Thus, it is likely that the waiver defense would be successful. There was no need for you to discuss Todd's reliance with respect to waiver because reliance is not an element of establishing this defense.

Unclean Hands

It is possible for Todd to raise the defense of unclean hands in response to the board's request for an injunction. The unclean hands defense is one available for equitable claims such as present here. Under the defense the board would be barred from obtaining the injunction it sought if it did something in connection the subject matter of its claim that makes it an unworthy litigant. It is possible to argue that the board's actions four years ago fit into this category, but it is not the strongest argument. Most unclean hands defenses are based on something in which there is an evil motive ascribed to one party. There is no indication that the board had such a motive; membership has changed. Thus, while Todd should assert this defense it is likely that a court will rule in his favor on some other basis.

Substantive Injunction Issues

Finally as a defensive matter you should have discussed the Association's ability to prevail under substantive injunctive standards. Essentially, for a permanent injunction the Association will need to establish that it would suffer irreparable harm without it (in other words that it has no adequate remedy at law). Todd could also defeat the injunction by showing that (1) the balance of hardships tips decidedly in his favor because the harm to him if the injunction is granted is far greater that the harm to the association if the injunction is denied or (2) the injunction is not in the public interest.

There would be no strong argument for Todd concerning the requirement of irreparable harm. The damages to the Association would be difficult to establish and, in any event, the covenant deals with real estate, which clearly implicates the irreparable harm.

Todd would also likely not be successful in terms of either the balancing of hardships or the public interest. In terms of the balance of the hardship because this is a permanent injunction

Todd would need to show that the harm to him if the injunction was granted is *substantially* more than the harm to the Association if the injunction is denied. Todd will not be able to meet this standard. It is true he will not be able to conduct his business from his home any longer if the injunction is entered. However, Todd could obtain substitute courts elsewhere. The Association could be harmed by losing sales or having more owners try to avoid the rule. In addition, it might very well be the case that balancing would be inappropriate here given Cheata's status as an intentional wrongdoer. Finally, there is no indication that the public interest would be harmed if the injunction were granted. In fact, it could be harmed if it were denied because the other Darbyville residents would not get the benefit of the covenant.

An Offensive Option: Declaratory Judgment

Stetson statute #4 provides that Todd could bring a declaratory judgment counterclaim in order to resolve the controversy between him and the Association. The central statutory requirement is that there be an "actual controversy" between the relevant parties. It does not matter if there are other legal or equitable remedies that could be adequate.

In this case, Todd would want to establish in a declaratory judgment action that the Association is equitably estopped from enforcing covenant #1 (or that the Association has waived the right to the enforcement of the covenant). It is probably not necessary that Todd bring the DJ action because a win on the Association's claim would, in all likelihood, bar later claims under res judicata principles. However, it would be prudent to bring the claim to ensure that a legal ruling on this issue important to Todd issues in this case.

<u>Question #2</u>

Todd wants to bring a claim under Stetson Statute #1 against Cheata for the theft of Todd's trade secret (the serve coaching technique). I would have addressed the question by discussing the remedies available under the Trade Secret Act first and then addressed additional remedial issues.

Trade Secret Act Remedies

I would have discussed three issues under the Trade Secret Act (the "Act"): compensatory damages; restitution and attorneys' fees.

Compensatory Damages

Section 1(a) of the Act provides that Todd may recover his actual damages flowing from Cheata's wrongful conduct so long as those damages are established with reasonable certainty. In this case there are two main options that Todd could use to try to establish actual damages.

One option would be to attempt and recover for the lost revenue Todd suffered as a result of Cheata's activities. The problems with this approach are many. To begin with, there is no way to determine with any accuracy how many, if any, of the 10 new clients Cheata got would have gone with Todd instead. Moreover, even if one were able to make this determination it is not possible to determine how much money Todd would have made from those new clients. Tennis players have variable incomes and Todd himself recognizes this point. Thus, this is not likely to provide a useful means to establish damages.

The second option would be to focus on what Todd would have charged Cheata if Todd had licensed the teaching technique. In the absence of any other license fees, this means of establishing damages would probably be considered too speculative. The danger that a plaintiff will overvalue his "license point" is too high. In this case, however, we do have a former license fee – $50,000. That is a certain number. The issue here is that Todd may argue that its is too low because it represents what Todd charged to a friend and not an arms-length bidder. That may very well be true and a court *might* adjust the amount upward to account for the fact. However, I suspect that without some additional evidence, a court would go with the $50,000 license figure here.

The final point would be to discuss section 1(c) of the Act which provides for the doubling of any damages awarded under subsection 1(a). In this case, the $50,000 damages would be doubled to equal $100,000.

Restitution

The Act also allows recovery of restitution of Cheata's unlawfully obtained profits. *See* subsection 1(b). The statute is written in such a way that Todd can have *both* compensatory damages under 1(a) and restitution of profits under 1(b). Of course, as with compensatory damages, the amount of restitution must be proved with reasonable certainty.

The starting point for the restitution analysis is the $1,000,000 that Cheata earned from the clients to whom he taught the serve. It was Todd 's burden to prove this gross amount, which was quite easy on these facts. The difficult issue is that you needed to determine what portion of that $1,000,000 is attributable to the serve coaching technique – the benefit Todd wrongfully conferred on Cheata. To do so, you needed to undertake two different allocations.

First, you needed to determine which expenses Cheata could deduct from the $1,000,000 in order to determine the net profit of the wrongdoing. You do so by evaluating categories of expenses. If an expense category does not apply at all to this portion of income, it is ignored. If a category does apply in at least some part, at least some part of the expenses in that category may be deducted.

In this case, one category of expenses should gave been totally excluded. Cheata's advertising expenses were entirely associated with the public coaching. As such, he would not be allowed to deduct any portion of them.

On the other hand, one category of expenses may be deducted in full. Specifically, the expenses related to travel to professional tennis events was associated with the professional lessons and not with respect to the public lessons. Thus, the relevant income is now $900,000 ($1,000,000 less the $100,000 in travel expenses).

The more difficult questions are raised by the remaining two expense categories: rent and equipment. Cheata would be able to deduct some portion of the expenses. The key would be to determine a reasonable method for allocation of those expenses. The same allocation method would not necessarily have to be used for both categories.

Beginning with equipment, it seems fairly easy to allocate 20% of the $50,000 equipment costs ($10,000) to the professional lessons. The facts make clear that 80% of the equipment Cheata used was in connection with the public lessons. Thus, after deducting the relevant portion of the equipment costs, the profit stands at $890,000 ($900,000 less the $10,000).

Finally, we come to rent. The most logical methodology to deal with this expense category was to base an allocation on the amount of time Cheata spent with the professional group as compared to the public group. All of these lessons were conducted on the same rented space. Under the facts this would lead to a 50% allocation of this expense category for the following calculation:

starting figure	=	$890,000
50% rent expense	=	$75,000
Net revenue	=	$815,000[1]

But we are not finished yet. The $815,000 represents the net revenue from the professional tennis lessons. The problem is that not all of that revenue is attributable to the serve.[2] So, since the serve was not sold separately as an item by Cheata we need to determine what portion of the revenue is realistically attributable to the serve technique.

[1]It would also have been possible to argue for a ratio based on the income from the two line of coaching. In this method you would take the $1,000,000 and compare it to the $1,200,000 for an allocation figure of about 83%. In my view, the other two methods discussed in the text make more sense on these facts.

[2]One could have tried to argue that since all the clients were new to Cheata all of the revenue is attributable to the serve technique. While one could imagine a court so holding given the right facts, I do not think the problem as drafted creates such a situation. The court’s concern with not using restitution as a punishment devise would almost certainly lead the court to conduct some type of allocation.

It seems to me there were two options for making the allocation in this case. Option 1 would be to base the allocation on the experts' opinion as to how much of a professional tennis player's game is made up by the serve. The expert opinion is 30%. A second option would be to base the allocation on the amount of time Cheats spent on the serve in his lessons. He spent one hour out of seven on the serve, or 14% of his coaching time. These options produce the following results:

<u>Option 1 (30%)</u>	=	$244,500 (i.e. $815,000 x 30%)
<u>Option 2 (14%)</u>	=	$114,100 (i.e. $815,000 x 14%)

While both of these figures are plausible, I suspect a court would err on the plaintiff's side and use the 30% allocation figure.

Attorneys' Fees

You should also have discussed the fact that Todd would be entitled to attorneys' fees if he prevailed on his trade secret claim (and could be on the hook for Cheata's fees in the unlikely event that he lost). *See* Stetson Statute #1 section (2) and Stetson Statute #2.

Non-Trade Secret Act Claims

First, you should have noted that the Act specifically allows a party to seek and receive additional appropriate remedies beyond those provided for in the Act itself. Thus, Todd could seek the following additional remedies: (1) punitive damages; (2) preliminary injunctive relief; and (3) permanent injunctive relief.

Punitive Damages

Stetson statute #6 provides that in certain situations a litigant may be entitled to receive punitive damages. The first step in the analysis is to determine whether Cheata's alleged conduct is such that punitive damages are an option under the statute. They are.

Under section 1(a), Cheata would likely be subject to punitive damages in this case because he has committed "intentional misconduct." According to the facts, Cheata had actual knowledge that his actions were wrongful and would injure Todd. Nonetheless, Cheata went forward with his plan and Todd was injured as a result. This is a textbook example of what the statute refers to as "intentional misconduct."

You should also have addressed any limitations on an award of punitive damages under the statute. As a general matter, section 2 sets forth limits on the award of punitive damages tied to compensatory damages. However, none of these statutory limits would apply in this case. Subsection 2(c) makes clear that where a defendant actually intends to harm a defendant, and succeeds in doing so, there will be no cap on punitive damages. It is highly likely in this case that a jury would determine that Cheata's conduct meets this standard.

Finally, you should have at least advised Todd that even though there is no statutory limit on the amount of punitive damages there are two limitations a court would consider after a verdict. First a court will consider common law excessiveness of verdict. Second, and independently, the court will need to ensure that the verdict is no unconstitutionally excessive under the Due Process Clause of the Fourteenth Amendment. *See Campbell.*

Injunctive Relief

Finally, you should have discussed the possibility of obtaining injunctive relief against Cheata. This is important because the facts indicate that Cheata plans to continue using the technique to teach serves. There were two types of injunctive relief you might have wanted to discuss with Todd: a preliminary injunction and a permanent injunction.

Preliminary Injunction

A preliminary injunction is a form of temporary relief designed essentially to preserve the status quo pending the outcome of the litigation. There are four factors considered in connection with the preliminary injunction: (1) likelihood of success on the merits; (2) irreparable harm (i.e., no adequate remedy at law); (3) balance of the hardships; and (4) the pubic interest. The factors work together in that, for example, with a high likelihood of success on the merits you may be able to get away with a lesser showing on irreparable harm or balancing.

There is an extremely high likelihood of success on the merits of the Trade Secret Claim. The evidence shows that Cheata intentionally stole the serve technique and that theft led to injury to Todd.

In terms of irreparable harm the analysis is a bit more complex. The only harm that counts in connection with this issue at the preliminary injunction stage is the harm that will occur from the filing of the lawsuit until the resolution of the case. Here, it might be possible to determine that harm (in dollars) without nearly as much difficulty as it would be for the long term (as discussed below). However, given the high likelihood of success on the merits and the relative difficulty in damages proof, it seems more likely than not that a court would conclude that this element of the equation has been satisfied.

The balancing at the preliminary injunction stage requires a comparison of the harm to Cheata if the injunction is granted compared to the harm to Todd if it is denied. Since we are only at the beginning of the case and the defendant has not yet been adjudicated to be a wrongdoer, a mere tip in the scales towards the defendant is all that is required to thwart a request for a preliminary injunction. In this case, it is likely that the balance of harms would not favor Cheata. First, it is not at all clear that Cheata will be harmed in any significant way if the injunction is granted. There is no evidence that his clients will leave or that he will not be able to maintain his business. In addition, the harm to Todd could be significant because each day the technique is used by another it can spread and potentially be copied by still more players. That is something Todd can never get back. Moreover, even if one considered the balancing to be closer, the strong likelihood of success on the merits again suggests that the court would err in favor of Todd.

Finally, there is no indication that the public interest would be harmed in any respect by the granting of the preliminary. Thus, it is likely that a court would grant a preliminary injunction.

Permanent injunction

A permanent injunction is a final judgment as much as is a damage award. While it is possible for a permanent injunction and a damage award to inappropriately award double relief for the same wrong it is not clear that this would be the case here. Todd will likely receive $50,000 in compensatory damages based on a license fee. It is conceivable that this amount might need to be prorated to only deal with the six months Cheata used the technique of Todd were also to get a permanent injunction. This is an issue that would require further study at the conclusion of a trial based on the precise basis for the compensatory award.

As discussed above with respect to question 1, there are three issues to consider in connection with a permanent injunction: irreparable harm, balancing of the equities and the public interest. The irreparable harm inquiry here is different from the one discussed in connection with the preliminary injunction. At the permanent injunction stage one must consider the matter beyond the point of the trial and into the future. Here Todd would be able to establish that there is no adequate at law for the reasons discussed above concerning the difficulty of proof associated with compensatory damages.

The balancing required at the permanent injunction stage is also different from the balancing at the preliminary injunction. At the permanent injunction Cheata would have to demonstrate that the burden on him if the injunction is granted substantially outweighs the burden on Todd of the injunction is denied. It is extraordinarily unlikely that Cheata would be able to do so. If the injunction is denied Todd will lose control of a major feature of his business. Cheata on the other hand can continue his business just without a single feature. In addition, it might very well be that Cheata, as an intentional wrongdoer, would not be entitled to have a balancing assessment done. At the very least, the intentional nature of his actions make it even less likely that balancing would favor Cheata.

Finally, as with the preliminary injunction it does not appear that the public interest is implicated in this matter in any substantial degree. Thus, the factors suggest that Todd would be entitled to a permanent injunction. There would also, of course, be a question of scope. In particular, one would need to consider how long the injunction should be in place. The key issue would be whether Cheata would ever have lawfully been able to develop the technique. If he would have been able to do so, the injunction should not last forever because the plaintiff would receive too much relief. Instead, the injunction should be calibrated so that Cheata would not be able to use the technique before he would have been able to develop it on his own.

Question 3

This question largely dealt with a remedy for a beach of contract. Technically the question asked about two claims, one for breach of contract and one for violation of the Stetson statute concerning horticultural malpractice.

The Contract Claim

The basic rule for breach of contract claims is that a party is entitled to expectancy damages, which is the amount of money it would take to place the non-breaching party in the position in which it would have been if the defendant had fully performed the contract.[3] In addition, it is possible for contracting parties to alter the baseline damages rules. In this case, Todd and Eve have done so through paragraph 3 excluding the recovery of consequential damages. Such exclusions are generally enforceable so long as they are not unconscionable. The facts here disclose nothing to support an argument of either procedural or substantive unconscionablity. In particular in this regard, paragraph 5 of the contract makes clear that both parties had the opportunity to have a lawyer review the agreement prior to its execution.

After having set the ground rules, you needed to determine which elements of damages would be recoverable. I would have started by dividing the damages into those that are direct and those that are consequential. Rough definitions of such damages are that direct damages are those that will always (or nearly always) flow from a breach while consequential damages are those damages that are caused by a breach but that will not always flow from it.

Todd has suffered one, and perhaps, two items of direct damages. First, Todd has had to "cover" by replacing the grass that Eve damaged. He did so by purchasing grass from a commercially reasonable source for $25,000. His original cost was $10,000 under the contract with Eve. Therefore, his cover damages are $15,000. There is no question that this is an element of direct damages. His second item of damages that might be direct is the fees he paid for storing the defective grass. He paid $100 for 3 weeks for a total of $300. These damages could be considered consequential because they will not always flow from the breach. However, some jurisdictions could consider storage costs to be so common that they would be deemed direct.[4] Thus, Todd's total direct damages are either $15,300 or $15,000. These are all recoverable

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[3]Stetson has not adopted the UCC. Therefore, the UCC should have been used at most as persuasive authority.

[4]Such a reading would be similar to an incidental damage under the UCC.

although there will be a deduction as I discuss below.

In terms of consequential damages, Todd expected to make a profit of $250,000 during the first year of operation of the grass tennis experience. He will not be able to do so as a result of Eve's breach. However, paragraph 3 of the contract will bar the recovery of these damages.

Todd will need to take a deduction from his direct damages because he received an off-setting benefit from Eve's breach. Todd was able to sell the defective grass to a local farmer for $3,000.[5] This was a sale that he would not have been able to make if Eve had preformed under the contract. Thus, one needs to subtract the $3,000 from the $15,300 in direct damages for a result of $12,300 in direct damages.

You would not need to subtract the $7,500 Todd received from insurance. The common law collateral source rule acts as an exception to the offsetting benefits rule. It provides that one need not subtract payments made as a result of a wrong if those payments come from a source totally apart from the defendant. That is precisely the case here.

Finally, you should have addressed the recovery of attorneys' fees. Paragraph 4 of the contract provides for the prevailing party in an action to recover attorneys's fees. Such provisions are generally enforceable. The one potential issue is whether Stetson statute #2 is sufficiently broad to recognize a contractual agreement to pay fees. In other words does the phrase "or is otherwise required" cover a contractual agreement to pay fees. It seems likely that it would, but one should have flagged the issue for your client.

Horticultural Malpractice Act

Todd also wants to bring a claim under the Stetson Horticultural Malpractice Act. The reason that Todd would very much like to bring this claim is that he would like to recover his $250,000 in lost profits, which he would be able to do under the terms of the statute. The problem that Todd will run into here is the economic loss rule.

This common law rule provides that a plaintiff is not entitled to recover for economic losses – quite often, as here, lost profits – in tort without some physical injury to it or its property. This rule applies even though the plaintiff's harm has been caused by the defendant's actions. One could have tried to argue that this action is not a "tort" within the meaning of the economic loss rule because it is created by statute and not common law. I am unaware of any jurisdiction accepting this argument, but it was one that you could have advanced.

The economic harm rule is one of common law. We do not know if Stetson has adopted

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[5]If Eve pushed about the $3,000 Todd would very likely be allowed to deduct from this amount the $300 in reasonable storage costs. These expenses were incurred in order to obtain the offsetting benefit

the rule. If it has not, and Eve is not successful in urging its adoption, the rule will have no impact on this case. In that case, Todd would be able to recover damages under the statute, including lost profits. He will not be able to "double recover" for his direct contract damages.

On the other hand, if the rule is a part of Stetson common law, Todd's claim for lost profits will almost certainly be precluded. Here Eve did not cause damage to Todd or his property (other than the property that is the subject matter of the contract). To allow recovery under the statute would be to allow Todd to avoid the contractually negotiated remedial limitations.