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The conventional wisdom among contemporary scholars is that courts will impose promissory estoppel liability for reliance investments undertaken prior to any agreement between commercial parties.[1] Evidence of promises made and relied upon during the negotiation process together with a "general obligation arising out of the negotiations themselves" are the supposed grounds for imposing liability even for preliminary negotiations that ultimately break down.[2] But even a casual survey of contemporary case law casts significant doubt on the accuracy of the conventional view. Courts actually make some form of agreement a necessary pre-condition to a promisee's recovery. The real issues are: When will a preliminary agreement be found? And how does the nature of such agreement determine when and how a promisee can recover?

These questions have generated a literal flood of litigation that has been virtually ignored in contemporary contract law courses. One reason that this question is ignored is because of the misplaced attention given to the decision of the Wisconsin Supreme Court in *Hoffman v.*

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* Alfred McCormack Professor of Law, Columbia University. This essay benefitted greatly from comments by Douglas Baird, Victor Goldberg, Jody Kraus and Alan Schwartz. It is forthcoming in a symposium on "Commercial Calamities, 68 Ohio State L. J. 1 (2007).

[1] *See e.g.*, E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217 (1987). ("In recent decades, courts have shown increasing willingness to impose precontractual liability.") Error! Main Document Only.Michael B. Metzger & Michael J. Phillips, *The Emergence of Promissory Estoppel as an Independent Theory of Recovery*, 35 Rutgers L. Rev. 472, 496-97 (1983) ("[I]t is clear that promissory estoppel has been used to enforce promises too indefinite or incomplete to constitute valid offers."); RALPH B. LAKE & UGO DRAETTA, LETTERS OF INTENT AND OTHER PRECONTRACTUAL DOCUMENTS 177 ("Liability for action during the precontractual stage of a transaction may be based on the obligation to bargain and to negotiate in good faith."); Restatement (Second) of Contracts § 205, comment c (1981) ("Bad faith in negotiations...may be subject to sanctions.") ..

[2] *Id.*

Red Owl Stores, Inc.[3] As a consequence of a fundamental misunderstanding of the law in action, lawyers bring suits claiming reliance on preliminary negotiations and, to their surprise and that of their clients, they lose. Meanwhile an entire new body of law enforcing certain preliminary agreements has emerged unbeknownst to most lawyers (and legal academics).

The story of this misunderstanding of the law of preliminary agreements begins with *Hoffman v. Red Owl*. In *Hoffman*, the court held that even if two parties had never reached agreement on essential factors necessary to establish a contract, a party who relied on representations made during the negotiations could recover sunk costs based on the doctrine of promissory estoppel as expressed in §90 of the Restatement of Contracts. Under this doctrine, the court held that a "promise"—here Red Owl's representation that $18,000 was sufficient capital to secure a franchise—need not be as definite in its terms as a promise that is the basis of a traditional bargain contract.[4]

Putting aside for the moment the dubious accuracy of that holding as a matter of contract doctrine, one fact has become clear in the intervening years during which time *Hoffman* has been ensconced as a favorite in contracts casebooks[5] and analyzed in numerous law review articles[6]: *Hoffman* is an outlier; the case has not been followed in its

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[3] 133 N.W. 2d 267 (1965).

[4] *Id.* at 275.

[5] *See, e.g.,* RANDY E. BARNETT, CONTRACTS: CASES AND DOCTRINE 732 (3d ed 2003); JOHN P. DAWSON, WILLIAM BURNETT HARVEY & STANLEY D. HENDERSON, CONTRACTS: CASES & COMMENT 409 (8th ed. 2003); E. ALLAN FARNSWORTH, WILLIAM F. YOUNG & CAROL SANGER, CONTRACTS: CASES & MATERIALS 235 (6th ed. 2001); LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 573 (7th ed. 2001); EDWARD J. MURPHY, RICHARD E. SPEIDEL & IAN AYRES, STUDIES IN CONTRACT LAW 435 (6th ed. 2003);STEWART MACAULAY, JOHN KIDWELL & WILLIAM WHITFORD, CONTRACTS: LAW IN ACTION 390 (2D ED. 2003); ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW & THEORY 204 (3d ed. 2002).

[6] *See, e.g.*, Gregory Duhl, Red Owl*'s Legacy,* 87 Marquette L. Rev. 297 (2004); Peter Linzer, *Rough Justice: A Theory of Restitution and Reliance, Contracts and Torts,* 2001 Wisc. L. Rev. 695, 717–20; Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation,* 85 Va. L. Rev. 387, 494–99 (1999); Avery Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations,* 105 Yale L.J. 1249, 1255–57 (1996); Richard Craswell, *Offer, Acceptance and Efficient Reliance,* 48 Stan L. Rev. 481 (1996); *Edward Yorio & Steve Thel, The Promissory Basis of Section 90,* 101 Yale L.J. 111 (1991); Mark P. Gergen, *Liability for Mistake in Contract Formation* 64 S. Cal. L. Rev. 1, 27–42 (1990); E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements:*

own or other jurisdictions.[7] Indeed, a recent case applying the Wisconsin law that governed *Hoffman* refused to award reliance damages on a promissory estoppel claim under similar facts.[8] Courts in other jurisdictions have established strict limitations for imposing promissory liability based on representations made during the negotiation process.[9]

All of this begs for answers to several key questions: How could the court in *Hoffman* find liability where so many other courts could not? And, what exactly is the law of contracts in the muddy area of preliminary agreements? In this essay, I begin with a close look at the *Hoffman* case. The transcript of the trial reveals a story far different from the conventional understanding of the dispute between Joseph Hoffman and the representatives of Red Owl Stores.[10] The truth suggests an important lesson for law teachers (and law students): It is dangerous to draw inferences about emerging doctrine from isolated cases and it helps to read cases systematically if one wishes to recover the law in action. By setting the record straight on what really happened in *Hoffman* and pointing where the legal rules governing preliminary agreements have evolved in the years since the case was decided, I

Fair Dealing and Failed Negotiations, 87 Colum. L. Rev. 217 (1987); Daniel Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake,* 52 U. Chi. L. Rev. 903 (1985); Jay M. Feinman, *Promissory Estoppel and Judicial Method,* 97 Harv. L. Rev. 678 (1984); Michael Metzger & Michael J. Phillips, *The Emergence of Promissory Estoppel as an Independent Theory of Recovery,* 35 Rutgers L. Rev. 472 (1983); Charles Knapp, *Enforcing the Contract to Bargain,* 44 N.Y.U. L. Rev. 673, 686–90 (1969); Robert Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code,* 54 Va. L. Rev. 195, 225 (1968).

[7] Farnsworth, *supra* note 1.

[8] Beer Capitol Distributing, Inc. v. Guinness Bass Import Co., 290 F.3d 877 (7th Cir. 2002). The court denied both promissory estoppel and unjust enrichment claims based on the plaintiff's reliance on defendant's representation during the negotiations that he would recommend plaintiff as the exclusive distributor of defendant's beer for southeastern Wisconsin.

[9] *See e.g.*, Banco Espirito Santo de Investimento v. Citibank, 2003 U.S. Dist Lexis 23062 (S.D.N.Y. 2003); R.G. Group v. Horn & Hardart*,* 751 F.2d 69,71 (2d Cir. 1984).

[10] Commentators have been virtually unanimous in accepting the story, as told by the Wisconsin Supreme Court, that Red Owl's escalating financial demands were the proximate cause of the breakdown in negotiations between the parties. Marvin Chirelstein is a notable exception to this uncritical view of the case in suggesting that there is a plausible alternative story to tell about *Hoffman.* MARVIN A. CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 57-58 (5th ed. 2005). *See also* Johnston, *supra* note 6, at 497–99.

hope to encourage a more systematic approach to the "discovery" of new legal doctrines.

The True Facts of *Hoffman v. Red Owl Stores*

The Supreme Court of Wisconsin relied on an edited transcript of the trial as the basis for its decision. But the complete trial transcript of the case[11] paints a very different picture of the relationship between Joseph Hoffman[12] and Edward Lukowitz and the other Red Owl agents headquartered in Minneapolis.[13] This is true even if one endeavors to interpret all facts in the light most favorable to Hoffman as the appellee holding a jury verdict.

The key to unraveling the true story behind *Hoffman* is to ignore the red herring. Specifically, let's put to one side a consideration of the various actions taken by Hoffman in reliance on statements made by Lukowitz and the other Red Owl representatives during the negotiation process. Rather, let's focus on a single fact. Hoffman claimed to have "about $18,000" available to be set up in a Red Owl franchise.[14] This much is conceded by all. These, then, are the pertinent questions: What was the understanding as to the composition of the $18,000? Was it supposed to be all equity, or was it to be cash composed of some equity and some debt? If the latter, from what sources was Hoffman to obtain his encumbered cash? Finally, how reasonable was Red Owl's reaction to the changing sources of Hoffman's prospective $18,000 contribution as he moved his assets around between September 1961 and January of 1962? While these financing questions are complex, they contain the answer to the puzzle that has perplexed students and commentators for years: What explains the behavior of Red Owl officials who, according to the court, repeatedly increased Hoffman's

[11] *Joseph and Shirley Hoffmann v. Red Owl Stores, Inc., and Edward Lukowitz*, Circuit Court, Outagamie County, Wisconsin, File No. 14954,Transcript (October 21, 1963, A.W. Parnell, J.). Trial Record at 77 et seq. [hereinafter Record].

[12] Joseph Hoffmann in fact spelled his name with two Ns," thus "Hoffmann" and it was so spelled in the trial transcript and in respondents brief to the Supreme Court of Wisconsin. The majority opinion of Justice Currie in the Supreme Court misspelled his name and the misspelling has remained ever since. *See* Record at 78.

[13] As I suggest in this essay, the misunderstanding between the parties that led to the dispute cannot be appreciated if one merely reads the edited transcript. Moreover, Red Owl's attorneys did a poor job of highlighting the key facts and their legal relevance either at trial or on appeal.

[14] Record at 86.

minimum capital requirements, first from $18,000 to $24,000, then to $26,000, and ultimately to $34,000?

1. The purchase and sale of the Wautoma grocery store and the $18,000 "assurance"

In the fall of 1959, Joseph Hoffman was restless. He had operated a bakery in Wautoma, Wisconsin since 1956 but he wanted to do more.[15] So, in November 1959, Hoffman contacted Sid Jansen, the Division Manager of Red Owl Stores,[16] and inquired about the possibility of acquiring a Red Owl franchise store. Informal discussions continued but without much progress and, by the fall of 1960, Edward Lukowitz had taken over from Jansen as Division Manager. Around Christmas that year Hoffman had an idea. He thought "it might be a good idea to get a little experience in the grocery business before I go into a bigger store."[17] A friend in Wautoma who was running such a store had suffered a heart attack and the store was available. He called Lukowitz who looked into it and advised him to go ahead.[18]

Hoffman bought the Wautoma grocery store business from his friend for $16,000 in February 1961 and assumed the lease on the building.[19] Things went well even though Hoffman was stretched thin in managing both the bakery and the grocery business at the same time. In May, Lukowitz and another Red Owl employee came to the store to conduct an inventory and they concluded that the store was running a 3 to 4% profit, which they judged as pretty good under the circumstances. Lukowitz thereupon urged Hoffman to sell the business to his assistant, Edward Wrysinski, in order to free up his equity for

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[15] Hoffman had done well in this business and, in February 1959, he had bought the building in which the bakery was located for $10,000 under an installment land contract ($100 down and $100 per month). By September of 1961, when he paid off this mortgage, he had paid down the principal liability to about $7,500.

[16] Jansen's responsibilities included "future development" (finding new franchisees and facilitating the process by which they could begin operations as a Red Owl franchisee).

[17] Record at 84.

[18] *Id.*

[19] Hoffman paid $7,000 for the business and $9,000 for the inventory and leased the store building for $175 per month. Record at 89. Hoffman's cost in acquiring and operating the grocery business in Wautoma was $18,000. *Id.* at 90. He financed this transaction in part by borrowing $9,500 from the Union State Bank of Wautoma and giving the bank a chattel mortgage on his bakery equipment. (Exhibit 41).

the larger Red Owl store.[20] Hoffman was reluctant to sell in June because the summer business in the lake country was historically very brisk (an estimated 5,000 tourists would increase the summer population significantly).

At this meeting in May 1961, Hoffman said to Lukowitz and his colleague, "Fellows, you know how much money I got—about $18,000. Will this put me in a bigger operation or won't it?"[21] Lukowitz replied that there would be no problem with that level of investment. There was, however, no discussion then (or at any time thereafter) as to the nature of the $18,000 investment. Was it to be all equity, or was it to be part equity and part borrowed cash?[22] Hoffman clearly assumed the latter. At the time, Hoffman had only $10,500 in cash of his own. The balance was to come from in the form of a loan to the business by his father-in-law, Simon Vanden Heuvel, a prosperous local farmer.[23] By saying he had $18,000, Hoffman treated what he had to contribute to the business the same as what someone else would lend to it. But a franchisor is hardly indifferent between the two. Red Owl regarded a substantial equity contribution from its franchisees as the key to a successful franchise.[24] Although the amount of unencumbered cash Hoffman was supposed to supply was never precisely identified by Red Owl officials, they had reason to believe that Hoffman could and would supply his own cash in setting up the business and would not rely on money lent by others.

On September 11, 1961, Hoffman had provided a financial statement to Lukowitz that was passed on to the home office in Min-

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[20] There also was evidence that Hoffman and Wrysinski were not working well together and that this might have been a contributing factor in the decision to sell. Record at 119. Though conflicting, the evidence is sufficient to find that Lukowitz urged this move so as to "set Hoffman up" in a bigger Red Owl store.

[21] Record at 86.

[22] On cross-examination, Hoffman was asked "Was there any discussion at any time as to how this $18,000 was to be made up? That is, was it all unencumbered cash or partly to be borrowed cash?" Hoffman answered: "I don't believe there was any discussion on that." Record at 167.

[23] See Hoffman's financial statement of September 11, 1961 (Exhibit 40).

[24] Equity participation helps to align the interests of a franchisee with those of the franchisor. *See* note 77 *infra*.

[26] *See* Exhibit 40. Financial statement dated 9/11/61. Although the statement also reflects a $6,000 equity in his residence in Wautoma, there was never any indication that personal as opposed to business assets were to be contributed to the franchise.

neapolis. This statement represented that Hoffman had business equity of at least $28,000, consisting of $10,000 in cash, $1,500 in inventory in the bakery, $4,500 equity in the bakery building and $12,000 equity in his bakery equipment.[26] Thus, from Red Owl's perspective, Hoffman would have ample equity provided he liquidated his bakery business. At that time, however, they did not know Hoffman had no intention of selling his bakery business in order to free up his own cash for the new franchise. Rather, he hoped to continue that business and operate the new Red Owl Store at the same time.

The Wautoma grocery store was sold to Ed Wrysinski on June 6, 1961 for $18,000.[29] At the time he sold in June, many details about establishing Hoffman in a bigger store were unresolved, including which town would be the best location for the new store, the size and site of the store building, fixtures needed for a store, etc.[30] Shortly afterward, Lukowitz suggested alternative locations for the new store—Lake Mills, Clintonville, Kewaunee and Chilton. The two of them traveled around looking at these places and finally settled on a lot in Chilton. On August 3rd, Hoffman bought a 30-day option to purchase the Chilton lot for $6,000 with $1000 down on exercise of the option.[31] The plan was that Hoffman would purchase the lot and then resell it at a profit to the contractor who was building the new store, taking back a lease at a rental that reflected the enhanced price the builder agreed to pay. In essence, the sale/ leaseback was designed both to capture equity in

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[29] Hoffman testified that it was his decision to sell the store business but that he acted on Lukowitz' advice that he should sell before the summer tourist season in order to prepare for the new store. Hoffman testified: "I told Ed that the fellow that was working for me was interested in the business. Ed says: Let's sell it to him now and go into a bigger operation." Record at 94.

[30] On cross-examination Hoffman was asked "Didn't you know at this time that in [selling the Wautoma store and] establishing a bigger store there would be a lot of things to be worked out?" "That's right", Hoffman replied. Record at 171.

[31] The option was subsequently extended to September 15th.

the lot and to serve as an indirect loan from the builder to Hoffman. The goal was to open the new store by December 1.

2. The September 27 proposed financing plan

Based on Hoffman's September 11th financial statement,[32] it appeared to Red Owl officials that, by selling the bakery building and business and combining the proceeds with cash on hand, Hoffman would have $28,000 in liquid assets, more than enough to make his equity contribution to the franchise operation. Hoffman, as we have seen, had much different intentions, however. He did not intend to sell the equipment or the bakery building. Rather, he wanted to lease the building and business to someone else and take some of the equipment to operate a bakery in the new store. Hoffman saw the bakery business as his livelihood, available to support his wife and six children while getting started in the new store.[33]

On September 13th, acting on Lukowitz's advice, Hoffman paid the $1,000 and exercised his option on the Chilton lot. Hoffman was eager to do so in any event because he had heard of the possibility of an A&P acquiring the same property for a store in Chilton. The next day, Hoffman paid off the $7,500 mortgage on the bakery building, reducing his cash on hand in the bank to $2,500. On September 27th Lukowitz called Hoffman and arranged for him to meet two people from the Red Owl home office—Herman Carlson, the future development manager, and Walter Hall, the credit manager—at the lot in Chilton.[34] During that meeting, Hoffman gave Carlson a second financial statement which listed the bakery building as worth $12,000 and clear of liens together with cash in hand of $2,500.[35] Based on that statement, the parties prepared the first "proposed financing plan."[36] It showed Hoffman making an $18,600 equity contribution, consisting of $3,600 cash, $12,000 from the sale of the bakery building and $3,000 from the re-

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[32] The statement showed $10,000 cash in the bank and additional equity in the bakery business of $18,000, consisting of the bakery building (worth $12,000 with a $7,500 mortgage) and equipment (worth $19,500 subject to a chattel mortgage of $7,500). See Exhibit 40. Apparently, this financial statement was prepared at Lukowitz' request.

[33] Record at 117.

[34] One reason to meet at the lot was to examine the map of the site and gauge its relationship to "downtown" Chilton. Exhibit 29.

[35] (Exhibit 38).

[36] *See* Exhibit 39. Record at 103–04.

sale of the lot to the builder.[37] Also listed under "Other trade payables" was a loan from Hoffman's father-in-law of $7,500, designated as "pay interest only at 5%." Hoffman's equity interest in the bakery equipment and the bakery merchandise was indicated in a note on the proposal under "Bakery" but these assets were not part of Hoffman's equity contribution for the proposed store. It thus appears from this first proposed plan that Red Owl assumed that the bakery would be a separate operation run by Hoffman out of the franchise store.[38]

At the end of this meeting, someone said: "There seems to be no hitch," and the parties left in an optimistic frame of mind. Several days later, Lukowitz called Hoffman, telling him to "get your money together." During this phone conversation, Lukowitz reiterated that the only remaining issue was the sale of the bakery business and building (presumably to realize the $12,000 in cash as per the September 27 financing plan). While Hoffman had preferred to lease the business minus enough equipment to have a bakery in the new store, he nonetheless agreed to sell the business if that was a necessary condition to obtaining the franchise.

3. The November 22 proposed financing plan

On October 11, Hoffman returned to the Union State Bank and borrowed $13,500 secured by a further $6,000 chattel mortgage on the bakery equipment and a $7,500 mortgage on the bakery building.[39] Hoffman left the bank with $13,500 in cash.[40] This amount was aug-

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[37] Hoffman's ontribution to the business was designated on the statement as "Equity capital: Amount owner has to invest." Exhibit 39. Based on this first financial proposal, it appears that both Red Owl and Hoffman understood that Hoffman would put in $18,600 of his own exclusive of any borrowed funds from his father-in-law.

[38] A key question, of course, was whether Hoffman mentioned during this meeting with Carlson and Hall his understanding that $18,000 was a sufficient contribution to establish a franchise *and* his understanding that he could make this contribution partly with cash and partly with borrowed money from his father-in-law. During cross-examination Hoffman was asked: "Did you mention your $18,000 understanding to Carlson and Hall when filling out your financial statement," and he answered, "I can't recall." Record at 179.

[39] Exhibit 42 (There is no copy of this mortgage in the record). The previous day, October 10, Red Owl officials had shown Hoffman a floor plan they had prepared of a proposed store in Chilton.

[40] Thus, as of October 11 Hoffman had $16,000 in cash equity. When asked on cross-examination about his timing in paying off the prior mortgage on the bakery building on September 14th and creating a new one less than one month later, Hoffman stated that he got the cash in response to Lukowitz'

mented a month later when Hoffman sold the bakery building for $10,000, using $7,500 of the proceeds to retire the mortgage and retaining $2,500 in cash.[41] Thus, as of November 6, Hoffman had over $18,000 in cash equity although his net worth had declined slightly given the lower than expected sale price for the bakery building. Most of his cash ($13,500) was borrowed against his equity in the bakery equipment. Thereafter, Hoffman took a job working nights at the Elm Tree Bakery.

Just before Thanksgiving, Lukowitz called to invite Hoffman to Minneapolis to iron out final details with the home office financial folks so as to get the store in operation after the first of the year.[42] Hoffman met with Lukowitz, Carlson, Hall and their boss, Frank Walker, in Minneapolis around November 22. At that meeting, the parties prepared a new financing proposal based on a new financial statement that Hoffman prepared and signed.[43] This new plan provided that Hoffman would contribute $12,500 in cash ($4,500 in savings plus $8,000 from the Chilton Bank secured by the bakery equipment) together with the bakery equipment. Because the equipment was worth $18,000 and subject to a loan of $8,000, it represented an in-kind capital contribution to the business of about $10,000...[44] In essence, the deal now proposed that the residual value of the bakery equipment (i.e., its value after the bank loan was paid off) become the major component of his contribution to the franchise. It replaced the previous plan to raise $12,000 in cash from the sale of the bakery building, an asset that Hoffman had previously listed as free from liens.

statement that he should get his money together in anticipation of consummating the deal.

[41] He also guaranteed the lease to his top baker Michael Grimm at $120 per month.

[42] Presumably, Hoffman still had $18,000 in cash equity on hand at that time.

[43] This new financial statement is not in the record.

[44] Exhibit 32. The plan called for Hoffman to contribute "equity capital" of $4,600 in cash and $17,000 in bakery equipment (now clear of liens). The plan again proposed that Hoffman would borrow $7,500 from his father-in-law, still on a "no pay, interest at 5%" basis. In addition, the "profit" on the resale of the lot was increased to $4,000, and Hoffman was to borrow an additional $8,000 from the Union State Bank in Chilton to be secured by the bakery equipment (thereby turning some of his equity in the equipment into cash). The parties must have agreed that Hoffman would use $13,500 of his cash to retire the chattel mortgage on the bakery equipment (that would leave him with about $4,500 in cash as per the proposed financing plan).

Shortly after the meeting, Hoffman received a copy of the November financing proposal in a letter from Carlson, the credit manager. In the letter, Carlson explained the changes from the previous plan: "You will find enclosed a report indicating our capital requirements. You will recall that in your visit to the office that our original thinking on this was subsequently revised in order to properly reflect the amount of equity capital that you personally have for investment."[45] The problem, in essence, was that the sale of the bakery building yielded less than was predicted and, moreover, contrary to Hoffman's initial representations, the building had been mortgaged. When it became clear that the building was not unencumbered and thus could not provide a major portion of Hoffman's equity contribution, the financing plan had to be revised. After some reflection, Hoffman agreed to this revised proposal.[46]

Throughout this period, while Red Owl was interesting in tying down Hoffman's equity contribution, Hoffman was concerned about an entirely different issue. Rather than focusing on how much equity he was putting into the operation, he was focused on the amount of cash, whether encumbered or unencumbered, that he was required to "contribute." Consequently, he considered this November proposal to require an additional $6,000 in cash beyond his original $18,000 commitment. He reached that conclusion by adding together the $7,500 loan from his father-in-law, plus his cash contribution of $4,600, plus the $8,000 loan from the Chilton bank secured by the bakery equipment, plus the $4,000 profit on the lot. This conclusion reflects Hoffman's basic misunderstanding of the economics of the transaction;[47] a

[45] Record at 144–45. This statement by Carlson reflects the realization on the part of the Red Owl financial people that Hoffman could raise $18,000 in cash equity only by committing his equipment to the enterprise. They had initially thought, based on the September 11th financial statement, that Hoffman had business equity of $28,000 ($2,500 cash + $12,000 bakery building + $14,500 equity in equipment and inventory). But the November financial statement showed business equity of only $22,100 ($4,600 cash + $17,500 bakery equipment).

[46] Record at 102.

[47] Hoffman was making an apples and oranges comparison. The $18,000 was his equity contribution. The amount of cash he might need to successfully start up the franchise was a different issue. Red Owl was eager to have him borrow sufficient cash to avoid a cash flow crunch in the early months. Their point to him was that he had control over this debt and if he did not need the additional cash he could retire any or all of it. *See* note 77 *infra*. It wasn't until the very end of the negotiations that Red Owl learned that Hoffman was constrained by his father-in-law from incurring any more debt. *See* TAN — *infra*.

misunderstanding that began with the first proposed financing plan, continued through the November meeting and ultimately was the proximate cause of the deal breaking down the following February.

In retrospect, the source of the misunderstanding following the November meeting seems clear. Hoffman believed he was making an additional $6,000 cash "contribution" while the Red Owl people believed that the equity Hoffman had available to contribute was $6,000 less than he had originally represented. Throughout the negotiations in Minneapolis and thereafter, Red Owl officials expressed concern that, of the $24,000 to $26,000 that Hoffman was planning to contribute, only $13,000 was equity (free cash and amounts borrowed against his equity in the bakery equipment).[48] The balance was to be borrowed unsecured from Hoffman's father-in-law and the building contractor.

4. The December financing proposal

Shortly after the November meeting, Lukowitz called Hoffman and asked to meet him at the Red Owl store in Appleton. Lukowitz had a wire from Carlson stating that they needed to secure an additional $2,000 for marketing and promotion of the new store. Hoffman replied, "I have to find out if I can make $2,000 more available." Several days later, Hoffman talked the situation over with his wife and his father-in-law. They hit upon a solution to Hoffman's evident problems in coming up with the needed financing: Hoffman and Simon Vanden Heuvel would go into the franchise as equal partners. Vanden Heuvel would contribute $13,000 in cash and Hoffman would contribute the balance.

Before this new scheme had been vetted with Lukowitz, the Red Owl home office people sent a third financing proposal in early December. This plan reflected the additional $2,000 needed for promotion. It showed Hoffman's equity contribution unchanged at $22,100 ($4,600 in cash and $17,500 in bakery equipment).[49] In order to raise additional cash to operate the store, the plan proposed a $8,000 loan from the Chilton bank secured by Hoffman's equity in the bakery equipment, a $7,500 no pay, 5% interest loan from his father-in-law, and a $6,000 cash "profit" from the resale of the Chilton lot to the builder. In short, Hoffman's cash contribution (borrowed funds plus equity) had been increased by $2,000 to $26,100 but the only change from the previous

Nevertheless, Hoffman's calculation was also used by Hoffman's lawyers, accepted implicitly by defendant's counsel and by the trial judge. As a result, the fundamental misunderstanding between Red Owl officials and Hoffman was never made clear to the jury. *See* TAN *infra*.

[48] Record at 223.

[49] Exhibit 33.

plan was to increase the "profits" from selling the lot from $4,000 to $6,000.

Shortly after receiving this proposal, Hoffman called Lukowitz and told him of the new arrangement he had made with Simon Vanden Heuvel to secure $13,000. Lukowitz replied, "This is good. I'm sure that we can go ahead at this point."[50] He then passed on this latest information to the Red Owl front office in Minneapolis. Two days later, Lukowitz called to arrange a meeting at the end of January with Carlson and Walker at the Red Owl store in Appleton. Prior to that meeting Lukowitz and Hoffman met to discuss the new arrangement in more detail. Upon learning of the terms for Vanden Heuvel's contribution, Lukowitz suggested, "Let's not go into the partnership with the front office. After it is all done, you can take your father-in-law in the way you want."[51]

5. The January 26 financing proposal

On January 26, 1962, Hoffman met Carlson, Walker and Lukowitz at the Appleton store. One of the Red Owl people said, "We are ready to go forward" and showed Hoffman a final financing proposal,[52] one that addressed Red Owl's continuing concerns about approving Hoffman for a franchise: the high debt to equity ratio reflected in Hoffman's proposed contribution to the enterprise. The solution was to have the $13,000 loan from Simon Vanden Heuvel subordinated to general creditors.[53] Without a subordination agreement, the $13,000 (whether considered an unsecured debt or a contribution to equity) would have reduced Hoffman's equity contribution to $9,000. But with a subordination agreement in place, Hoffman's equity would remain at $22,500 and his cash position would be significantly enhanced. The additional $6,000 from Simon together with a further proposed bank loan of $2,000 would increase the cash available to fund operations from $62,500 (as reflected in the previous plan) to $70,500. This latest (and last) plan listed Hoffman's equity contribution as essentially un-

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[50] Record at 149.

[51] Record at 186. Notwithstanding his trial testimony (which we must assume that the jury believed), in deposition, Hoffman was asked: "To whom in the Red Owl organization did you tell that your father-in-law had to be a partner?" Answer: "I don't know if I ever told anybody."

[52] Exhibit 34.

[53] Red Owl had prepared a subordination agreement that was also delivered to Hoffman to be signed by his father-in-law. *See* Exhibit 46.

changed at $22,500, consisting of $5,000 in cash and $17,500 in bakery equipment.[54]

From Hoffman's perspective, however, this latest plan required $8,000 more in borrowed funds, bringing to $34,000 the combined total of debt and equity. He had two objections to the plan. The first revealed clearly the divergence in the parties' understanding of the transaction: Hoffman felt that with the additional cash from his father-in-law and the new bank loan of $2,000 he should not be required to borrow $8,000 from the Chilton bank secured by his equity in the bakery equipment. Frank Walker, the senior Red Owl officer, attempted to reassure him that the additional $8,000 in cash to begin operations was for his benefit and was not an increase in his equity contribution. After all, Hoffman had complete control over those borrowed funds. "It's your money" Walker said, "It isn't ours." He tried again: "Joe, if after a reasonable length of time these funds aren't used, pay them back to the bank."[55] Hoffman was adamant in reply, "My father-in-law won't let me be in debt." That was the end of the meeting.

It seems plain, in retrospect, that Hoffman's real objection had to do with his personal relationship with his father-in-law, who appears to have been a prosperous, but stern, Calvinist. Hoffman could not borrow the $8,000 from the Chilton bank because his father-in-law didn't believe in debt. He could not propose to his father-in-law that his $13,000 contribution be subordinated to creditors and treated legally as a gift because his father-in-law was sufficiently skeptical about Joe's business acumen that he wanted to have some control over his money. As a consequence, despite Lukowitz' urging, Hoffman never even asked his father-in-law to sign the proposed subordination agreement. He returned home and called Walter Hall, the development officer, in Minneapolis to complain. Hall admitted "this thing has gotten a little goofed up." But when Hoffman asked "what about a smaller store," Hall replied "It's this store or none and that's it..."[56] Finally, on February 2, 1962 Hoffman wrote to Lukowitz: "After doing my utmost to put this together for 2½ years, it seems to me Red Owls'[sic] demands have gotten beyond my power to fulfill. Therefore, the only thing I can do at this time is drop the entire matter and try to make up the losses I suffered, due to your ill-advice." [57]

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[54] *Id.*

[55] Record at 333.

[56] Record at 156.

[57] Exhibit 35.

The Trial

Joseph Hoffman's plan to "make up" for the losses he had incurred from the failed negotiations with Red Owl officials was to consult legal counsel and ultimately to sue Red Owl and Lukowitz for damages arising out of his reliance on their representations made during the negotiation process. A year and a half later, on October 21, 1963 at 9:30 a.m., trial was begun in the Circuit Court of Outagamie County in the City of Appleton, Wisconsin. The presiding judge was A. W. Parnell. Representing Joseph and Shirley Hoffman was G.H. Van Hoof and John Wiley of the firm of Van Hoof & Van Hoof of Little Chute, Wisconsin. Representing the defendants, Red Owl Stores, Inc. and Edward Lukowitz, was David Fulton of the firm of Benton, Bosser, Fulton, Menn and Nehs of Appleton.[58]

The word "promise" was not uttered during the trial. The plaintiffs' theory of the case was that a representation made by the defendants on which Hoffman reasonably relied to his detriment was actionable without more. As Hoffman's attorney argued to the court following the conclusion of the trial: "It is our position that if Mr. Hoffmann acts in reliance on any representations, statements or misconduct, we don't care if it ever results in a final contract. Our position is that they are then liable for damages, regardless, because they have jockeyed him out of position." In response, the court replied: "I don't think what you are saying makes legal sense—if you will pardon me. In other words, they had to make a material representation that if he would do certain things the end result would be they would give him a store in Chilton. Unless there is a *promise* all the representations in the world wouldn't make any difference. If they are dealing at arm's length, without any eventual *promise* to do anything on the part of Red Owl, it doesn't make any difference what they represented to him."[60]

Here was the big opening for Fulton, the defendants' lawyer, to press the point that there were no grounds for misrepresentation liability whether in tort or contract in the absence of a legal duty owed to the plaintiffs. In the absence of a promise conditioned on such a misrepresentation there was no duty in contract. Moreover, courts generally hold that there is no tort duty of care owed to a commercial party

[58] Record at 77.

[60] This is the only time in the entire proceedings that the word "promise" was spoken. Record at 439–40(emphasis added) .

engaged in arm's length negotiations.[61] Nor have courts in the United States recognized a duty to bargain in good faith, much less a duty to bargain carefully to avoid careless but non-willful misrepresentations. Mistake, in other words, is relevant generally only if the parties have already formed a contractual relationship.[62]

But Fulton, as he had throughout the trial, chose to rest on a single argument: The negotiations were too indefinite to form a contract and absent a contract there was no basis for liability. This might well have been true, but Fulton did not educate the court as to why it was so. Nor did he try to narrow the scope of the special verdict that permitted the jury to find liability based on innocent misrepresentations that were relied upon. Thus, the issue of mutual misunderstanding—that neither party knew or had reason to know the meaning attached by the other to the representations about Hoffman's capital contribution—was not put before the jury.

In consequence, the court prepared a special verdict that took the contract question away from the jury but left them with the task of determining: 1) were representations made by Red Owl officials that if Hoffman fulfilled certain conditions a deal for a franchise store would be concluded?; 2) Did Hoffman reasonably rely on those representations? 3) Was it reasonable for Hoffman to so rely? 4) Did Hoffman fulfill all the conditions required by the terms of the negotiations? And 5) what sum of money would reasonably compensate Hoffman for the sale of the Wautoma store, the bakery building, the option on the lot, moving to Neenah and the rental of a house in Chilton? [63]

Subsequently, when instructing the jury, the court used the subjective/objective test of reasonable reliance usually reserved for fraudulent misrepresentation. Judge Parnell told the jury to determine the reasonableness of Hoffman's reliance by taking into consideration Hoffman's experience, his education and all other circumstances. Thus, the question was not whether a reasonable person would have so relied, but whether a person of like business experience, knowledge and background acting under the same circumstances would have relied.[64]

Following the court's instructions, the jury retired at 12:06 p.m. to elect a foreman and have lunch. They returned with their verdict at

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[61] *See* RESTATEMENT (FIRST) OF TORTS §762 (1939).

[62] There are exceptions, most notably the construction bid cases such as Drennan v. Star Paving, 333 P.2d 757 (1958). *See* Mark P. Gergen, *Mistake in Contract Formation,* 64 S. Cal. L. Rev. 1, (1990).

[63] Record at 26–28.

[64] Record at 448–51.

4:27 p.m., having eaten lunch and elected Abe Golden as foreman. The jury found for Hoffman on all the specific questions and fixed damages at $140 for the moving expenses, $125 for the house rental, $1000 for the option on the lot, $2,000 for the sale of the bakery building and $16,735 for the sale of the Wautoma store. Given that these items sum to $20,000, and given the short time for deliberation, it seems plausible that the jury decided that $20,000 would be the right amount to punish Red Owl for disrespecting one of their fellow citizens and then simply designated the balance of the "damages" to losses arising from the premature sale of the Wautoma store after making specific findings on the other items. In any event, there was no evidence introduced that would have supported the $16,735 figure reached by the jury.

Judge Parnell immediately questioned whether there was any evidentiary basis for that finding and dismissed the jury with his thanks.[65] The defendants' filed a motion for judgment not withstanding the verdict on the ground that the evidence was insufficient as a matter of law to support Red Owl's liability and, in the alternative, to reduce the awards for losses on the sale of the store and bakery building to such sums as an unprejudiced jury could have awarded or, in the alternative, to grant defendant a new trial on the issue of damages.

On March 16, 1964 Judge Parnell entered his order on the motion for judgment. He affirmed the jury verdict in all respects save damages, in particular the claimed losses in the sale of the Wautoma store. There he found the award of $16,735 against the weight of the evidence, wholly without foundation or support and contrary to the instructions of the court. Thus, he ordered a new trial on the sole issue of damages for loss, if any on the sale of the Wautoma inventory and fixtures. Red Owl appealed the court's decision affirming the jury verdict to the Supreme Court of Wisconsin and Hoffman appealed that portion of the order that reversed the verdict on damages.[66]

The Appeal

1. The appeal briefs

Red Owl's brief to the Supreme Court of Wisconsin raised three substantive issues. First, Red Owl argued there should be no recovery as a

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[65] There seems more than a little irony in his final statement to the jury that: "I know that it has been a long and protracted case and called for considerable patience on your part, and sacrifice and considerable effort, as is evidenced by the fact that you have been out all afternoon on the verdict."

[66] Red Owl perfected its appeal to the Supreme Court of Wisconsin from the Order on Motions after Verdict on June 25, 1964.

matter of law in contract because, as found by the trial court, the statements made by Red Owl representatives were preliminary negotiations and any statements made during the negotiations were too uncertain or indefinite to be the basis for finding an enforceable contract claim. Second, recovery could not be had under a theory of estoppel in pais since, under Wisconsin law, equitable estoppel can be used only as a shield—to prevent the defendant from denying that a particular fact is true—and not as a sword to create a right of recovery that does not exist in the first instance. Third, the plaintiff could not recover on the basis of promissory estoppel because there were no representations definite enough to qualify as "promises" within §90 and, in any event, plaintiff suffered no injustice since the reason the deal fell through was Hoffman's refusal to present the subordination issue to his father-in-law.[67]

In response, Hoffman's lawyers primarily rested their case, as they had at trial, on the theory of equitable estoppel. They argued that, in light of the misrepresentations of its agents, Red Owl was estopped from claiming that there was no contract.[68] They also argued for an implied-in-fact contract on the grounds that Hoffman would not have done the things he did had there not been a contract to award him the store.[69] Finally, they claimed a right to damages on the basis of promissory estoppel, simply ignoring the appellant's argument that promissory estoppel is available where there is a promise but no consideration, but is not available when there is no promise in the first place.[70]

2. The decision of the Wisconsin Supreme Court

Writing for a unanimous court, Justice Currie ignored the issue of equitable estoppel and focused exclusively on the promissory estoppel argument. The Court asked: Should the doctrine of promissory estoppel as embodied in Restatement §90 be recognized and, if so, is it satisfied here? The court held that this issue was squarely presented since "no

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[67] With respect to damages, Red Owl claimed that the award of $16,735 was reached by merely subtracting awards for moving expenses, rent of a house in Neenah, sale of the bakery building, option on the lot, from a gross figure of $20,000, demonstrating that the jury pulled the figure out of the air. There was no evidence of loss of bargain in the June sale of the grocery business and thus it was error to remand for a new trial.

[68] Appellee's brief at 23.

[69] *Id.* at 19–20.

[70] With respect to the promissory estoppel claim, the appellee's brief simply quoted from Restatement of Contracts §90, Ill. 3 that if "*A* promises *B* that if *B* will go to college and complete his course he will give him $5,000 and *B* does so: Then *A*'s promise is binding." *Id.* at 24.

other possible theory has been presented to or discovered by this court which would permit plaintiffs to recover."[71] Promissory fraud was the only other possible theory the court could imagine might cover this case, but the court held that such action would not lie absent a present intent by Red Owl not to fulfill a promise at the time it was made. The court rejected the possibility that Red Owl had made any of its "promises" in bad faith or with a present intent not to perform.

Turning then to §90, the court endorsed and adopted the doctrine of promissory estoppel and found ample evidence of all of its elements to support the jury verdict. Indeed, the court identified a number of "promises and assurances" made by Red Owl representatives, the foremost being the promise by Lukowitz "that for the sum of $18,000 Red Owl would establish Hoffman in a store."[72] The court adopted Hoffman's claim that, after the store was sold and the lot purchased, the $18,000 figure was changed to $24,100, then increased to $26,100 with the assurance that the deal would go through, then Hoffman was induced to sell his bakery building on the assurance that this was the last necessary step but instead the figure was increased yet again to $34,000. Based on these findings, the court concluded that there was ample evidence to sustain the jury's findings that the promissory representations made by Red Owl were reasonably relied upon by Hoffman to his detriment.

The court then turned to the central question raised by Red Owl on appeal—that the representations made by Lukowitz were simply too uncertain and indefinite to form the basis of contract liability. Under the indefiniteness doctrine, a representation does not qualify as a promise if the undertaking is uncertain or unclear or if key material facts essential to that undertaking have not been specified. The court conceded that many factors were never agreed upon, including the design, layout, and cost of the store, who the builder would be, the price the builder would pay for the land and the resulting rental, the term of the franchise and the renewal and purchase options. All of these con-

[71] Given that the plaintiff's primary theory at trial and on appeal was equitable estoppel, this is a most peculiar statement, only exceeded by the following "the trial court frame[d] the special verdict on the theory of sec. 90 of the Restatement." In fact, the word "promise" was never uttered during the trial testimony or in the court's instructions to the jury, not to mention "§90" or "promissory estoppel."

[72] This statement by the court is not supported by the record, even as it was edited for the appeal. Hoffman testified only that Lukowitz assured him that $18,000 was a sufficient amount to secure a franchise. There was no testimony that Lukowitz ever said that in return for an $18,000 contribution "he would establish Hoffman in a store."

siderations are what led the trial court to conclude as a matter of law that the parties negotiations were preliminary and could not form the basis for a contract. But, the appellate court held, a promise sufficient to sustain a claim in promissory estoppel need not be the equivalent of an offer that would result in a binding contract if accepted.[73]

Finally, the court turned to the issue of damages and here it affirmed the trial court's order of a new trial on the issue of damages for the premature sale of the Wautoma store. The court held that since recovery was had under §90, Hoffman's damages should not exceed his actual reliance losses suffered by the sale and thus the evidence did not sustain the $16,735 jury award.

The Hoffman Saga as a Cautionary Tale

Even with the facts as found by the court, grounding Red Owl's liability on a promissory estoppel theory is simply untenable as a matter of contract doctrine. Nothing in the law of contracts supports the court's legal analysis. To the contrary, the Restatement of Contracts has only one definition of a promise, and that definition applies equally to a promise that is the product of a bargained-for exchange and a promise for which enforcement is sought on the grounds of induced reliance.[74] The doctrine of indefiniteness holds that, for a representation to qualify as a promise, it must be sufficiently clear and definite that it justifies the promisee in believing that a commitment has been made. If the terms of a manifestation of intent are uncertain or indefinite, then, by definition, it fails to qualify as a promise.[75] If neither party has made a promise, there is no claim under §90. Rather, the parties initial communications to each other fall in the category of unenforce-

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[73] Specifically, the court held that:

> If promissory estoppel were to be limited to only those situations where the promises giving rise to the cause of action must be so definite with respect to all details that a contract would result were the promise supported by consideration, then the defendant's promises to Hoffman would not meet that test. However, §90 of the Restatement does not impose the requirement that the promise giving rise to the cause of action must be so comprehensive in scope as to meet the requirements of an offer that would ripen into a contract if accepted by the promisee. *Id.* at 275.

[74] *See e.g.,* RESTATEMENT (SECOND) OF CONTRACTS §§2 and 90 (1979) [hereinafter RESTATEMENT]. (Restatement §2 defines a *promise* as a manifestation of an intention to be bound so made that it justifies the promisee in believing a commitment has been made. Restatement §90 begins "A *promise*....").

[75] RESTATEMENT §33.

able preliminary negotiations. Hoffman thus is wrong as a matter of contract doctrine.

1. Are there any theories on which liability could be based?

Some scholars have suggested that the opinion in Hoffman can be grounded on a duty to negotiate in good faith.[76] Putting aside the difficulties inherent in applying such a standard, there is simply no evidence of any bad faith by any of the Red Owl officials. At most Lukowitz was careless in his initial representation because he did not inquire further as to what Hoffman meant by his statement that he had about $18,000 to contribute. But, if anything, Hoffman was much more careless. Certainly, he could see by September 1961, when he was handed a proposed financing plan, that what he was to contribute was "equity" of at least $18,000. While the proposed cash requirements for the franchise did increase over time, the equity requirements remained largely fixed and the additional proposals for cash were loans that Hoffman was free to repay if he didn't need the cash flow for his grocery business.[77]

Moreover, Red Owl's continued insistence that Hoffman make a substantial equity contribution to the franchise reflects perfectly appropriate business judgment. The risk in any franchise contract is that the interests of the parties will be misaligned and, as a consequence, the franchisee may manage its operation in a manner inconsistent with the interests of the franchisor. A widely recognized conflict that arises with excessive debt financing is that the agent may be motivated to increase the riskiness of his management of the franchise. By "putting all his eggs in one basket," the agent can gamble with the borrowed funds. If the venture is successful, all the returns in excess of the fixed debt accrue to the agent. But if the venture fails, the agent shares the

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[76] *See, e.g.,* Duhl, *supra* note 6, at 315–21; PATRICK ATIYAH, PROMISES, MORALS, AND LAW 80-92 (1981); Charles Knapp, *Enforcing the Contract to Bargain,* 44 N.Y.U. L. Rev. 673, 686–90 (1969); Robert Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code,* 54 Va. L. Rev. 195, 225 (1968).

[77] Red Owl was appropriately concerned that Hoffman have sufficient cash on hand to begin operations, since a failure of a new franchise store would adversely affect the Red Owl brand. Lukowitz testified that the proposed increase in cash reflected in the January financing plan was prompted by Red Owl's experience in opening new franchises and finding that additional cash was often needed to "get them off the ground, especially if you are new in a location." This additional cash was intended "for the protection of the operator." Record at 307.

loss with his creditors.[78] Red Owl, therefore, was properly concerned about avoiding this problem by working toward a jointly beneficial financing plan, one that protected their brand name from the possibility that its value would be diluted by Hoffman's risky business decisions.

Mark Gergen and others have suggested that the best theory of liability is negligent misrepresentation.[79] But there are many problems applying this theory to arm's length bargaining contexts. Many courts don't recognize this tort at all[80] and the Restatement rule requires that the party making the statement owe a duty to the plaintiff to supply correct information to him.[81] Because casual statements and contacts are prevalent in business, under the majority rule in commercial contexts, liability for negligent misrepresentation is imposed only where the party making the statement possess unique or specialized expertise or is in a special position of trust and confidence with the injured party such that reliance on the negligent misrepresentation is justified.[82] It has been specifically held, for example, that a franchisee could not maintain an action for negligent misrepresentation where the franchisor was not in a business of supplying information.[83] Moreover, a claim for negligent misrepresentation ordinarily cannot be based on unfulfilled promises or statements as to future events. Finally, recovery of purely economic loss for negligent misrepresentation is available only

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[78] For discussion, see Robert E. Scott, *A Relational Theory of Secured Financing,* 86 Colum. L. Rev. 901, 919-22 (1986).

[79] *See, e.g.,* Mark P. Gergen, *Liability for Mistake in Contract Formation*, 64 S. Cal. L. Rev. 1, 34–36 (1990); CHARLES FRIED, CONTRACT AS PROMISE 24 (1981).

[80] *See, e.g.*, Haigh v. Matsushita Elec. Corp., 676 F. Supp. 1332 (E.D. Va. 1987) (applying Virginia law).

[81] Under Restatement (Second) of Torts §552, an action for negligent misrepresentation lies only against one "who in the course of his business or profession, or in any other transaction in which he has a pecuniary interest supplies false information for the guidance of others in their business transactions..."

[82] *See, e.g.*, Eternity Global Master Fund, Ltd. v. Morgan Guar. Trust Co., 375 F.3d 168 (2d Cir. 2004). Thus, many courts hold there is no tort of negligent misrepresentation in the vendor/purchaser context. The key to the tort is that plaintiff must allege and prove that the defendant owes a duty to plaintiff to communicate accurate information. Thus, plaintiff must show that defendant either was in the business of supplying information or that defendant had a pecuniary interest in plaintiffs transaction with a third party. Continental Leavitt Communications, Ltd. v. Paine Webber, Inc., 857 F. Supp. 1266 (N.D. Ill 1994); American Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988).

[83] Bonfield. v. AAMCO Transmissions, Inc. 708 F. Supp. 867 (N.D. Ill. 1989).

when there is a special relationship between the parties or when the representation is made by one in the business of supplying formation for the guidance of others.[84]

A final theory of liability is recovery in quasi-contract for unjust enrichment. Here the argument would be that Hoffman conferred a benefit on Red Owl during the period from May through November when he purchased and then sold his grocery store, sold the bakery building and purchased an option on the lot in Chilton. All these actions gave Red Owl some further indication of the kind of franchisee that Hoffman was likely to be—was he enterprising and resourceful or was he a bit of a doofus? Quasi-contract claims based on unjust enrichment rarely succeed, however, unless the defendant specifically and wrongfully induced the benefit. A quasi-contract claim does not lie simply because one party benefits from the efforts or obligations of others, but instead "it must be shown that a party was unjustly enriched in the sense that the term 'unjustly' could mean illegally or unlawfully."[85] This at least puts the key question to a court: Was Hoffman induced to provide information to Red Owl by trick or was he a "mere volunteer"?

The trial transcript strongly suggests that Lukowitz was trying to mediate between Hoffman's meager capital assets and the home office's capital requirements. The facts as found by the court show only that Lukowitz was eager to secure a franchise for Hoffman, no doubt because he would earn a commission if the deal went through. The steps that he urged Hoffman to take—selling the store, buying the lot and moving to Neenah—all seem designed to accelerate the approval process, not to induce an unbargained-for benefit for Red Owl. Under the circumstances, then, shouldn't Hoffman have been more cautious in nailing down exactly how much capital he would have to provide prior to buying the grocery store, selling the store, selling his bakery, and buying an option on a lot?

Jason Johnston has argued that Red Owl might properly be held liable if the facts showed that Red Owl had a low opinion of Hoffman's prospects as a franchisee but hid that fact from Hoffman and instead encouraged his subsequent actions to see whether—against the odds—

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[84] Gebrayel v. Transamerica Title Ins. Co., 888 P.2d 83 (Or. 1995); Continental Leavitt Communications, Ltd. v. PaineWebber, Inc. 857 F. Supp. 1266 (N.D. Ill. 1994).

[85] *See, e.g.*, First National Bank of St. Paul v. Ramier, 311 N.W. 502, 504 (Minn. 1981); Greg Fimon v. Kenroc Drywall Supplies, Inc., 203 Minn. App. Lexis 311 (Minn. 2003).

he turned out to have better talents than they initially believed.[86] The problem with this argument is that the facts simply belie that story. The evidence shows that Red Owl officials worked hard to find a way to stretch what they discovered to be Hoffman's meager capital so as to make the franchise deal work. The series of financial proposals from September 1961 to January 1962 were motivated less by Red Owl's escalating financial requirement than by Hoffman's frequent shifting of his capital. That the deal broke down is more a function of the thin margin on which Hoffman was operating than any attempt by Red Owl to disguise their pessimism about the proposed transaction.

2. What about "fundamental fairness"?

But, as others have noted, there is a highly salient aspect to the Hoffman story–the evident disparity in income, education and business acumen between Joe Hoffman and the Red Owl corporate officers. Is *Hoffman v. Red Owl* simply a case about fundamental fairness—one where the search for a strong doctrinal justification for liability is beside the point? In Peter Linzer's words, this may be a case for "rough justice" and not for doctrinal niceties.[87] The story of the hometown "little guy" pitted against a large, impersonal and out-of-state corporation certainly seems the best explanation for the jury verdict, but more, surely, is required from the Wisconsin Supreme Court. And, the truth is that the facts as revealed at trial simply do not support the fairness claim. Nowhere in the record, for example, is there any testimony that Lukowitz said what was attributed to him by the Wisconsin court nor were Hoffman's proposed equity contributions ever substantially increased as the court implied.

The testimony is that Hoffman said to Lukowitz and his associate at the May 1961 meeting, "Fellows, you know how much money I got—approximately $18,000. Will this put me in a bigger operation or won't it?" And Lukowitz then responded that an investment at that level "would not be a problem."[88] At most this is a representation that $18,000 of capital is enough for one to be established in a store assuming all other details are ironed out. In addition, the capital requirements for Hoffman were not increased in the manner the court suggests. As indicated earlier, Hoffman's proposed equity contribution

[86] Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 Va. L. Rev. 387, 496-99 (1999) (suggesting that Red Owl should be found liable if it misrepresented its relative optimism about the deal in order to learn more about Hoffman as a potential manager).

[87] Linzer, *supra* note 6, at 719–20.

[88] Record at 86.

changed from $18,600 in the first financial proposal in September to $22,100 in the second proposal in November. This change was apparently motivated by the fact that the bakery building was encumbered (contrary to Hoffman's earlier representation) and the resulting need to shift the focus of Hoffman's proposed equity contribution to the bakery equipment. Thereafter, Hoffman's equity contribution remained essentially unchanged through the third and fourth financing proposals in December and January.

To be sure, Lukowitz did make two subsequent assurances—that with the additional $2,000 in promotion "the deal would go through," and that the sale of the bakery building in November "was the last step." But these statements were all made after the September meeting between Hoffman and Carlson and Hall from the home office. By that time, Hoffman knew well that their approval and not Lukowitz's was the key to securing the franchise. Given these facts, the question is not whether Hoffman was exploited by corporate barons (Lukowitz, after all, had less education than he did).[89] The real issue was whether Hoffman's understanding of the transaction was a reasonable one and, more importantly, was it the only reasonable one.

At the end of the day, imposing liability for precontractual reliance because one party failed to correct the other's misunderstanding has significant costs, especially if one believes that, ordinarily, precontractual negotiations are essentially truthful. Jason Johnston has argued persuasively that such "cheap talk" should not be subject to liability in the ordinary case because delay in reaching a deal is costly to the parties and thus negotiators already have incentives to communicate useful information.[90] There may be sound reasons to accept the costs of chilling future negotiations in order to prevent exploitation of the weak by the strong, but there is scant evidence of any exploitation in the negotiations between Joseph Hoffman and the representatives of Red Owl Stores.

3. Lawyering matters: Arguments that Red Owl failed to pursue

One lesson from a close review of the *Hoffman* case is that the quality of legal argument matters. The record of the case reveals much to criticize about the way Red Owl's attorneys defended their clients.[91] In

[89] Lukowitz had a high school degree; Hoffman had a year of business and management courses at a local business college. Record at 78.

[90] Johnston, *supra* note ●, at 418-39

[91] [Among other dubious trial tactics, Red Owl's attorneys responded to the plaintiffs' request to call Carlson, Hall and Walker as adverse witnesses by instructing the Red Owl home office personnel not to be present in court during

particular, they failed to raise three issues, either at trial or on appeal, that seem quite cogent given the trial testimony. First, did Lukowitz have apparent authority to make financial representations? This question is particularly important once the chronology is clear. According to Hoffman, Lukowitz made his first representation in May when he assured Hoffman that $18,000 would be a sufficient capital investment. In September, Hoffman met with Carlson and Hall and, by then, he was aware that they were the parties who would negotiate the financial terms of the transaction.[92] In the interim, the only actions Hoffman plausibly took in reliance on the Lukowitz assurance were the sale of the grocery business in June and the purchase of the option on the lot in Chilton in September. But the moving expenses, the house rental in Neenah and the sale of the bakery building all occurred subsequently. There is no testimony that either Hall or Carlson made any similar representations to Hoffman. Thus, the one representation which Hoffman might reasonably assume Lukowitz was authorized to make was the initial assurance in May regarding the minimum "capital" requirements for a franchise, and, as suggested earlier, the parties attached different meanings to this assurance.

the plaintiffs' case in chief. Thus, the following colloquy occurred in the presence of the jury:

> Mr. Van Hoof (Hoffman's attorney): I would like to call Mr. Carlson adversely.
>
> Mr. Fulton (Red Owl's attorney): Carlson is not present.
>
> Mr. Van Hoof: I would like to call Mr. Hall adversely.
>
> Mr. Fulton: He is not present
>
> Mr. Van Hoof: I would like to call Mr. Walker adversely.
>
> Mr. Fulton: He is not present.
>
> The Court: Did you make a request to have them present?
>
> Mr. Van Hoof: They are out of state, and I couldn't subpoena them.
>
> Record at 344-45.

It is hard to imagine any more powerful way in which Hoffman's attorney could have emphasized to the jury that this was a case of a native son of Wisconsin who was in a dispute with out-of-state corporate big-wigs who were too busy to even show up to hear what Hoffman had to say.

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[92] RESTATEMENT, SECOND, AGENCY §136(1) provides that an agent's apparent authority is terminated (a) when the principal states such a fact to the third person." Thus, the key question was whether Hall and Carlson indicated directly or indirectly to Hoffman that Lukowitz had no authority to make financial representations on behalf of Red Owl. Clearly, Hoffman had reason to know that this was so.

Second, was Hoffman's reliance reasonable? At the September meeting with Hall and Carlson, and thereafter until he broke off negotiations, Hoffman never asked the Red Owl home office people to confirm his understanding about the source of funds for his contribution or to explain what Red Owl meant by its assurance that $18,000 would be a sufficient capital investment. This silence is all the more puzzling since Hoffman saw four different financing proposals, each of which specifically listed "Equity Capital (Amount owner has to invest)" as a separate line item apart from "Loans."[93] To be sure, the reasonableness of Hoffman's reliance was a question of fact for the jury. But recall that the trial court instructed the jury on the subjective/objective test of reasonable reliance, one that required the jury to assess Hoffman's behavior against the standard of a person with similar education, business experience and acumen rather than the purely objective standard of the reasonable person. This more forgiving test of reasonable behavior is properly applied to fraud, duress and other intentional acts but not to a promissory estoppel or a negligent tort theory of the case. Thus, Red Owl's attorneys had an opportunity to object to that instruction and thereby challenge the reasonableness of Hoffman's behavior on appeal.

Third, and most important, the transcript makes clear that the parties never had a mutual understanding about the meaning of the statement: "I have approximately $18,000—will this put me in a bigger operation or won't it?" The Red Owl representatives clearly meant that he would have to contribute equity of at least that amount and Hoffman clearly was focusing on how much cash he would put into the transaction, whether borrowed or not. Who is responsible for Hoffman's misunderstanding about the assurance that $18,000 of capital would be sufficient? The rule in contract negotiations is that each party is responsible for clarifying his understanding of the meaning the other attaches to ambiguous words and phrases, and this rule would strongly argue against liability in this case.[94] While the appellant's brief does point out that this ambiguity was unresolved, Red Owl's attorneys failed to tie this apparent misunderstanding to any legal conclusion and they raised the point only to show that the negotiations were ongoing and indefinite.

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[93] *See* Exhibits 32, 33, 34 & 39.

[94] RESTATEMENT (SECOND) OF CONTRACTS §20 provides "There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and (a) neither party knows or has reason to know the meaning attached by the other..."

One shouldn't be too hard on the attorneys for Red Owl, however. From their perspective there was no theory on which liability could properly be based as the law existed at the time. There was no justifiable claim for breach of a bargain contract because the representations were too indefinite to be a promissory commitment. For the same reason, liability could not properly be based on promissory estoppel. Equitable estoppel was inappropriate under Wisconsin law as it could not be used to create a right where none previously existed. And, there was then no cause of action in Wisconsin for negligent misrepresentation. Where Red Owl's lawyers failed, from the outset, was to present their clients' behavior and actions in a reasonable and defensible light. They could and should have elicited testimony about how hard everyone worked to make the negotiations succeed, and how it came to naught ultimately because of Hoffman's personal constraints: He needed Simon Vanden Heuvel's money to make the deal work and yet those funds came with strings attached that ultimately undermined the deal.

4. Epilogue

How was this dispute resolved and what happened to Joseph Hoffman? Professor Stewart Macaulay and his colleagues report that the parties settled the case for $10,600. Of that sum, $4,000 went for attorney's fees and the Hoffmans' retained the balance. Joseph Hoffman, meanwhile, became a very successful insurance salesman, wining several awards for sales volume. He and his family moved to Milwaukee where he rose through the ranks of the Metropolitan Life Insurance Company to become District Manager. Thereafter, he was transferred to Indiana and remained with the company in a managerial capacity. [96] Finally, why was Hoffman so restless and eager to escape the bakery business in the first place? Grant Gilmore reported some years ago that Hoffman's motivations may have been largely independent of Red Owl's representations: the poor fellow, he told me, was allergic to bread!

Whither the Law of Preliminary Negotiations and Preliminary Agreements?

How do contemporary American courts actually treat reliance investments made before the parties have written a complete contract? Alan Schwartz and I report the results of a study of recent litigation in

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[96] STEWART MACAULEY ET AL, CONTRACTS: LAW IN ACTION 403-4 (2D ED. 2003).

a forthcoming article.[97] We began with a sample of 108 cases litigated between 1999 and 2003.[98] Thirty of the cases raised the issue of reliance in the context of on-going negotiations. The underlying question in each case was whether the plaintiff could recover reliance costs if the parties had not yet reached agreement. The courts denied liability, whether premised on promissory estoppel, quantum meruit, or negligent misrepresentation, in 87% of these preliminary negotiation cases. The case data show that, absent intentional misrepresentation or deceit, there is generally no liability for reliance investments made during the negotiation process.[99]

In sum, courts will not grant recovery for "early reliance" unless the parties, by agreeing on something significant, have indicated their intention to be bound. Put more directly, the cases do not revolve around preliminary negotiations, but rather around preliminary agreements. Thus, for example, in the remaining seventy-eight cases in our sample, the parties had agreed on at least some material terms. In twenty-nine cases, the court denied recovery, even though the parties had reached agreement on some (or even most) terms, because the parties had indicated, either expressly or by implication, that they did not yet intend to be legally bound. In thirty-seven cases, the court held that the parties had made a complete contract, even though they contemplated a further memorialization of terms, because the evidence showed that the formal writing was not essential. Finally, and most interesting, in twelve cases involving agreements to agree, the court found a binding preliminary agreement to negotiate further in good faith. These latter cases are interesting because they are the forefront of an emerging rule governing preliminary agreements.

The common law has historically had great difficulty with preliminary agreements that expressed a mutual commitment on agreed terms but where significant additional terms remained to be negoti-

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[97] Alan Schwartz & Robert E. Scott, *The Law and Economics of Preliminary Agreements,* 120 Harv. L. Rev. — (2007).

[98] We examined all public data bases for preliminary negotiation and preliminary agreement cases proceeding under the following theories of liability: promissory estoppel, quantum meruit, implied contract, definiteness and intent to be bound. The final sample of 108 relevant cases represented 29 state jurisdictions, 19 federal district courts and seven federal courts of appeal.

[99] "It is fundamental to contract law that mere participation in negotiations and discussions does not create a binding obligation, even if agreement is reached on all disputed terms. More is needed than agreement on each detail, which is over all agreement to enter into the binding contract." Teachers Insurance & Annuity Association v. Tribune, 670 F. Supp. 491, 497 (S.D.N.Y. 1987); *See also* Reprosystem, BV v. SCM Corp., 727 F.2d 257 (2d Cir. 1984).

ated. Typically, parties have agreed to negotiate further over the remaining terms. These "agreements to agree" confronted the indefiniteness doctrine head on. Until recently, courts have held consistently that such "agreements to agree" were unenforceable so long as any essential term was open to negotiation.[100] The cases in our sample thus reflect a major shift in doctrine involving agreements to agree where key terms remain unresolved. The modern framework for determining intent in agreements to agree (as well as cases dealing with the timing of enforcement) was first proposed by Judge Pierre Leval in *Teachers Insurance and Annuity Association of America v. Tribune.*[101] The Leval framework has subsequently been adopted by the Second Circuit,[102] and is now followed in at least thirteen states, sixteen federal district courts and seven federal circuits.[103] The framework sets out a new default rule for cases where the parties contemplate further negotiations. This rule relaxes the knife-edge character of the common law under which agreements are either fully enforceable or not enforceable at all.[104]

Leval's framework relies on two distinct categories of preliminary agreements that will have binding force. The first (Type I) is a fully binding preliminary agreement. Here the parties agree on all the terms that require negotiation (including whether to be bound) but agree to memorialize their agreement in a more formal document. A Type I agreement binds both sides to their ultimate contractual objective just as if it were a formalized agreement, since the signing of a more elaborate contract is seen only as a formality. Thus, either party may demand performance of the transaction even though the parties fail to produce the more elaborate documentation of their agreement.[105]

The second and more interesting type of preliminary agreement (Type II) is a binding preliminary commitment which is created when the parties have reached agreement on certain major terms of the deal but leave other terms open for further negotiation. The parties to such an understanding "accept a mutual commitment to negotiate together

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[100] ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW AND THEORY 34–44, 322–25 (3d ed. 2002).

[101] 670 F. Supp. 491 (1987).

[102] Adjustrite Sys., Inc. v. GASB Business Services., Inc., 145 F.3d 543, 547-48 (1998).

[103] Schwartz & Scott, *supra* note 97, at ––.

[104] 145 F.3d. at 548.

[105] *Id.*; Gorodensky v. Mitsubshi Pulp Sales (MC), Inc., 92 F. Supp. 2d 249, 254-55 (S.D.N.Y. 2000)

in good faith in an effort to reach final agreement."[106] Neither party, however, has a right to demand performance of the transaction. Rather they have a legal obligation to attempt to negotiate the open issues in good faith within the agreed framework. If a final contract is not agreed upon, the parties may abandon the transaction. Our sample shows that the enforcement of these binding preliminary agreements is now well-accepted. Indeed, a federal court recently declared the enforcement of such agreements as "the modern trend in contract law."[107]

The preceding discussion demonstrates that scholars interested in commercial contracting should shift their focus from the largely irrelevant issue of precontractual reliance to the fundamental questions raised by the enforcement of these preliminary agreements. The emerging rule requires courts to resolve two key questions. When have the parties reached "an agreement" sufficient to impose a duty to negotiate in good faith? And, what behavior constitutes a breach of that duty? The current framework fails to provide much guidance in answering these questions.[108]

Indeed, we can't answer the legal questions until we first understand better the commercial behavior that has generated this litigation. The sheer volume of litigation over these preliminary agreements exposes a deep puzzle. Parties often write fully binding contracts before they invest in reliance. And, when they need to invest early prior to final contract they can (and do) contract directly on reliance. Yet these parties invest prior to final contract and they fail to contract specifically on reliance. Why do parties put themselves in this situation? And, finally, when negotiations break down and one party exits, when would the other party have a reasonable expectation of compensation absent an explicit promise to reimburse reliance expenditures? Schwartz and Scott provide one answer to this question,[109] but the aca-

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[106] Teachers Insurance & Annuity Association v. Tribune, 670 F. Supp. 491, 498 (S.D.N.Y. 1987).

[107] Beazer Homes Corp. v. VMIF/Anden Southbridge Venture, 235 F. Supp. 2d 485, 498 (E.D. Va. 2002).

[108] The multi-factored character of the Leval test confines the court's discretion more than a broad standard based on intent. But so long as the courts do not attach weights to the factors or otherwise specify the relationship between them, the factors may point in different directions and thus the test will lack transparency.

[109] Schwartz and Scott argue that the duty to bargain in good faith arises where one party promises to make a simultaneous investment prior to negotiating the remaining terms and thereafter delays its investment strategically. Under those circumstances, they argue that the party who invested first should

demic debate over the law of preliminary agreements is only just beginning. The delay in understanding this important and heretofore largely ignored area of commercial law is attributable, at least in part, to the myth of precontractual reliance and the unfortunate case of *Hoffman v. Red Owl Stores, Inc.*

be entitled to recover its reliance costs and a failure by the delaying party to bargain over the amount of those costs would qualify as a breach of the duty. Schwartz & Scott, *supra* note 97, at —.