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Contracts - Reservation of Power to Terminate Existing Contract

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not technically in custody, he is faced with a representative of the government who possesses an awesome array of coercive powers.[43]

An adversary process is begun when a special agent has entered an investigation, and it is submitted that it is logically irrelevant to distinguish the situation in terms of having a crime and seeking an offender, as opposed to having a suspect and trying to ascertain if a crime has been committed. In either instance, the investigation is conducted with an ultimate view to criminal prosecution and conviction. It is at this point, in keeping with the fundamental concepts of constitutional safeguards, that the taxpayer should be fully apprised of his fifth and sixth amendment rights. Custody provides a concrete point at which it can be said that the adversary process has begun, however, this not the only situation in which the investigative machinery of government is directed at a particular individual.*

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CONTRACTS—RESERVATION OF POWER TO TERMINATE EXISTING CONTRACT —The Pennsylvania Superior Court has held that a clause requiring written notice of termination within sixty days is satisfied by notice received two days beyond termination date.

Music, Inc. v. Henry B. Klein Co., 213 Pa. Super. 182, 245 A.2d 650 (1968).

Plaintiff contracted to provide defendant Klein programmed music service. The contract as quoted by the court provided:

> The term of this agreement shall be for three (3) years and eight (8) months from the date of installation and shall continue there-

43. *See, e.g.*, INT. REV. CODE of 1954, § 7602. (Statutory right to inspect books and records, etc.).

* During the writing of this casenote the IRS changed policy regarding constitutional warnings at the initial stages of a tax investigation. Now at an initial meeting with a taxpayer, an IRS special agent is required to identify himself, describe his function, and advise the taxpayer that anything he says may be used against him. The agent must also tell the taxpayer that he cannot be compelled to incriminate himself by answering any questions or producing any documents, and that he has the right to seek the assistance of an attorney before responding.

Previously, the special agent identified himself and described his function at the first meeting with a taxpayer, but was not required to give further advice unless the taxpayer was in custody or the investigation proceeded beyond the preliminary stage. See *Standard Federal Tax Reports*, 55 TAXES ON PARADE 54 (Nov. 1968).

> after for subsequent like periods unless at least (60) sixty days prior to the end of any term either party shall give the other written notice of desire to discontinue said service at the end of the current term.[1]

One day before the termination date, a Friday, defendant attempted to cancel the contract by written notice. The notice was received on the next business day, a Monday, two days beyond the termination date. Defendant had notified plaintiff of his desire to discontinue the service by telephone one day before the sixty day period. There was no provision in the contract making time of the essence.

The lower court held,[2] as a matter of law, that the notice of cancellation was effective notwithstanding the seemingly clear and unambiguous language requiring notice to be given sixty days before the contract's end. The Superior Court of Pennsylvania,[3] in affirming the lower court's decision, reasoned that:

> Absent a showing that appellant [Music, Inc.] was damaged in any way by receipt of the termination notice on October 3rd, or that he changed his position to his detriment, it would be unconscionable to hold appellee [Klein] to an additional contract of three years and eight months.[4]

It is essential to underscore the difference between time of the essence in the ordinary contract where the promisor has bound himself to perform within a stated period, and in an option contract where notice of intention to exercise the option is to be given within a stated time. In the former instance it is said that a court of equity will not view time as of the essence unless so stated in express terms, while at law time is generally of the essence.[5] It is the latter area with which this note is concerned.

Simply stated, the problem is whether or not a power to terminate an existing contract must be exercised within the period expressly provided in the contract. An early Pennsylvania case seemed to recognize the principle that where a certain time is designated within which to

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1. 213 Pa. Super. at 184, 245 A.2d at 651.
2. See n.1, at 184 of 213 Pa. Super. 182 and at 651 of 245 A.2d 650, which cited the unreported opinion of the County Court of Allegheny, filed February 7, 1968 at No. 595 of 1967.
3. Judge Spaulding wrote for the majority. Judge Montgomery concurred in the result. Judge Hoffman, with whom Judge Watkins joined, wrote a dissenting opinion.
4. 213 Pa. Super. at 186, 245 A.2d at 652.
5. Bellas v. Hays, 5 S. & R. 427 (Pa. 1819). This position has been criticized as nondescriptive by one writer. 5 A. CORBIN, CORBIN ON CONTRACTS § 713 (1952).

exercise an option, it must be exercised within that period.[6] In *Central Guarantee Co. v. Union National Bank*,[7] defendant was given an option to cancel the contract "at the end of the first year" which fell on July 1, 1923. The court held defendant's attempt to cancel on July 11, 1923, ten days after the termination date, ineffective, and reasoned: "We are of the opinion that time was of the essence in the provision of the contract as to the right of appellee to cancel, and that the question whether the notice of cancellation was given within a reasonable time is not involved in this case."[8] This result was expressly overruled by the instant case.[9]

Courts in other jurisdictions have treated language substantially the same as that in *Central Guarantee Co. v. Union National Bank* as giving the optionee a reasonable time after the expiration date to exercise the option.[10]

However, all courts seem to have consistently held that termination must be within the specified period where the clause has read "prior to,"[11] "within,"[12] or "on or before."[13] Indeed some courts have based their holdings on the difference in the language used in the termination clause.[14] In support of these holdings, the two leading writers in this area agree that time is nearly always of the essence in contracts containing options to cancel.[15]

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6. Markley v. Godfrey, 254 Pa. 99, 98 A. 785 (1916).

7. 92 Pa. Super. 70 (1927).

8. *Id.* at 75. For similar reasoning see: Farmers and Mechanics National Bank v. Central Guaranty, 241 S.W. 600 (Tex. Civ. App. 1922); Lewis-Hale Coal Co. Inc. v. Enterprise Fuel Co., 33 F.2d 727 (4th Cir. 1929); Monmouth County Electric Co. v. Consolidated Gas Co. of New Jersey, 83 N.J.L. 531, 83 A. 900 (1912); Santa Clara Properties Co. v. R. L. C. Inc., 32 Cal. Rptr. 333 (1963).

9. See n.4, at 186 of 213 Pa. Super. 182 and at 652 of 245 A.2d 650, where the court stated: "To the extent that *Central Guarantee Co. v. Union Nat'l. Bank*, 92 Pa. Superior Ct. 70 (1927), derogates from this opinion in that it makes time of the essence as a matter of law in such contracts, that opinion is overruled."

10. Central Guarantee Co. v. National Bank of Tacoma, 137 Wash. 24, 241 P. 285 (1925); Rogers v. Burr, 97 Ga. 10, 25 S.E. 339 (1895); Davis v. Godart, 131 Minn. 261, 154 N.W. 1091 (1915); McDougall v. O'Connell, 72 Wash. 349, 130 P. 362 (1913); Reitz v. Brouhard, 198 Iowa 37, 199 N.W. 420 (1924).

11. Fred-Mosher Grain v. Kansas Co-Op Wheat Market Ass'n, 136 Kan. 269, 15 P.2d 421 (1932).

12. Santa Clara Properties Co. v. R. L. C. Inc., 32 Cal. Rptr. 333 (1963).

13. First Securities Co. v. American Hecolite Denture Corp., 153 Ore. 499, 56 P.2d 339 (1936).

14. Central Guarantee Co. v. National Bank of Tacoma, 137 Wash. 24, 241 P. 285 (1925); First Securities Co. v. American Hecolite Denture Corp., 153 Ore. 499, 56 P.2d 339 (1936).

15. 6 A. CORBIN, CORBIN ON CONTRACTS § 1266, at 65 (1962). "The time and manner of exercising a power of termination may be specified in the contract; in such cases an attempt to exercise it otherwise will be ineffective." 6 S. WILLISTON, WILLISTON ON CONTRACTS § 853, at 222 (3d ed. 1962). "Time is likewise of the essence of options to termi-

The court in *Music* relied on three cases[16] for the proposition that notice given within a reasonable time after the contract date is sufficient absent a showing of prejudice to the other party. However as Judge Hoffman's dissent pointed out, this reliance is misplaced.[17] In *Central Guarantee Co. v. National Bank of Tacoma,*[18] the Washington court reasoned that the power to terminate a five year contract "at the end of the first year" could be exercised at any time during a reasonable period after the expiration of the year so that the optionee would have the entire year to decide whether or not to exercise the option. It observed, however, that an opposite result would be reached if the clause in question had been in the nature of an option which had to be exercised at some point prior to the last moment of the last day (the situation in *Music*) or if the language had been "within one year."[19]

Similarly, neither *Bennett's Inc. v. Krough*[20] nor *Mayhew v. Vanway*[21] supports the court's conclusion in *Music*. In both cases, the courts were willing to assume, for the purposes of arguement, that reserved options to cancel need not be exercised within the specified periods. They then proceeded to hold as a matter of law that even under such a construction of the termination clause, the delay in giving notice was beyond a reasonable time. Clearly, neither decision is authority for a conclusion that a clause compelling notification within a time certain is satisfied upon the receipt of notice within a reasonable time thereafter.

The majority in *Music* viewed the issue as appearing "to be one of first impression."[22] However, it is believed that the dicta in *Markley v. Godfrey*[23] and the compelling language in *Central Guarantee Co. v. Union National Bank*[24] provide sufficient precedential grounds upon which *Music* could have been decided. In any event, it is at least noteworthy that the court, while treating the issue as one of first impression, felt compelled to take the precaution of reversing *Central Guarantee*

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nate or cancel an existing contract, and the same principles apply." (Principles pertaining to ordinary contracts of option).

16. Central Guarantee Co. v. National Bank of Tacoma, 137 Wash. 24, 241 P. 285 (1925); Mayhew v. Vanway, 371 S.W.2d 90 (Tex. Civ. App. 1963); Bennett's Inc. v. Krough, 115 Colo. 18, 168 P.2d 554 (1946).
17. 213 Pa. Super. at 188, 245 A.2d at 653.
18. 137 Wash. 24, 241 P. 285 (1925).
19. 241 P. at 287.
20. 115 Colo. 18, 168 P.2d 554 (1946).
21. 371 S.W.2d 90 (Tex. Civ. App. 1963).
22. 213 Pa. Super. at 185, 245 A.2d at 652.
23. 254 Pa. 99, 98 A. 785 (1916). See text at note 6, *supra.*
24. 92 Pa. Super. 70 (1927). See text at note 8, *supra.*

in so far as it "derogates from this opinion in that it makes time of the essence as a matter of law in such contracts. . . ."[25] What appears more likely than a judicial belief that there was extant no sufficient precedent to decide *Music,* is that the court was straining to reach what it believed to be an equitable result not sanctioned by existing law. Notwithstanding the danger to the legal process that can occur if the courts fail to give the true reasons for their decisions, it remains to be seen whether the court has in fact reached a truly "desirable" result, and if so, whether or not there are precedents or logical reasons to support such a result.

As previously stated, a court of equity normally does not regard time as being of the essence unless stated in express terms.[26] However, even equity regards time of the essence in option contracts.[27] The rationale for this position is that if the concept of option is regarded as an offer, it must be accepted before its lapse; or if regarded as an express condition, it must be accepted in order to bind the other party.[28] The cases and writers in discussing the issue of a reserved power to terminate appear to have, without explanation, applied the general rules concerning option contracts.[29] It is believed that the continued failure to distinguish between these dissimilar situations is erroneous.

Certainly in the ordinary option contract where *A,* in return for a valuable consideration, is given a ten day option to purchase Blackacre, it cannot be said that a severe penalty or forefeiture results in denying *A* the right to purchase Blackacre on the eleventh day. *A* has received full value for his consideration and has tendered nothing additional which he must now forfeit.[30] Both a court of equity and a court of law are correct in treating time of the essence in such a situation and not extending *A*'s option to purchase Blackacre—something which the parties obviously did not intend.

Notwithstanding the authority noted above,[31] it is believed that a distinction can be drawn between the ordinary option contract and the situation in the instant case where, if the terminating party is not

25. See n.4, at 186 of 213 Pa. Super. 182 and at 652 of 245 A.2d 650.
26. Bellas v. Hays, 5 S. & R. 427 (Pa. 1819).
27. Ray v. Thomas, 191 Tenn. 195, 232 S.W.2d 32 (1950).
28. For a discussion on the subject *see* Corbin, *Option Contracts,* 23 YALE L.J. 641 (1913).
29. See notes 8, 10 and 15, *supra.*
30. See Corbin, *supra* note 27, at 660 for a discussion on the character of an option holder's interest.
31. See notes 8, 10 and 15, *supra.*

permitted to revoke within a very reasonable time after the termination date, he is made a party to another three-year, eight-month contract of which he wants no part. It has been suggested that time will not be of the essence where a severe penalty or forefeiture results.[32] Accordingly, it is strongly urged that to bind an unwilling party to a contract of such length is, to a certain extent, a severe penalty which a court of equity should avoid if possible. Judge Hoffman's dissent did point out that the terminating party "would still be entitled in the future to whatever benefits were conferred upon him by the contract."[33] However, if the delay was not an unreasonable one and cannot be shown to have resulted in any prejudice, a seemingly just conclusion is reached without such conceptual difficulty as to make the result untenable.

Indeed, with the facts before it, a court of equity might easily reach this result: the self-continuing contract was an extremely lengthy one, three-years, eight-months; the terminating party had given oral notice one day before the sixty-day period,[34] seemingly not too great a delay; and, most importantly, no prejudice was shown as a result of this delay. While these facts may serve to distinguish the present holding from subsequent cases, it is urged that a workable principle be evolved permitting equity to reach a desired result without distorting any basic contract principles.

This is not to suggest that the time period provided for in the cancellation clause be ignored in every case. If the parties intended to make time of the essence and this intention is clear from their language or the surrounding circumstances, unquestionably, it should be honored whether or not the exact provision to this effect is inserted. To do otherwise would be to enforce a different contract than that which the parties made. Of course if the other party is prejudiced by the tardy notice, he should be entitled to his lost profits for the renewal term.

The instant decision appears to go further than any modern case in relieving the terminating party from the automatic renewal provision of the contract. It seems clear that the precedent before the court

32. 5A A. CORBIN, CORBIN ON CONTRACTS § 1177, at 321 (1964).
33. 213 Pa. Super. at 188, 245 A.2d at 653.
34. However, Judge Hoffman's analysis and criticism of the majority's alternate holding "that notice on the first *business* day of the contract period satisfies the contract even under a strict construction" (See n.4 at 186 of 213 Pa. Super. 182 and at 652 of 245 A.2d 650) is quite convincing in that notice was received on the 58th day, a Monday, and that notice could certainly have been received by mail on the 60th day, a Saturday.

commanded a contrary result. While equity may well justify the result reached, the instant court has subjected its decision to critcism by reliance on seemingly inappropriate precedent rather than facing the problem before it. It is urged that with the reasoning set out above, the present case might have served as an appropriate vehicle to make a significant contribution in an area of the law which has developed on a matter-of-fact basis.

Charles J. Romito

TORTS—NEGLIGENCE—LIABILITY OF AN OCCUPIER—The California Supreme Court has stated that the proper test to be applied to the liability of a possessor of land is whether in management of his property he acted as a reasonable man in view of the probability of injuries to others, and plaintiff's status as a trespasser, licensee, or invitee is not determinative.

Rowland v. Christian, 70 Cal. Rptr. 97, 443 P.2d 561 (1968).

The Supreme Court of California had rejected the distinctions between trespasser, licensee, and invitee as determinative elements in deciding whether or not an occupier has been negligent in causing injuries to a person upon his land. Although section 1714[1] of the California Civil Code sets forth the standard of reasonable care under the circumstances, and there are no provisions in the code granting any exceptions to occupiers of land, California had heretofore made exceptions to section 1714 and followed the common law classifications of plaintiff together with the corresponding gradations of duty owed by an occupier.[2] In *Rowland*, the court declared that these exceptions were no longer justified, and that the proper test to be employed was whether in management of his property defendant had acted as a reasonable man in view of the probability of injuries to others. Section 1714 of the code so closely resembles the foundation of common law negligence that a study of the facts of this case and the doctrines

1. CAL. CIV. CODE § 1714 (West 1954), provides:
Every one is responsible, not only for the result of his willful acts, but also for an injury occasioned to another by his want of ordinary care or skill in the management of his property or person, except so far as the latter has, willfully or by want of ordinary care, brought the injury upon himself . . . .
2. Hansen v. Richey, 237 Cal. App. 2d 475, 46 Cal. Rptr. 909 (1965).