

ESSAY QUESTION NO. 5

Answer this question in booklet No. 5

Landon owns a vacant lot located adjacent to Tina's home in Anchorage, Alaska. At a neighborhood picnic in 2002, Tina told Landon that if he was interested in selling the vacant lot, she would be willing to pay about \$250,000 for it. A few days later, Landon called Tina and said, "I'm not willing to sell right now, but let's try for a five-year lease with an option to purchase the property during the lease period." Tina told Landon she would think about it. In the interim, Landon asked his lawyer to draw up a draft lease agreement.

A few weeks later, Landon sent Tina a draft five-year land lease, but instead of an option to purchase, the lease contained a right of first refusal. Under the latter provision, Tina would be able to purchase the property only if Landon decided to sell it. Tina made several changes to the lease, but left the "Right of First Refusal" section untouched. Tina sent her revised draft to Landon, and he called to say he approved it. Landon emailed an unsigned copy for Tina to execute.

Tina decided to re-read the lease, and noticed that the draft did not contain the option to purchase – which she honestly believed the parties had agreed to. Tina changed the lease by deleting the right of first refusal and inserting an option to purchase. She did not amend the section's heading. Therefore, the heading remained "Right of First Refusal," but the language created an option to purchase. Tina signed the lease. A few days later, Landon went to Tina's office and signed the lease agreement without reading it, believing it to be the same as the document he had approved the week before. Tina never told Landon about the final change.

In 2007, Tina called Landon to tell him that she wanted to exercise her option to purchase the property. Landon told her that he didn't think he wanted to sell, but he would get back to her. A few days later, Tina called Landon again and stated that she decided to exercise the option to purchase. Landon told her that he did not think he had to sell the property. Tina responded that she was sure that the wording in the lease gave her an option to purchase. Landon said that he would look into it and get back to her.

A month later and on the day the lease was set to expire, Landon faxed Tina a signed form titled "Lease Extension," extending the lease for an additional two years under the same terms as the 2002 lease. Tina assented. Six months later, Tina sent Landon a letter exercising her option to purchase the property. Landon refused to sell. Tina sued Landon for breach of contract, seeking specific performance or damages for breach of the lease agreement. Landon counter-claimed, alleging material misrepresentation and seeking rescission of the lease agreement.

1. Discuss the merits of Landon's material misrepresentation claim and explain whether the lease is void.
2. Did the Lease Extension affect Landon's right to void the lease? Explain.
3. Tina seeks to introduce evidence at trial of the oral conversation between herself and Landon at the neighborhood picnic in 2002. Discuss whether the conversation can be introduced to:
 - a. Defend against Landon's counter-claim seeking rescission of the agreement; and
 - b. Support Tina's breach of contract claim.

GRADER'S GUIDE

*** QUESTION NO. 5 ***

SUBJECT: CONTRACTS

1. Discuss the merits of Landon's material misrepresentation claim and explain whether the lease is void. (40 points)

Tina is claiming that Landon's failure to sell the vacant lot to Tina after receiving notice that she was exercising her option to purchase the property under the terms of the lease was a breach of contract. Landon does not believe that the lease contained an "option to purchase" the property, but rather it gave Tina a "right of first refusal" if Landon chose to sell the property during the lease term.

This question tests the examinees' knowledge of the effect of a material misrepresentation on the formation of a contract. The fact pattern does not raise any issues relating to offer, acceptance, and consideration, and therefore examinees should not receive any credit for discussion of those principles.

Leases are contracts and are reviewed according to the principles of contract interpretation. *Rockstad v. Global Finance & Inv. Co.*, 41 P.3d 583, 586 (Alaska 2002).

a. Material Misrepresentation

If a party is induced to enter into a contract by a fraudulent or material misrepresentation, he may be able to avoid the contract. *Industrial Commercial Elec., Inc. v. McLees*, 101 P.3d 593 (Alaska 2004) (citing *Cousineau v. Walker*, 613 P.2d 608, 612 (Alaska 1980)). In order to rescind a contract on the basis of a material misrepresentation, three elements must be satisfied: (1) it must be determined whether party seeking rescission in fact relied on the misrepresentation; (2) it must be determined whether the misrepresentation was material to the transaction, that is, objectively, whether a reasonable person would have considered the misrepresentation important in deciding whether to complete the transaction; and (3) it must be determined whether the party's reliance was justified. *Cousineau*, 613 P.2d at 612.

Tina's act of changing the "right of first refusal" clause to an "option to purchase" without changing the caption and without notifying Landon was a misrepresentation – an express and implied assertion that the right of first refusal clause in the third draft was unchanged. *See Adams v. Adams*, 89 P.3d 743 (Alaska 2004) (citing Restatement (Second) of Contracts § 159 (1981)). Even though the facts indicate that Tina "honestly" believed that the parties'

original agreement included an option to purchase the property, an “honest” misrepresentation is still a misrepresentation under the law.

1. Subjective Reliance

Landon relied on Tina’s misrepresentation when he signed the lease without reading it. The draft Landon approved had been last edited by Tina, and he had no reason to believe that Tina would make additional changes to the document during the time between his approval of the lease and signing it.

2. Materiality

The misrepresentation was material. A right of first refusal would have allowed Tina to purchase the property if Landon chose to sell it; an option to purchase would give Tina an affirmative right to purchase the property during the lease term. Because these provisions create disparate rights (one allows Landon to choose to sell the property, the other forces him to sell), a reasonable person would have considered the change important in deciding whether to enter into the agreement.

3. Justifiable Reliance

Finally, Landon’s reliance on the misrepresentation was probably justified. Although Landon’s attorney created the first draft of the lease, the lease that Landon approved had been last edited by Tina. During negotiation, Tina never objected to the Right of First Refusal clause, and when she noticed that the clause created a right different from what she originally discussed with Landon at the picnic, she changed the agreement without notifying Landon. While it is arguable that Landon should have read the lease, it is possible that he would have overlooked the change anyway – Tina had never expressed any issue with the “Right of First Refusal” clause and she did not amend the heading of the clause when she edited the agreement.

b. Void versus Voidable

If a party has a reasonable opportunity to read an agreement before signing it, the party’s apparent assent is effective, and the agreement is voidable rather than void. *Adams*, 89 P.3d at 750-51 (citing Restatement (Second) of Contracts §§163, 164). Two illustrations to the Restatement (Second) of Contracts § 163 are similar to the fact pattern of this question.

Illustration 2 states:

A and B reach an understanding that they will execute a written contract containing terms on which they have agreed. It is properly prepared and is read by B, but A substitutes a writing containing essential terms that are different from those agreed upon and thereby induces B to sign it in the belief that it is the one he has read. B’s apparent manifestation of assent is not effective.

Illustration 3 states:

A and B reach an understanding that they will execute a written contract containing terms on which they have agreed. A prepares a writing containing essential terms that are different from those agreed upon and induces B to sign it by telling him that it contains the terms agreed upon and that it is not necessary for him to read it. B's apparent manifestation of assent is effective if B had a reasonable opportunity to read the writing. However, the contract is voidable by B under the rule stated in § 164 ... In the alternative, at the request of B, the court will decree that the writing be reformed to conform to their understanding under the rule stated in § 166.

The Alaska Supreme Court distinguished these illustrations to the Restatement in *Adams*, 89 P.3d at 751. The primary difference between Illustrations 2 and 3 is that the individual in Illustration 3 had a reasonable opportunity to read the writing in the final form before he signed it. *Id.* Landon could have read the agreement when he arrived at Tina's office to sign it. Therefore, Illustration 3 is more analogous to the situation in the fact pattern. The lease was voidable by Landon, but not void.

2. Did the Lease Extension affect Landon's right to void the lease?
Explain. (20 points)

As noted above, the lease was voidable by Landon. This question asks whether Landon lost his power of avoidance by extending the lease. The power of avoidance is subject to the limitations set out in chapter 16 of the Restatement. *Id.* (citing Restatement (Second) of Contracts § 164, cmt. a). Restatement § 380(2) provides that a party's power of avoidance due to a misrepresentation is lost when "he knows of the misrepresentation if it is fraudulent, or knows or ought to know of a nonfraudulent misrepresentation...." *Adams*, 89 P.3d at 751 (quoting Restatement (Second) of Contracts § 380, cmt. b).

Landon's extension of the lease expressed his willingness to go forward with the contract after he learned of the option to purchase language in the lease, and was thus an affirmance. Although it is debatable whether Landon actually knew that the language in the original lease created an option to purchase the property rather than a right of first refusal, it is clear that Landon had reason to know Tina believed that she had an option to purchase the property. When Tina first tried to exercise the option to purchase, Landon told her that he didn't think he had to sell, but he "would look into it." Had Landon read the lease before sending Tina the extension, he would have discovered that the lease language created an option to purchase. Landon's power to void the contract was probably lost when he extended the lease without changing or clarifying its terms because his actions affirmed the original lease.

3. Discuss whether evidence of the oral conversation between Tina and Landon at the neighborhood picnic in 2002 may be used at trial. (40 points)

This question tests the examinees' knowledge of the parol evidence rule.

When the terms of an agreement between contracting parties are set forth in writing, the parol evidence rule generally precludes the parties from using evidence of prior agreements to contradict the written terms. *Philbin v. Matanuska-Susitna Borough*, 991 P.2d 1263, 1270 (Alaska 1999); *Alaska Diversified Contractors, Inc. v. Lower Kuskokwim Sch. Dist.*, 778 P.2d 581, 583 (Alaska 1989); see AS 45.02.202 (parol or extrinsic evidence). The parol evidence rule is implicated when one party seeks to introduce extrinsic evidence which varies or contradicts an integrated contract. Once triggered, the parties' reasonable expectations are determined by applying a three step test:

"The first step is to determine whether the contract is integrated. The second step is to determine what the contract means...." Extrinsic evidence may always be received in resolving these first two inquiries. The third step is to determine whether the prior agreement conflicts with the integrated writing. *Western Pioneer, Inc. v. Harbor Enters., Inc.*, 818 P.2d 564, 657 n.4 (Alaska 1991) (citations omitted).

a. Discuss whether the conversation can be introduced to defend against Landon's counter-claim seeking rescission of the agreement.

The parol evidence rule does not apply when reformation or rescission of the agreement is sought as a result of misrepresentation or mutual mistake. *Still v. Cunningham*, 94 P.3d 1104, 1110 (Alaska 2004) (citing *Diagnostic Imaging Center Assocs. v. H&P*, 815 P.2d 865, 867 (Alaska 1991)). The Alaska Supreme Court has explained:

The parol evidence rule does not apply where a contract has been formed as a result of misrepresentation or mutual mistake. [Where a party offers parol evidence] to show that the parties did not intend that the [contract] had the meaning the [other party] ascribed to it, not to vary or contradict the terms of the written contract ... [t]his was a permissible use of extrinsic evidence to prove mutual mistake. *Philbin*, 991 P.2d at 1270 (internal quotations omitted).

Under the present fact pattern, the parol evidence rule does not apply because Landon is seeking rescission of the lease as a result of Tina's misrepresentation. Evidence regarding the conversation between Tina and Landon at the 2002 neighborhood picnic should be allowed.

b. Discuss whether the conversation can be introduced to Support Tina's breach of contract claim.

Evidence of the pre-contract conversation between Tina and Landon implicates the parol evidence rule because it is extrinsic evidence and their discussion occurred prior to consummation of the written contract. The facts indicate that the contract is an integrated agreement. The language of the written contract conveys an option to purchase the property under a heading titled "Right of First Refusal."

Extrinsic evidence may always be received when determining the meaning of the contract, and examinees must next determine whether evidence of the oral conversation conflicts with the integrated writing. Whether there is conflicting extrinsic evidence depends on whether the prior agreement is inconsistent with the integration. Inconsistency is defined as "the absence of reasonable harmony in the terms of the language and respective obligations of the parties." *Western Pioneer*, 818 P.2d at 657 n.4.

If the examinee determines that evidence of the oral conversation conflicts with the meaning of the contract due to the "Right of First Refusal" section heading, then the parol evidence rule would properly preclude use of this conflicting evidence to contradict the agreement's written terms. If the examinee determines that evidence of the oral conversation does not conflict with the meaning of the contract because the language of the provision, although improperly titled, conveys an option to purchase the property, then the parol evidence rule would not preclude use of Tina and Landon's prior conversation to prove Landon breached the written contract. Either argument is plausible, and examinees should be given credit for the analysis of the issue rather than the outcome reached.