Essential Principles of Contract and Sales Law in the Northern Pacific: Federated States of Micronesia, the Republics of Palau and the Marshall Islands, and United States Territories and Political Entities

A dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy Degree in Judicial Studies

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Abstract

This text includes the general contract and sales law that applies in the geographic region identified as the Northern Pacific, including the Republics of Palau and the Marshall Islands, Hawaii, Guam, Commonwealth of the Northern Mariana Islands, American Samoa and in the Federated States of Micronesia. It then compares and contrast this regional substantive law to international standards governing contract and sales law.

It is unique in that it is the only text compiling in one source the current statutes and case law for contract and sales for Northern Pacific region through 2009. Although the focus of the text will be on those independent nations in the Northern Pacific that are developing their own unique substantive law identity, the text will also include a comparison to contract and sales law that is prevalent in the United States and applicable in its Northern Pacific State of Hawaii, and in its Pacific territories of Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

The book will emphasize any divergence and highlight regional anomalies in the substantive law of contract and sales. It will also examine the inter-relationship between customary and traditional law and the law of contract and sales. This anthropological approach will highlight how regional customary and traditional law have interacted with Anglo-American concepts of contract and sales law to produce a unique amalgam of contract and sales law in this Northern Pacific region.
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PREFACE

This text is dedicated to the memory of the late Professor Edward J. Murphy of the University of Notre Dame Law School who was one of the authors of *Studies in Contract Law*, 6th Edition (Foundation Press, 2003) and who was as a role model and mentor while I served as his research assistant during my formative years as a lawyer. I would also like to dedicate this text to the memory of Justice Wanis Simina of the Chuuk Supreme Court who passed away during the first session of the Pacific Islands Legal Institute in August 2003 and to American Samoa Associate Justice Anthony Sagapolutele, Marshall Islands Judge Billy Samson, and Pohnpei Supreme Court Justice Ioanis Kanichy who were also participants in the first session of the Pacific Islands Legal Institute and who have passed away in the interim. These judges were good friends and dedicated to establishing the rule of law and promoting justice in the Pacific islands.

This book was written as a dissertation in partial fulfillment of the requirements for a Doctor of Philosophy Degree in Judicial Studies from the University of Nevada, Reno. It was initially and particularly written to serve as a text or bench book for members of the Northern Pacific judiciary attending the Pacific Islands Legal Institute’s Contract and Sales class in Majuro, Republic of Marshall Islands in February 2005. The Pacific Islands Legal Institute was a continuing judicial education project coordinated by Peggy Vidal and William Brunson of the National Judicial College, supervised by U.S. 9th Circuit Court of Appeals Senior Judge J. Clifford Wallace and funded by the United States Department of the Interior and the United States Ninth Circuit Court of Appeals. The original materials were updated and presented to the U.S. Department of Interior,

The original participating members of the Pacific Islands Legal Institute were: High Court Chief Judge Carl Ingram, former Associate High Court Chief Judge Richard Hickson, Judges Billy A. Samson (deceased), Milton Zackios and Riley Albertter (retired to become Mayor of Majuro) from the Republic of the Marshall Islands; Associate Justices Anthony A. Sagapolutele (deceased) and Siaki Logoai from American Samoa; Judges Ronald Rdechor and Salvador Ingereklii from the Republic of Palau; FSM Supreme Court Chief Justice Andon Amaraich, former Kosrae Chief Justice Yosiwo P. George (former FSM UN Ambassador and current FSM Ambassador to the United States), Kosrae Chief Judge Aliksa B. Aliska, former Pohnpei Chief Justice Judah C. Johnny, and Pohnpei Supreme Court Justices Nelson A. Joseph and Ioanis Kanichy (deceased), Chuuk Supreme Court Justices Wanis Simina (deceased) and Machine O’Sonis, and Justice Mugunbay from the Yap Supreme Court. Participants in the Second Pacific Islands Legal Institute were American Samoa Associate Justices Saole Mila, Su’a Edmund C. Pereira, and Mamea Sala, Jr., Kosrae Judge Robinson Timothy, former Kosrae Judge Charolton Timothy, Kosrae Justice Ombudsman Marris Jackson, Marshall Islands District Court Judge Jimata Kabua, current Pohnpei Supreme Court Chief Justice Benjamin Rodriguez, Pohnpei Supreme Court Justice Nickontro Johnny, FSM Law Clerk Johnson Asher, FSM Supreme Court Justice Ombudsman John William, FSM Supreme Court Administrative Assistant to the Chief Justice Marlyn Tom, and Chuuk Supreme Court Justices Keske Marar and Camillo Noket. The participating judges of the Pacific
Islands Legal Institute are committed to implementing the rule of law in these developing Pacific Island nations and improving the quality of justice for their people. Some of their opinions are included in this text. I value their friendship developed over the years and greatly appreciate their assistance and input into this project.

Since it was first published, this text book has been used by the Pacific Islands Legal Institute, lawyers, law schools and judges in the region and has been cited as “an in-depth analysis of contract law in the North Pacific” by the Asian Development Bank (ADB), and as an authoritative “Pacific law text” by Globalex and NYU Law School, the Enterprise Research Institute (ERI), and other sources.¹

I also wish to thank Professors James Richardson and Richard Mason of the University of Nevada, Reno, Professors Kevin Govern and Patrick Quirk of Ave Maria Law School, former Professor Stephen Safranek of Ave Maria School of Law, former Ave Maria School of Law and current Campbell University School of Law Professor Kevin Lee, and Judge Adam Fisher for their review, guidance, constructive criticism, and other efforts as dissertation committee members in regard to this project. I also greatly appreciate the efforts of Sharon Sansoterra my former administrative assistant at Ave

¹ For example, this author’s original text published in 2005 has been listed as an authoritative source of Pacific Law in Section 4.4 Pacific Law Texts in Update: Introduction to Researching South Pacific Law by Peter Muratroyd which was published by NYU Law School and Globalex and that can be found at http://www.nyulawglobal.org/Globalex/South_Pacific_Law1.htm. For those not familiar with Peter Muratroyd, he is the former Law Librarian at the University of South Pacific in Port Vila, Vanuatu and is currently Information Resource Centre Manager at the Secretariat of the Pacific Regional Environment Programme (SPREP) and Coordinator of the Pacific Environment Information Network (PEIN). Mr. Muratroyd was a member of the working group that established Pacific Legal Information Institute (PacLII) and continues to offer support to PacLII. He has also been a contributing editor to WorldLII.org. This author’s original analysis of Palau’s legal system, property rights and contract law published in 2005 was quoted and cited as “an in-depth analysis of contract law in the North Pacific” by a subsequent Technical Assistance report prepared by the Asian Development Bank in Chapter 5. Issues Related to Palau’s Legal System and Property Rights, p. 28, fn 17, www.adb.org/Documents/Reports/PSA/PAL/Chap05.pdf.
Maria Law School for her word processing assistance. I also would like to thank my father, U.S. Sixth Circuit Court of Appeals Judge James L. Ryan, who has inspired, shared with and instilled in me his great devotion and appreciation of the substantive law of contract.

Additionally, I would like to acknowledge Chief Justice Andon Amaraich, Justices Dennis Yamase, Martin Yinug, and Ready Johnny of the FSM Supreme Court, former law clerk Tammy Davis, and current Law Clerk Larry Wentworth for their assistance regarding the materials from Micronesia. I would also like to thank High Court Chief Judge Carl Ingram, former High Court Judge Richard Hickson, and District Court Judge Milton Zackios from the Marshall Islands for their efforts regarding this project and the materials from the Marshall Islands. I am also extremely appreciative of the support of Chief Justice Arthur Ngitolksong, former Associate Justices Miller and Michelson, and the efforts of Emily Grant, former Senior Court Counsel of the Palau Supreme Court in regard to gathering case law and statutes from Palau.

I would also like to thank my wife, Mary Catherine, and my eight children for their patience, understanding, and support while I was undertaking this project.
INTRODUCTION

This text includes the general contract and sales law that applies in the geographic region identified as the Northern Pacific, including the Republics of Palau and the Marshall Islands, Hawaii, Guam, Commonwealth of the Northern Mariana Islands, American Samoa and in the Federated States of Micronesia. It then compares and contrast this regional substantive law to international standards governing contract and sales law.

It is unique in that it is the only text compiling current statutes and cases for contract and sales law through 2009 in one source for this particular region. Consequently, it is essential reading for members of the judiciary, academics, practitioners, law students, and businesses both within and outside the region.

Although the focus of the text will be on those independent island nations in the Northern Pacific that are developing their own unique substantive law identity, the text also will include a comparison to contract and sales law that is prevalent in the United States and applicable in its Northern Pacific State of Hawaii, and in its Pacific territories of Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands. Although substantive law in Guam, Hawaii, and the CNMI closely mirror the contract and sales statutes and case law in the continental United States, American Samoa

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2 Since the initial publication of this text, many of the cases cited are now available online. The only jurisdiction that does not have online accessibility is Palau. This text will still assist the reader in providing case descriptions since many of these websites simply list cases and do not contain a topical index or description of the case. The United States cases included in this text are available on Westlaw or Lexis. The American Samoa cases may be found at [www.asbar.org](http://www.asbar.org). The Marshall Islands cases may be located at [www.rmicourts.org](http://www.rmicourts.org) and the Federated States of Micronesia cases found at [www.fsmlaw.org](http://www.fsmlaw.org). A note of caution regarding internet sites listed in the text in that they were current and valid at the time of publication but due to the dynamic nature of the internet they may and do change.
diverges; is unique in its approach; and is anthropologically closer to its neighboring independent island nations in the Northern Pacific. Other U. S. territories in the Northern Pacific include Midway, Wake, Johnston Atoll, Baker, Howland and Jarvis, Palmyra, and Kingman. Only Wake, Midway, and Johnston are inhabited and the others have no indigenous population. Due to the lack of indigenous population and reported cases, the islands of Wake, Midway, and Johnson are outside the scope of this text.

The text will emphasize any divergence and highlight regional anomalies in the substantive law of contract and sales. It will also examine the inter-relationship between customary and traditional law and the law of contract and sales. This anthropological approach will highlight how regional custom and traditional law have interacted with Anglo-American concepts of contract and sales law to produce a unique blend of contract and sales law in this Northern Pacific region.

As a baseline of analysis, the text will initially compare and contrast contract and sales law in the Northern Pacific region to international standards of contract and sales law set forth in the Uniform Commercial Code (UCC) which has been adopted in Hawaii, Guam, the Commonwealth of the Northern Mariana Islands, and, in part, by the Federated States of Micronesia, the Revised Uniform Commercial Code (Revised UCC), and the Restatement (Second) of Contracts which is the current statutory rule of decision in Palau and Micronesia and formerly the rule of decision in the Marshall Islands. Where applicable, the text will also compare and contrast regional contract and sales law to the United Nations Convention on the International Sale of Goods (CISG), and the UNIDROIT Principles of International Commercial Contracts.
As a result of the research for this text, two significant developments were noted: 1) that the American Law Institute’s Restatements of Law has been elevated from simply persuasive authority as it is in the United States to the rule of decision in some of these Pacific Island nations, and 2) that the anthropological implications of local custom and traditional law on the substantive contract and sales law have created a unique regional amalgam.
HISTORICAL BACKGROUND

General Regional History

The Federated States of Micronesia (FSM) is the largest of the Northern Pacific island groups formerly known as the Eastern and Western Caroline Islands. The Republics of Palau and the Marshall Islands are much smaller island groups in this same island chain.

This area was first settled over 3000 years ago as evidenced by artifacts and such impressive ruins as Nan Madol in Pohnpei, Micronesia. Spanish and other European explorers first arrived in the Northern Pacific in the 1500’s and onward. Spain claimed many of the Micronesian islands as part of the Mexico to Philippines trade route and named them the Philippines (after Spain’s King Philip), the Marianas (after King Philip’s wife, Queen Mariana of Austria), and the Eastern and Western Caroline Islands (“Islas de Carolina” after King Charles II of Spain). The islands were subject to commercial and territorial disputes primarily between Germany and Spain in the 1800’s. German traders had a significant impact in the Marshall Islands establishing trading outposts in the 1850’s and a consulate in 1875. When Germany tried to expand into other areas in Micronesia from the Marshall Islands, Spain was granted a Papal Bull which officially gave them title to the Caroline Islands in 1885. The Marshall Islands became a German protectorate in 1885.

From that time until 1899, the Caroline Islands remained under Spanish control when they were sold and transferred by Spain to Germany after Spain’s loss in the Spanish-American War. Germany maintained control of these islands until World War I.
Japan joined the Allies and took military possession of the islands in 1914. Beginning on December 17, 1920, Japan officially controlled the Caroline, Marshall, and Mariana Islands (except Guam) under a League of Nations mandate. The islands remained under Japanese control through the end of World War II.

In 1947, after World War II, these island nations became a United Nations Trust Territory under the supervision of the United States. In 1979, the Federated States of Micronesia formed a constitutional government that remained under the supervision of the Trust Territory. Four of the Trust Territory districts (Kosrae, Pohnpei, Truk, and Yap) decided to form a single federated Micronesian state in 1979. Similarly, the Marshall Islands adopted a Constitution in 1979 like its island neighbor. Palau did not participate initially in this drive for independence officially declaring individual sovereignty later.

Although they adopted their constitutions in 1979, Micronesia and the Republic of the Marshall Islands did not officially become independent sovereign nations until 1986. Although declaring independence and adopting a constitution shortly after Micronesia and the Marshall Islands, independence for the Republic of Palau followed even later but only after a series of referenda which resulted in Palau’s official declaration of sovereignty in 1994.

Other Pacific islands such as American Samoa, Guam, the Northern Mariana Islands and Hawaii took different routes and instead of declaring independence have continued their affiliation with the United States becoming a State, commonwealth, or territory of the United States. As various political entities in association with the United States, Hawaii, Guam, and the Commonwealth of the Northern Mariana Islands apply and follow the substantive common law of contract and sales as set forth in such
persuasive authorities as the *Restatement (Second) of Contracts* and have statutorily adopted the Uniform Commercial Code (UCC) which is applied in the United States. The only American Territory which is an exception is American Samoa which has not adopted the UCC and retains a strong customary and traditional law influence. American Samoa is anthropologically unique from other U.S. territories and also diverges slightly in its approach to contract and sales law. The contracts and sales statutes and case law of Hawaii, Guam, and the Commonwealth of the Northern Mariana Islands closely mirror the substantive law found in the continental United States.
The Federated States of Micronesia (FSM) is a fledgling democracy in the north Pacific eight degrees north of the equator. Its estimated population as of July 2009 is 107,434 scattered over 607 islands and nearly 1 million square miles of ocean. The FSM extends 1800 miles from one end to the other. It is approximately 2900 miles southwest

of Honolulu and 1000 miles southeast of Guam. Total land mass is about 271 square miles or 702 square kilometers.

The Federated States of Micronesia have been inhabited for nearly three thousand years by its indigenous population as reflected by the ancient ruins at Nan Madol. Portuguese navigators first encountered the islands of Yap and Ulithi in 1525 while searching for the Spice Islands in Indonesia. Spain claimed the islands known as the Eastern and Western Caroline Islands until 1899 when it sold them to Germany after the Spanish-American War. During World War I, the Japanese military seized control of the islands in 1914 and Japan was given a League of Nations mandate in 1920. During Japanese control, significant capital and infrastructure improvements were made to the islands. Sugar cane and pepper plantations, mining, fishing, and tropical agriculture became major industries. The islands remained under Japanese control through World War II. In 1947, they became a Trust Territory and Protectorate of the United States. The Federated States of Micronesia became an independent sovereign nation on May 10, 1979 when it formed its own constitutional government. Authority was gradually transferred from the Trust Territory government to the new constitutional government from 1979 to 1986, and the FSM officially became independent on November 3, 1986. Trusteeship was officially terminated by the UN Security Council on December 22, 1990.

Since September 17, 1991, Micronesia has had its own seat on the United Nations and has established diplomatic relations with 56 countries including the USA, Japan, China (PRC), Israel, France, Italy, Australia, India, Canada, Russia, Ireland, Switzerland, Argentina, the Vatican and Sovereign Order of Malta, and two of its former Trust Territory cousins, Palau and the Marshall Islands. Micronesia historically votes
consistently with the United States in the United Nations. The Federated States of Micronesia is the largest group of islands among the former Trust Territory and consists of four island states: Kosrae (formerly Kusaie), Pohnpei (formerly Ponape), Chuuk (formerly Truk), and Yap.

Under a Compact of Free Association originally negotiated in November 1986 with the United States (PL 99-239) and recently renewed in December 2003 (PL 108-188), the United States provides economic assistance and defense of these islands. From 1986 to 2001, the United States provided over $1.3 billion in grant aid to the FSM under the first Compact. The Second Compact reduces the level of future aid and creates a Trust Fund which is to serve as an ongoing source of revenue after 2023 and is intended to contribute to the long term economic self reliance of the Micronesia. The Second Compact is divided into six primary grant sectors: Education, Health Care, Public Infrastructure, Environment, Public Sector Capacity Building, and Private Sector Development.

English is the official and most commonly used language although there are a number of other languages spoken in the islands: Trukese, Pohnpeian, Yapese, Kosrean, Ulithian, Woleaian, Nukuoro, and Kapingamarangi. According to the 2000 census, nearly 90 percent of the population is indigenous to the islands with 1.8% Asian, 1.5% Polynesian, 6.4% other and 1.4% unknown. Most of the population is Christian with 50% of the population being Roman Catholic and 47% belonging to various Protestant denominations. The population growth rate has leveled off and is projected at -.238% for 2009.
The official currency of the Federated States of Micronesia is the United States dollar (USD). Micronesia has tremendous potential for eco-tourism like some of the neighboring island nations due to its splendid beaches and spectacular scuba diving opportunities particularly in Chuuk and Yap. However, it has yet to realize its full potential due to its geographic isolation and lack of infrastructure. Although its Foreign Investment Act of 1997\(^4\) contains onerous foreign investment requirements, bond and employment provisions which need revision in order to encourage private sector development, Micronesia also has great economic potential for light industry such as the garment industry and light manufacturing due to its readily available work force, low wage rates, and close proximity and favorable trade agreements with the U.S., China (PRC), Japan, Australia, and Philippines. Despite the Foreign Investment Act of 1997, the FSM can potentially be a conducive environment for investment if one is familiar with the nuances of the Foreign Investment Act.

In 2008, the FSM labor force was estimated at 16,360 with .9% of the labor force involved in agriculture, 34.4% in industry, and 64.7% employed in services. Labor force figures have been as high as 17,502 in 1995 and as low as 16,162 in 1999 with an average of 16,585 from 1995 to 2006. A potentially economic destabilizing factor is the low ratio of formal employment to population that was a high of 16.5% in 1995 and which dropped to 15.2% in 2006. As a result of the restrictions on foreign investment imposed by the Foreign Investment Act of 1997, there has been slow growth in the private sector and there has been exponential growth in the public sector. In 2005, the public sector

\(^4\) Micronesia’s Foreign Investment Act of 1997 (P.L. No. 10-49) is codified at 32 FSMC § 200 et seq.
accounted for nearly two-thirds of the labor force that was employed by either federal or state governments. Due to lack of private sector development and the inability of foreign investment to stimulate small private sector business growth, an average of 15.5% of the total population was formally employed during the 1995-2006 period. These conditions are potentially economically destabilizing and contribute to emigration rather than job creation. The net migration rate is estimated at a negative 21.03 migrants per 1000 population in 2008. As a result of the lack of private sector development, the FSM’s GDP has dropped from $277 million in 2002 to $238.1 million estimated for fiscal year 2008. The GDP is supplemented by grants in aid averaging around $100 million annually. From 1996 through 2006, the FSM’s real GDP increased a dismal 0.1% per year. Correspondingly, there has been a drop in per capita GDP from an estimated $2,300 in 2005 to an estimated $2,200 in 2008.

A valuable source of general information regarding the lack of and challenges to private sector development in the Pacific islands including those in the Northern Pacific can be found in the Pacific Studies Series published by the Asian Development Bank particularly their 2004 text entitled *Swimming Against the Tide? An Assessment of the Private Sector in the Pacific.*

The chief agricultural products and crops of Micronesia are fish, pigs, chickens, yams, coconuts, black pepper, breadfruit and other tropical fruits and vegetables, betel

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nuts, and cassava (tapioca). Micronesia is also known for its high-grade phosphate deposits but has few other mineral deposits.

The rising cost of fuel has had a detrimental impact on economic growth which is dependent on fuel oil to power its energy needs. The cost of purchasing fuel oil is significant and reduces overall economic growth. Since it is favorably located near the equator, Micronesia needs to explore alternative energy sources such as wind and solar energy in order to break its dependence on foreign oil supplies and should create favorable tax incentives or exemptions for foreign investment to encourage local private sector energy development.

Micronesia operates on a trade deficit. It had $22 million in exports in 1999-2000 which dropped to an estimated $14 million in 2004. Its major export commodities are fish, garments, bananas, sakau (kava), betel nut, and black pepper. Its major export partners are Japan, the United States, and Guam. In 1999-2000, Micronesia imported approximately $149 million in food, manufactured goods, machinery and equipment, and beverages. Imports have dropped to $132.7 million in 2004 which has kept the trade imbalance about the same. Micronesia’s primary import partners are Australia, the United States, and Japan.

Elected in May 2003, former President Joseph Urusemal indicated that his goals as President included improving and expanding international partnerships with Japan and Australia that are and continue to be important regional partners. Current FSM President Emanuel Mori elected on May 11, 2007 has continued to cultivate diplomatic relationships with Pacific Rim partners and to expand the foreign relations policies of his predecessor in an effort to achieve economic self-sufficiency.
The Republic of the Marshall Islands (RMI) consists of two archipelagic island chains (the Ratak or “Sunrise” chain and the Ralik or “Sunset” chain) of 29 atolls and 1,225 islands covering an area of 181.3 square kilometers. None of the islands are more than a few meters above sea level which presents a significant ecological concern as

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ocean levels rise. The Marshall Islands are the most eastern part of the chain of islands known as the “little islands” or Micronesia that are scattered over 3 million square miles of the northwest Pacific Ocean and include the FSM, Palau, Guam, CNMI, Kiribati, and Nauru. The Marshall Islands lie to the northeast of the Federated States of Micronesia and are located about half way between Hawaii and Australia.

The Marshallese are a great seafaring people known for traveling tremendous distances over the open ocean through the use of stick charts that map the islands, reefs, and ocean currents. Although occupied by its indigenous population for thousands of years, the Marshall Islands were named after English sea Captain John William Marshall who sailed through the islands in 1788. The Marshalls had been claimed earlier by Spain in 1592 and were left virtually undisturbed for hundreds of years until Germany took over administration of the islands in 1885 setting up copra (dried coconut meat) trading stations on the islands of Jaluit and Ebon. Marshallese iroij (traditional chiefs) ruled the islands while under German control and still continue to have significant control today. In fact, former President Kessai Note who was first elected in January 2000 and re-elected in 2003 was the first president to be elected in the Marshall Islands who was not a traditional iroij. The RMI legislative branch currently consists of a popularly elected Nitijela which is equivalent to parliament or congress and an advisory council of Iroij (high chiefs) who make certain that all legislation is consistent with Marshallese custom.

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7 I wish to thank Chief Judge Carl Ingram, Judge Milton Zackios, former judges Richard Hickson and Riley Albetter, and other members of the Marshall Islands judiciary for the stick chart that they presented to me so that I could always find my way back to the Marshall Islands.

8 The current President of the RMI is the Hon. Litokwa Tomeign who was elected by the Nitijela (18 votes for Tomeign to 15 votes for incumbent President Kessai Note) after the November 2007 general elections and took office January 7, 2008.
Likewise, the judicial system has a parallel Traditional Rights Court which advices on customary and tradition law issues.

The Marshall Islands were seized from Germany by Japan during World War I and were later conveyed to Japan under a League of Nations mandate in 1920. The Marshall Islands remained under Japanese control until World War II. The Marshalls were the site of intense fighting during World War II including battles on Kwajalein and Enewetak atolls in 1944. After World War II, the United States conducted nuclear testing on Bikini and Enewetak atolls from 1946 to 1958 and is still making payments to former residents of these atolls to cover claims related to this testing. The Marshall Islands became part of the UN Trust Territory in 1947 under the supervision of the United States until the RMI drafted a Constitution in 1979 and officially declared independence in 1986.

The estimated population of the Marshall Island has recently steadily increased from an estimated population of 57,738 in July 2004 to an estimated 64,522 as of July 2009 and has a birth rate of 30.7 per 1000.

The Marshall Islands adopted their Constitution on May 1, 1979. Like Micronesia, the Trust Territory gradually transferred authority to the constitutional government. The Marshall Islands officially became an independent nation in October 1986. Although independent, the Marshall Islands entered into a Compact of Free Association with the United States on October 21, 1986 (P.L. No. 99-239) which was extended in a Second Compact of Free Association by the United States for another 20

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9 My daughter Katherine and I had the distinct privilege of being guests of then Speaker, and current RMI President, Hon. Litokwa Tomeing, who invited us to the opening session of the Nitiljela, 26th Congressional Regular Session, on August 8, 2005. Then President Kessai Note also presided at the opening session.
years in January 2004 (P.L. No 108-188). Under the First Compact, the RMI received more than $1 billion in aid from the United States between 1986 and 2002. The First and Second Compacts with the RMI were negotiated in conjunction with the aid provided by the United States to the FSM and contain similar features including a grant reduction, six primary sectors of grant assistance, and creation of a Trust Fund intended to contribute to the long term economic self-sufficiency of the RMI. The Marshall Islands officially became independent from the U.S. administered UN Trusteeship on October 21, 1986. The Marshall Islands became a member nation of the United Nations on September 17, 1991 and has established bilateral relations with over 72 countries including the U.S., Taiwan, Israel, France, and the Vatican.

The currency utilized in the Marshall Islands is the U.S. dollar (USD). Marshallese and English are the official languages. It is primarily a Christian country with the Assembly of God (25.8 %) having the strongest foothold and with 54.8 % of the remaining population divided among various Protestant denominations, and including 8.4% Roman Catholic, 2.8% Bukot nan Jesus (indigenous Christian religion native to the RMI), 2.1% Mormon, and other Christian denominations 3.6%.

By occupation, the labor force of the Marshall Islands is primarily service based (57.7 percent) followed by agricultural (21.4 %) and industry (20.9 %) as determined in 2000.

The major agricultural products of the Marshall Islands are fruits, coconuts, tomatoes, melons, taro, breadfruit, pigs, and chickens. Major industry and exports from the Marshall Islands include copra (dried coconut meat), coconut oil, fish, tourism, and craft items made from shell, wood, and pearls. The Marshall Islands are also known for
sport fishing and spectacular scuba diving. The natural resources of the Marshall Islands are coconut products, deep seabed minerals, and marine products.

Small scale industry is limited to handicrafts, tuna processing, and copra. The tourism industry has now expanded to approximately 10% of the labor force and remains the best opportunity for future potential private sector growth. Japan Airlines launched charter flights from Tokyo to Majuro in 2007 which should boost tourism and Shanghi Tuna announced plans to re-open a tuna cannery it closed in 2004 which at its peak employed 600 Marshallese.¹⁰

The Republic of the Marshall Islands also has favorable tax, maritime registration, and incorporation laws drawing offshore investment. For example, the Marshall Islands is regularly in the top countries in the world in foreign ship registries. This tiny little pacific Island nation has a merchant marine fleet of 1049 ships and is currently ranked 10th in the world with 990 foreign owned ships registered under the RMI flag. To facilitate in the registration process, foreign ships can be registered in the RMI online over the Internet.

Unlike some of the onerous foreign investment, bonding and employment laws and regulations found in the FSM and Palau, the RMI has taken significant steps to actively seek and encourage foreign investment by setting up government entities to assist in obtaining Foreign Investment Business Licenses (FIBL) within 7 days of application and to facilitate creating either a domestic liability company or to register as a foreign business entity. Although reserving a limited number of targeted small scale

domestic activities from foreign investment, the RMI places no restrictions on non-citizen investment and actively seeks foreign private investment in fisheries, tourism, manufacturing, and agricultural sectors. There are also provisions in place including tax exemptions to encourage certain business activities and development. With the passage of the Land Recording and Registration Act and the Land Recording and Registration (Amendment) Act of 2006, the government also clarified an area of ambiguity which inhibited foreign investment and contract formation which will be subsequently discussed by creating a voluntary registry of customarily owned land, standard lease agreements, and establishing a legal framework defining the rights of parties leasing or purchasing land.

Unlike the FSM, the Marshall Islands GDP has grown an average of 3.7% a year from 2000 through 2006. From 2005 to 2006, the GDP grew 4.9%. Much of this can be attributed to public sector growth and as a result from grants from Taiwan (ROP) and sources other than the United States. With the worldwide economic downturn, the real GDP growth rate for 2008 was a negative .3% bringing down the average annual GDP growth rate to 1% over the last decade. The per capita GDP growth rate was an estimated $2,900 in 2005 and $2,500 in 2009.

Rather than a top heavy public sector economy like the FSM, the Marshall Islands have maintained a balanced economy which has only recently began to slightly shift toward the public sector. In 1997, the public sector comprised 38.6% of GDP and

\[1\] P.L 2006-59, 24 MIRC 4
increased only to 42.5% in 2006. The private sector correspondingly contributed to 53.7% of the GDP in 1997 and 50.1% of the GDP in 2006.

In addition to positive developments in the private sector, the economy of the Marshall Islands benefits from the presence of the Ronald Reagan Ballistic Missile Defense Test Site located on the Kwajalein Atoll, the largest lagoon in the world, which the United States leases from the Marshall Islands. The base employs many RMI residents and pays rent to the residents of Kwajalein Atoll. Despite the tremendous economic benefits to the local economy, the lease of Kwajalein to the United States and dislocation of its residents remains a highly sensitive political issue.

Like the FSM, an economic negative for the RMI economy which presents problems for the future is the increasing trend toward public sector employment and the low number of individuals employed versus total population. Approximately 17% of the total population in 2005 was employed which indicates that a small percentage of the population is economically supporting the majority unlike in many balanced economies. Of the small number of the total population employed, over 40% of the working population is employed by the national or local governments. The RMI also has a disproportionately high unemployment rate of 33.6% in 2004 and 36% in 2006. These combined factors can be economically destabilizing.

The rising cost of fuel has also had a detrimental impact on economic growth of the Marshall Islands which is dependent on fuel oil to power its energy needs. The cost of purchasing fuel oil is significant and reduces overall economic growth. Since it is favorably located near the equator and prevailing trade winds, the Marshall Islands need to explore alternative energy sources such as wind and solar energy in order to break its
dependence on foreign oil supplies and should create favorable tax incentives or exemptions for foreign investment to encourage local private sector energy development.

When I visited the islands, there were some initial private sector alternative fuel development efforts being undertaken by Jerry Kramer and others who were converting copra or coconut oil into diesel fuel to be used by ships, construction equipment, and power generators on some of the outlying islands. Mr. Kramer explained that because the temperature never goes below 78 degrees Fahrenheit in the Marshalls the coconut oil does not congeal or clog diesel engines. Mr. Kramer and others are to be applauded for their efforts and innovation but more needs to be done by the government to encourage these private sector efforts such as tax or investment credits.

The budget deficit is tremendous with only $123.3 million in revenue and expenditures of $1.213 billion in 2008. This gap between revenues and expenditures will obviously need to be addressed if the country seriously intends to become economically self-reliant. The economy also operates on a trade deficit with $9 million in exports and $54 million in imports in 2000. Exports increased to an estimated $19.4 million in 2008. Major export partners are the United States, Japan, Australia, and China. Imports increased from $54 million in 2000 to $79.4 million in 2008. Major import partners are the United States, Japan, Australia, New Zealand, Singapore, Fiji, China and the Philippines. Primary imports include foodstuffs, machinery and equipment, beverages, tobacco, and fuel.
The Republic of Palau (ROP) is located in the Northern Pacific Ocean approximately 600 miles southeast of the Philippines and 800 miles south of Guam covering an area of 458 square kilometers or roughly 190 square miles. It is the westernmost archipelago in the Caroline chain consisting of six island groups totaling

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more than 300 islands. These 300 islands are divided into sixteen states.\textsuperscript{13} English and Palauan are the official language in all of these states except three.\textsuperscript{14}

Although inhabited by its indigenous population for thousands of years and claimed by Spain from the 1500’s until 1899, the first significant contact with European explorers occurred in 1783 when English Captain Henry Wilson shipwrecked near the islands. Although claimed by Spain, the British dominated trade with Palau until 1899 when Spain, who had lost the Spanish-American War, sold the islands to Germany. The Germans introduced coconut planting and phosphate mining along with widespread sanitary measures which significantly reduced disease in the islands. As a result of disease brought to the islands by Europeans traders and without these sanitary measures, the population of Palau was decimated and fell from 40,000 to 4,000 over 120 years due to a series of influenza and dysentery epidemics. The islands remained under German control until World War I when the Japanese seized the islands in 1914. In 1920, the League of Nations gave Japan a mandate and Palau remained under Japanese control until World War II. The Japanese increased mining, agriculture and commercial fishing in Palau. The islands became a closed Japanese military area in 1938. During World War II, Palau was the site of intense fighting particularly in battles for Beliliou (Peleliu), Koror, and Angaur. Tens of thousands of American and Japanese troops died in these battles.\textsuperscript{15} In 1947, Palau became part of the Trust Territory administered by the United

\textsuperscript{13} Aimeliik, Airai, Angaur, Hatohobei, Kayangel, Koror, Melekeok, Ngaraad, Ngarchelong, Ngardmau, Ngatpang, Ngchesar, Ngeremlengui, Ngiwal, Peleliu, and Sonsorol.
\textsuperscript{14} Sonsorol (English and Sonsorolese); Hatohobei (English and Hatohobei); Angaur (English, Japanese, and Angaur).
\textsuperscript{15} When discussing my work in the region one of my legal colleagues, Roger H. Cummings, an attorney at Dickenson Wright law firm in Bloomfield Hills, MI, he mentioned that he lost an uncle who was shot down
States and was the last of the former trust territories to gain independence finally emerging from the Trusteeship in 1994.

The estimated population of the Republic of Palau in 2004 was 20,800 and has remained relatively stable with an estimated population of 20,796 in July 2009. In 1990, the total population was 15,122. The estimated population growth rate in 2009 is .428% but the estimated 2009 fertility rate is below replacement levels at 1.82 children born per woman.

Palauan culture has three major components including: 1) prestige orientation, 2) competition between individuals and clans, and 3) reciprocity and manipulation of gifts, money, goods, and services which can have a significant impact the issue of contract formation which we will discuss subsequently. Kinship and clan membership is a major determinant of social behavior, employment, and political status. Each individual in Palauan society has a definite rank in the family, clan, and village from the moment of birth. Each family has a rank based on family background. Culture and tradition still play a significant political role in which a Council of Chiefs consisting of tribal leaders advise the President and legislature on matters concerning traditional law and custom while possessing constitutional authority to negate legislation to the contrary.

Due to its closer proximity to Asia, Indonesia, and the Philippines than its Pacific island neighbors, Palau is more multi-cultural than the FSM and RMI. Native Palauans comprise only 69.9% of the population and 15.3% of the population is Filipino, Chinese in a plane and died in Palau during Operation Desecrate in 1944 when an inexperienced co-pilot inadvertently disclosed their elevation. Roger shared with me the military records regarding this operation and how his uncle’s plane was recently located. He showed me pictures of its location in the shallows off of Koror. Roger Cummings continues his connection to the region and is now head of the Japanese Business Practice group at Dickenson Wright.
4/9%, other Asian 2.4%, white 1.9%, Carolinian 1.4%, other Micronesian 1.1% and 3.2% unspecified or other. According to its 2000 census, Palau is predominantly a Christian nation with Roman Catholic 41/6%, Protestant 23.3%, Modekngei (a religion indigenous to Palau) 8.8%, Seventh Day Adventist 5.3%, Jehovah’s Witness .9%, Mormons.6% other 3.1%, none or unspecified 16.4%. Palau’s predominantly Christian culture was recently highlighted by the effort of the United States to relocate 16 Chinese Uighur Muslims held captive at the U.S. military base in Guantanamo Bay to Palau when some of the detainee’s demonstrated reluctance to move to a country which only has 500 Muslims.16 Tied to this agreement to take these 16 prisoners was a promise by the United States of $200 million in aid to Palau and a renewal of the Compact of Free Association which previously cost more than $700 million over 15 years.

The Republic of Palau adopted its Constitution on July 9, 1979, and officially became the Republic of Palau on January 1, 1981. The Trust Territory gradually transferred authority to the newly formed constitutional government. The process of independence for Palau was more protracted than the FSM and RMI. After 1986, Palau was the only remaining part of the U.S. Trust Territory. It took eight years, Constitutional amendments, and a series of referenda to adopt the Compact of Free Association with the United States in 1994. Once the Compact was adopted, Palau officially became an independent sovereignty from the U.S. administered UN Trusteeship on October 1, 1994. On December 15, 1994, the Republic of Palau became a member of the United Nations.

and has established bilateral relations with 40 countries including the United States, the European Union, and Taiwan (ROC). The Republic of Palau does not have diplomatic relations with the People’s Republic of China (PRC) which enabled it politically to take the Chinese Uigher Muslims from Guantanamo Bay over the PRC’s objections.

In an effort to gain independence, the Republic of Palau originally signed the Compact of Free Association with the United States in 1982. The Compact went into effect twelve (12) years later in October 1994 but only after eight (8) referenda and an amendment to the Palau Constitution. The Compact of Free Association with the United States (P.L. No. 99-658) was for a 15 year term and is due to expire in 2009. Under the First Compact, the United States provided Palau with approximately $700 million in aid. In exchange for recently agreeing to take the 16 Chinese Uighur Muslims from Guantanamo Bay, the United States has promised to provide Palau with $200 million in aid for taking the prisoners in addition to renewing a second terminal compact containing provisions similar to those in the second compacts recently negotiated in 2004 with the FSM and RMI.

Another significant development in Palau involved the relocation of its capitol. The capitol of Palau recently moved in October 2006 from Koror to Melekeok which is on Babeldaob, a larger, less occupied island. The move is intended to spread out the population base which was primarily concentrated in and around Koror. With the construction of a new capital, Palau completed several other significant infrastructure projects including the Compact road.

The official currency of the Republic of Palau is the United States dollar (USD). Like its neighbors, the Republic of Palau operates on a trade deficit. However, the overall
economic picture for Palau is somewhat brighter than its island nation neighbors. In 2001, the Republic of Palau had nearly $18 million in exports of shellfish, tuna, copra, and garments. Major export partners of Palau are the United States, Japan, and Singapore. That same year, the Republic of Palau had $99 million in imports of machinery and equipment, fuels, metals, and foodstuffs. Major import partners are the United States, Guam, Japan, Singapore, and Korea. Palau continues to have a significant trade imbalance estimated in 2004 to be $5.882 million in exports and $107.3 million in imports. Of significant concern, it should be noted that exports dropped nearly $13 million over a 3 year period while imports increased by nearly $8 million.

Palau is known as a diver’s paradise particularly with world famous spots such as Blue Corner and Dexter’s Wall. Palau was also recently featured in the television show “Survivor: Palau” and “Survivor: Micronesia” which were both filmed in the remote Rock Islands. The primary private sector industries in Palau are tourism, mining, craft items, construction, and light industry such as garment making. Palau also has abundant natural resources including forests, minerals (especially gold), marine products, and deep seabed minerals.

The rising cost of fuel oil has had a detrimental impact on Palau’s economic growth which is dependent on fuel oil to power its energy needs. The cost of purchasing fuel oil is significant and reduces overall economic growth. Since it is favorably located near the equator, Palau needs to explore alternative energy sources to reduce its dependence on foreign oil supplies and should create favorable tax incentives or exemptions for foreign investment to encourage local private sector energy development.
Like the FSM, Palau has onerous foreign investment, bond and employment rules and regulations which can discourage foreign investment and need to be revised in order to encourage private sector growth. Add to that an absence of commercial legislation leaving contract and sales disputes to be resolved by the common law and an environment is created which is not conducive to private sector development. Further, under the laws of Palau, land cannot be owned by any non-Palauan citizen or firms but can be leased for a limited term of years. As in other island nations, problems with who has authority to lease clan or customarily owned property frequently arise creating uncertainty in contracting. Another problem with this land acquisition limitation is that it discourages foreign investment because the investment may not be recovered during the duration of the lease.

Despite these issues, the economic outlook in Palau is extremely positive and its population enjoys a per capita income twice that of the Philippines and much higher than the neighboring island nations of Micronesia and the Marshall Islands. The Palau per capita GDP, however, remains about half of the per capita income of Guam. Palau’s GDP climbed from $124.5 million in 2004 to an estimated $164 million in 2008. The per capita GDP was estimated at $7,500 in 2005 and $8,100 in 2008. An estimated 50,000 tourists visited Palau in 2000-2001 and the prospects for the long term tourist trade have been enhanced with expansion of air travel in the Pacific, the prospering economies of East Asian countries which border the region, and with the willingness of foreigners to invest in infrastructure improvements. In 2007, business and tourist arrivals climbed to 85,000. Many of these tourists are from Taiwan and Asia.
With a labor force of 9,777, Palau also has a higher employment to total population ratio than its neighboring island nations, lower unemployment rate of 4.2%, and lower inflation rate of 2.7% based on 2005 figures. Unlike its neighbors, Palau also has an estimated 2008 budget surplus with revenues of $114.8 million and expenditures of $99.5 million. This revenue figure, however, includes Compact funds.

Other Trust Territory Islands and United States Possessions in the Northern Pacific Region

Hawaii, Guam and the remaining United Nations Trust Territory islands of Saipan, Tinian, Rota and other smaller islands chose not to declare independence but to become a commonwealth and territory of the United States.

Guam

Guam is 13 degrees north of the equator, the most southern of the Marianas chain, and at 209 square miles it is the largest island in Micronesia. Guam became an organized, unincorporated United States territory in 1950. Guam was first inhabited by the indigenous Chamorros approximately 4000 years ago. Ferdinand Magellan reached the island of Guam in 1521 during his circumnavigation of the globe. Spain used the island as a stop on the Mexico to Phillippines trade route and began colonizing the island in 1668. Spain considered Guam and the other Marianas islands of Saipan, Tinian, and Rota

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17 This author’s original analysis of Palau’s legal system, property rights and contract law published in 2005 was quoted and cited as “an in-depth analysis of contract law in the North Pacific” by a subsequent Technical Assistance report prepared by the Asian Development Bank in Chapter 5. Issues Related to Palau’s Legal System and Property Rights, p. 28, fn 17, www.adb.org/Documents/Reports/PSA/PAL/Chap05.pdf
as a part of the Philippines colony. In 1668, the island chain was named after Mariana of Austria, the widow of Spain’s Philip IV. The United States took possession of Guam in 1898 after the Spanish-American War and sold the rest of the Marianas to Germany. As a historical footnote, Guam is the only U.S. territory lost to the Japanese during World War II which occurred when the Japanese seized the island in December 1941. The Americans reclaimed the island in July 1944. Guam was invaded and seized within hours of the Japanese attack on Pearl Harbor. Because Guam had been an American territory since 1898; was seized from the U.S. by Japan during the war; and was liberated and returned to the United States in 1944, it did not become part of the post World War II Trust Territory established by the United Nations in 1947.

According to the U.S. Census, Guam had a population of 154,805 in 2000 and an estimated population of 173,460 in 2007. With the closure of the U.S. military base in Okinawa, Japan and the troop transfer to Guam between 2010 and 2014, Guam will experience an unprecedented population increase of 20-25% or approximately 40,000 residents. The United States is spending approximately $3 billion dollars to improve Guam’s infrastructure in advance of the transfer of the troops and their families. The current population is 57% Chamorros, with 25.5% Filipino and 10% Caucasian. The predominant religion is Roman Catholic with an 85% affiliation. Guam’s economy is mainly supported by tourism and approximately seven different U.S. military bases. Guam’s motto is “Where America’s Day Begins” and is known as “America in Asia,” or “Little Honolulu.” Guam has over 20 major hotels, ten golf courses, duty free shopping at the Galleria, high end retail shops, and Las Vegas style entertainment. Over a million
tourists come to Guam annually with 90% coming from Asia and Japan. Remaining tourists come from South Korea, the Philippines, and Taiwan.

Residents of the FSM, Palau, and Marshall Islands are free to travel to the United States per the Compact and many of those who chose to move go to Guam, Hawaii and the CNMI placing a significant burden on their public services and educational system resulting in additional aid from the U.S. to cover the shortfall. Guam’s GDP was an estimated $3.2 billion in 2000 with a per capita GDP of $21,000 which is clearly the highest in the region. In 2003, Guam had a 14% unemployment rate and the territorial government suffered a shortfall of $314 million.

An interesting provision passed by Congress permits the Guam treasury, and not the U.S. Treasury, to collect federal income taxes paid by local taxpayers including military and civilian federal employees residing in Guam. The political and judicial structure of Guam is similar to the continental United States in that the government is divided into three separate branches: executive, legislative, and judicial and the judicial branch is divided into a Superior Court (general jurisdiction trial court) and Supreme Court (appellate). Guam also has a Federal District court but the federal District Judge is appointed for a term of years s opposed to federal judges in the continental United States who are appointed for life.

**CNMI**

The remaining islands of the Marianas chain: Saipan, Tinian, Rota and 12 other minor islands are collectively referred to as the Commonwealth of the Northern Mariana Islands (CNMI). Total land area of all 15 islands is 179.01 square miles. The northern
islands are volcanic with active volcanoes on three islands. Adjacent to the islands is the Marianas Trench which is the deepest part of the Pacific Ocean.

The Northern Mariana Islands were sold by the United States to Germany in 1898 and were seized by Japan in 1914 during World War I. The Northern Marianas remained under Japanese control through the end of World War II and became part of the Trust Territory after World War II. Tinian and Rota were the site of fierce fighting during World War II.

The Japanese invade Guam on December 8, 1941 within hours of the Pearl Harbor attack. In order to assist in administering Guam, the Japanese brought with them some of the Chamorros from the Northern Marianas which they had controlled since 1914. The Guamanian Chamorros were treated harshly by the Japanese with the assistance of the Northern Mariana Chamorros. This harsh treatment during World War II is not forgotten by the Guamanians and still has current political implications.¹⁸

The United States invaded the Northern Marianas on June 15, 1944 and captured Saipan on July 9. The U.S. military then moved to Guam and then invaded Tinian on July 24. Tinian provided the air base from which the Enola Gay flew one year later to drop the atomic bomb on Hiroshima. Rota was militarily insignificant and left alone until after the Japanese surrender in August 1945. While most of the Japanese troops stationed in the Northern Marianas surrendered in Saipan after the armistice on December 1, 1945, many hid out in the island caves for years after the war with the last Japanese soldier, Shoichi Yokoi, surrendering in the Guam village of Talofofo in 1972.

¹⁸ This harsh treatment during World War II has caused a rift between the two Chomorro groups which is the main reason the two have politically gone their separate ways and why Guam rejected efforts for reunification with the Northern Marianas in the 1960’s.
After World War II, the Northern Marianas became part of the Trust Territory in 1947. After efforts at reunification with Guam failed in the 1960’s due to lingering animosity over World War II mistreatment, the Northern Marianas began negotiations for territorial status in 1972. A covenant to establish a Commonwealth in political union with the United States was approved in 1976. A Constitution was adopted in 1977 and a new government installed in January 1978. As a political entity of the United States, the CNMI is represented by a non-voting delegate in the U.S. Congress.

The official population as determined by the U.S. Census in 2000 was 69,221 with an estimated 2006 population of 84,487. Population growth rate was estimated above replacement values at 2.54% in 2006. The bulk of the population resides on the islands of Saipan, Tinian, and Rota. Two of the 15 islands in the CNMI have fewer than ten (10) residents and ten (10) of islands have no population.

The Northern Marianas were able to use its Congressional exemption from prevailing U.S. wage rates, labor, and immigration laws, and free trade areas to its benefit from 1997 until 2007 when preferential treatment was eliminated. During this ten year period, foreign investment and workers poured into the CNMI from other parts of Asia. Foreign immigration was so extensive that foreigners constitute the majority of the population; Asian, Chinese, Filipino, Korean and Japanese comprise 56.3% of the population. The remaining population is Indigineous Chamorro, Carolinian and other Micronesians 36.3%, mixed 4.8, Caucasian 1.8%, and other 0.8%. Another interesting population fact attributable to the garment influx of foreign female workers in the

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19 Much of the information obtained regarding the CNMI was found in numerous sources including U.S. Census records and from the Pacific Magazine: 2007 Pacific Almanac: Commonwealth of the Northern Mariana Islands, http://www.pacificmagazine.net/almanac/profile/?id=5&commit=Go.
garment industry is that the CNMI has the lowest male to female sex ratio in the world with an average of 76 men to 100 women.

The foreign garment industry was able to go to the CNMI and produce goods with “Made in the U.S.A” labels and experienced exponential growth. The “Jack Abramoff/Tom DeLay” scandal exposed many of the CNMI abuses like sweatshops, child labor, child prostitution, sex slavery, and forced abortions. When these loopholes were closed in 2007, so did at least 11 garment factories leaving behind tens of thousands of foreign workers straining the local economy to the brink of collapse\textsuperscript{20}. As a result of legislation enacted in 2007, exemption from immigration policies ends on November 28, 2009. The CNMI must now come in line with prevailing U.S. wage rates by 2015 with prevailing wages to be increased $0.50 every May until equalization occurs.

With the rapidly dwindling garment industry, the economy relies heavily on tourism from Japan which has also dropped off the past couple years leading Japanese airlines and other carriers to cancel or reduce daily flights to the islands. At its peak, CNMI tourism numbers rivaled Guam’s at nearly a million people per year. However, tourism in the CNMI dropped 15.23 \% from 2005 to 2006 which translated to a loss of 73,000 potential visitors. In 2006, tourism dropped another 17\% to 443,812 from 529,557. Other than tourism, fishing is the primary other industry in the islands. The economy relies on significant aid from the United States.

The government and judicial structure of the CNMI is similar to the continental United States in that it is divided into legislative, executive, and judicial branches. The

\textsuperscript{20} For more information, see Krikorian, Mark, Back in the CNMI, The Commonwealth of the Northern Mariana Islands is No Model when it comes to Immigration, National Review, pp. 22-23 (December 11, 2005)
judicial branch is divided into a Superior Court (general jurisdiction trial court) and an appellate Supreme Court. The CNMI also has a federal District Court and the federal District Judge is appointed to a term of years instead of lifetime appointment like federal judges on the U.S. mainland.

Other U.S. territories in the Northern Pacific include Midway, Wake, Johnston Atoll, Baker, Howland and Jarvis, Palmyra, and Kingman. Only Wake, Midway, and Johnston are inhabited and the others have no indigenous population. These miscellaneous islands are outside the scope of this text.

American Samoa

American Samoa, which is south of the equator but on the cusp and often grouped with the U.S. entities in the Northern Pacific region, consists principally of five volcanic islands and two coral atolls. It is an unorganized, unincorporated territory of the United States. It is “unincorporated” because it has its own Constitution which was adopted on July 1, 1967. For many years, not all provisions of the U.S. Constitution and federal laws like prevailing wage rates, immigration policy, and labor laws applied to the territory. Like the CNMI, many of these gaps were closed in 2007. Like the CNMI, these 2007 reforms are similarly being implemented over time.

21 A good basic source of information regarding American Samoa can be found at the United States Department of Interior, Office of Insular Affairs, http://www.doi.gov/oia/IslandPages/asepage.htm last updated 04/29/2008 and the American Samoa Bar Association website www.asbar.org. The American Samoa Bar Association has created a website located at www.asbar.org which under the “Legal Resources” describes among other things America Samoa and its judiciary, provides court rules, decisions and digests, the AS Reports 1st series (1901-1974), 2nd series (1974-1996) and 3rd Series (1997-present) and also supplies a useful link to the American Samoa Constitution, Code, and selected regulations. The reader can now access all American Samoa Constitutional provision, statutes, and cases cited in this text by going to the www.asbar.org website “Legal Resources” link.
The 2000 U.S. census indicated that the population of American Samoa was 57,291 and of that population 32,470 had been born in American Samoa.

Historically, the indigenous seafaring Polynesians have occupied American Samoa for over a thousand years with early evidence of their presence in 825 A.D. French and English explorers along with missionaries settled in the islands in the 18th and early 19th centuries. England and Germany renounced all claims to the eastern islands of Samoa in the Treaty of Berlin in 1899 conveying the islands of Tutuila and Aunu’u to the United States. The matai (customary chiefs) formally ceded these islands on April 17, 1900. In 1904, the King and matai of Manu’a ceded the islands of Ta’u, Ofu, Olosega, and Rose Atoll to the United States. Pago Pago harbor and the Samoan islands were an important coaling station for the Navy during World War I. Swains Island became a part of American Samoa in 1925.

The basic government structure of American Samoa is similar to the United States. The bicameral legislature is known as the Fono; the judiciary is known as the Fagatogo; and the Governor or executive is referred to as the Utulei. Of the American territories, customary law and tradition remain very strong in American Samoa. The matai still control 90 percent of the land which may not be alienated to anyone who has less than 50% Samoan blood. Likewise, communally owned land cannot be alienated for more than 55 years unless the Governor approves the transfer in writing. The matai also hold many of the appointed and elected legislative, judicial, and executive positions. The American Samoan Senate consists of 18 members who are chosen according to Samoan custom and tradition (i.e matai) in each of the 14 political subdivisions. The House of Representatives is elected by popular vote.
The Judicial Branch of American Samoa is structurally and anthropologically unique from any other United States state or territory. Although Hawaii, the CNMI, Guam, and even the U.S. Virgin Islands have a federal district court, American Samoa does not. Instead, unlike any other U.S. state or territory, the High Court of Samoa has been granted limited federal jurisdiction over certain issues such as food safety, protection of animals, conservation, and shipping issues. A recent GAO report and proposed legislation recommends even further expansion of the High Court jurisdiction including jurisdiction over Federal crimes in lieu of establishing a Federal District Court in part because it would eliminate the threat that a federal court would adjudicate cases involving matai titles and communal lands. The American Samoan Constitution and American Samoa Code create a High Court and local district court under the supervision of the High Court Chief Justice. The current Chief Justice of the High Court, Michael Kruse, is the first native Samoan appointed to the position, and the Associate Justices are appointed by the U.S. Secretary of the Interior based upon recommendation

from the Governor. The Chief Justice and Associate Justice must be law trained. Since the 1970’s, U.S. 9th Circuit federal judges have been generally assigned by the Secretary of Interior to serve temporarily as Acting Associate Justices in the High Court Appellate Division. There are six associate judges who are appointed by the Governor and are not required to have formal legal training although many of the associate judges have attended the National Judicial College’s Pacific Island Legal Institute.26 The associate judges are matai or customary chiefs and may preside over all cases in the High Court but are particularly instrumental in deciding issues of matai titles and land. The High Court consists of 4 divisions: 1) trial, 2) the family, drug and alcohol division, 3) land and titles, and 4) appellate. The trial division hears felony cases and civil cases in excess of $5000. There is one district court judge, Judge John Ward, who is appointed by the governor and who must be legally trained and who hears misdemeanor criminal cases and civil cases under $5000.

The distinctive Samoan way of life or fa’a Samoa is deeply imbedded in traditional American Samoan history, culture, their Constitution,27 and the legal system.

26 This author has had the distinct honor and privilege of being involved in training many of the American Samoan Associate Judges. It was a great cultural honor and humbling experience for this author to be given the title “honorary talking chief” or honorary “Tula Fala” by matai and Associate Judges Anthony A. Sagapolutele (deceased) and Siaki Logoai from American Samoa and given a wood carving bearing the traditional symbols of a matai including the “fue” and “to’o to’o” and the phrase “Samoa Muamua Le Atua” which are displayed in my office to this day. My family, especially my son Daniel, and I also appreciate the strong friendship and being welcomed into the agia of American Samoa matai and Associate Judges Saole Mila, Su’a Edmund C. Pereira, and Mamea Sala, Jr.

27 In the Bill of Rights, the American Samoa Constitution, Article I, §3 states: “It shall be the policy of the Government of American Samoa to protect persons of Samoan ancestry against alienation of their lands and the destruction of the Samoan way of life and language, contrary to their best interests. Such legislation as may be necessary may be enacted to protect the lands, customs, culture, and traditional Samoan family organization of persons of Samoan ancestry, and to encourage business enterprises by such persons. No change in the law respecting alienation or transfer of land or any interest therein, shall be effective unless the same be approved by two successive legislatures by a two-thirds vote of the entire membership of each house and by the Governor.” American Samoa Constitution Article I, §4 provides: “The dignity of the
The foundation of *Fa’a Samoa* is the concept of extended family groups related by blood, marriage or adoption—or *agia*. Family members acknowledge allegiance to island leader hierarchy headed by the matai and the matai are responsible for the welfare of their respective *aiga* and play a central role in protecting and allocating family lands. When Associate Judges who are also matai resolve a matai or land title case it has both judicial and cultural implications. Further, Samoan law allows for a custom of *ifoga* or ceremonial apology. If a member from one family commits an offense against another family, the family of the offender proceeds to the headquarters of the aggrieved family and asks for forgiveness pursuant to this customary tradition. After an appropriate confession of guilt and ceremonial contrition by the offending family, the aggrieved family can forgive the offense. If the offending individual is also convicted in court, the court may take notice that customary law has already addressed the grievance and reduce the sentence of the offender if it finds that an ifoga was performed. Similarly, traditional or customary law also has an impact on contract and sales law in American Samoa which will be subsequently discussed.

Turning to America Samoa’s economy, government revenues in 1996 were $121 million of which local revenues were only $45 million and the local economy received an additional $76 million in grants including $23 million for the U.S. Department of Interior, Office of insular Affairs. Imports annually exceed exports. Tuna or wahoo canning is the primary industry and export in American Samoa. In 1996, total imports were $471 million. Seventy-eight percent of those imports were from the United States. In 1996,
there were $313 million in exports. Two years earlier, in 1994, $295 million in exports came almost exclusively from the Star Kist and Chicken of the Sea Tuna canneries located in Pago Pago. After the government which is the largest employer with approximately 4,282 employees, the tuna canneries are the second largest employer in American Samoa. Because of labor and immigration exemptions about one third of the total labor force of 14,800 workers are aliens from Western Samoa. American Samoa has a respectable 1/3rd ratio of total labor force to total population. According to 1990 census figures, the per capita income was $3,020 which is higher than the RMI and FSM but significantly lower than Guam, Hawaii and the CNMI. Although the cost of living is lower in American Samoa, nearly 56.5 % of the Samoan population was living below the poverty level.

With the recent 2007 U.S. initiatives to eliminate wage, labor law and immigration exemptions, the tuna industry in Samoa, like the garment industry in the CNMI, is currently re-evaluating its long term economic strategy in American Samoa. The loss of the tuna industry because of these legislative changes would be devastating to the American Samoan economy. For example, it was reported that prior to the 2009 tsunami that killed over 100 people in Samoa that the tuna canneries had planned to close and lay off approximately 2000 employees.

**Hawaii**

Of all U.S. political entities in the Pacific, Hawaii is the most familiar. Hawaii is a volcanic archipelago consisting of eight main islands located approximately 2000 miles southwest of the North America mainland. Hawaii is the southernmost state of the United
States. Alaska is the furtherest state west but Hawaii is second. American Samoa is the southernmost territory and Guam is the westernmost.

The first European explorer to “discover” Hawaii in 1778 is Captain James Cook who named the islands the Sandwich Islands after the Earl of Sandwich. During Cook’s second visit to the islands, he was killed by islanders in a dispute over a boat. From 1778-1893, the islands were frequently visited by visitors from Europe and North America who brought diseases which ravaged the local population. In 1893, Queen Lili’uokalani was overthrown by local businessmen and from 1893 until 1898 a provisional government established the Republic of Hawaii. Hawaii became a U.S. territory and was annexed by the United States in 1898. After 60 years as a territory, Hawaii ultimately became the 50th U.S. State on August 21, 1959.

According to estimated 2005 census figures, it has a population spread over eight main islands in excess of 1.3 million including military personnel. The population is concentrated in the islands of Molokai and Oahu. The largest city and capitol of Honolulu is also located on the island of Oahu. Population increased nearly 5.3% from the 2000 census. Between 2000 and 2005, immigration from outside the United States resulted in an increase in population of 30,068 while an additional 13,112 people emigrated from within the United States. Asians constitute the majority of Hawaii’s population but the islands are culturally diverse according to 2005 figures with Caucasian 41.26%, Black 3.33%, American Indian/Alaskan Native .51%, Asian 57.53% and Native Hawaiian/Pacific Islander 22.10%.

Of all U.S. entities in the Pacific, Hawaii’s economy is the most diverse and stable and its future economic prospects are the brightest. The economy of Hawaii is heavily dependent on tourism (generally 24% of the gross state product) and military installations. Since becoming a State, tourism is the leading private sector industry with millions of people visiting every year generating significant income from room and general excise taxes. Hawaii has the highest per capita income among the Pacific Islands with a 2003 per capita income of $30,441. However, Hawaii also has extremely high state taxes and in 2002 and 2003 had the highest per capita state tax per capita at $2,757 and $2,838 per year. Education and food exports are also becoming a significant portion of the economy. In 2002, the Hawaii Agricultural Statistics Service reported that food exports of coffee, macadamia nuts, pineapple, livestock and sugar cane exceeded $530 million.\(^{29}\)

The government and judicial structure of Hawaii is similar to the continental United States with three branches of government: executive, legislative, and judicial. The Hawaiian judicial branch is divided between Superior Courts or general jurisdiction trial courts and appellate Supreme Courts. There is no intermediate court of appeals in Hawaii. Appeals from the Hawaiian Supreme Court go directly to the United States Supreme Court. Hawaii has a U.S. District Court and appeals are filed with the 9th Circuit Court of Appeals.

\(^{29\text{ Hawaii Department of Business, Economic Development & Tourism, Federal Activity and Hawaii’s New Economy,}}} \text{ www.hawaii.gov/dbedt/info/economic/data_reports/eropts/fr07-01r.pdf#search=hawaii%20economy.}
Although the government and judicial structures in the RMI, FSM, and Palau have some similarities to those in Hawaii, the United States, and its territories, they also have significant differences which will be explored in the next section.

**GOVERNMENT AND JUDICIAL BRANCH STRUCTURE**

Like the federal, state, and territorial governments of the United States, the Federated States of Micronesia, the Marshall Islands, and Palau are divided into three co-equal branches of government: judicial, executive, and legislative. The Republic of Palau, Republic of the Marshall Islands, and the Micronesian State of Yap also expressly recognize an equivalent “fourth” branch of government, a “Council of Chiefs,” which reflects the strong influence of customary or traditional law in the region. The matai in American Samoa, the iroij of the Marshall Islands, and the customary or “Council of Chiefs” in Palau and Yap retain significant influence over the legislative and judicial branches when it comes to traditional and customary law matters. The judicial branches of these countries are structured as follows.

**Republic of the Marshall Islands: Judicial Branch**

Article VI of the Constitution of the Marshall Islands addresses the creation and authority of the judicial branch. The judicial branch in the Marshall Islands consists of a

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30 The RMI Judiciary has created a website located at [www.rmicourts.org](http://www.rmicourts.org) which describes among other things the Marshall Islands and its judiciary, provides court rules, decisions and digests, and also supplies a useful link to the RMI Constitution, Revised Code, and selected regulations. The reader can now access all RMI Constitutional provision, statutes, and cases cited in this text by going to the [www.rmicourts.org](http://www.rmicourts.org) website.

31 *Constitution of the Marshall Islands, 1979, Article VI, § 1(1)* provides: “The judicial power of the Republic of the Marshall Islands shall be independent of the legislative and executive powers and shall vest
Supreme Court, High Court, District Courts and miscellaneous community courts. The High Court is equivalent to a general jurisdiction superior or trial court.\textsuperscript{32}

The Supreme Court is the superior constitutional court of record. It has one Chief Justice and two Associate Justices.\textsuperscript{33} The current Chief Justice, Daniel Cadra, was appointed to a 10 year term in October 2003. Historically, the Associate Judges are pro tem judges authorized by the legislature from other jurisdictions, e.g. the United States 9th Circuit Court of Appeals, the Republic of Palau, the Federal District Court in Hawaii, the Commonwealth of the Northern Mariana Islands, and even Canada. The Supreme Court has original jurisdiction in certain matters and also hears appeals from the High Court involving substantial questions of law or constitutional issues.\textsuperscript{34} Marshallese citizens appointed to the Supreme Court would serve to age 72.

The High Court is a court of original general jurisdiction for civil cases over $10,000 and felony criminal cases having a penalty in excess of three years or over $2000. The High Court also has appellate jurisdiction over cases tried in subordinate courts and jurisdiction to review the final decisions of government agencies.\textsuperscript{35} A Marshallese citizen appointed to the High Court would serve until age 72. The current

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\textsuperscript{32} Constitution of the Marshall Islands, 1979, Article VI, § 2 and §3. In addition to those provision in the Constitution that create the judiciary, additional information regarding the structure of the Marshall Islands judiciary was obtained from a web page entitled “Marshall Islands Courts System Information” published by the University of the South Pacific which can be found at http://www.pacli.org/mh/courts.html.\textsuperscript{33} The current Marshall Islands Supreme Court Chief Justice is Daniel Cadra who was appointed to a 10 year term in 2003. The High Court Chief Justice is Carl Ingram and the current High Court Associate Justice is James Plasman. The Chief Judge of the Traditional Rights Court is Berson Joseph (Alap or head of commoner/worker clan) and the Associate TRC Judges are Botlang Loek (iroij member) and Kalemen Jinuna (drijerbal/commoner/worker). The Presiding District Court Judge is Milton Zackios and Associate District Court Judge Jimata Kabua.\textsuperscript{34} Constitution of the Marshall Islands, Article VI, §2.\textsuperscript{35} Constitution of the Marshall Islands, Article VI, §3.
\end{flushright}
High Court Chief Justice, Carl Ingram, was appointed to a 10 year term in 2003 and current Associate Justice, James Plasman, was appointed to a 4 year term in 2008. Former Associate Justice Richard Hickson retired in 2008 and returned to Australia to the practice of law.

The Marshall Islands also have District Courts which are statutory courts of record consisting of a Presiding Judge and two Associate Judges. The District Court hears civil cases under $10,000, (excluding matters within the High Court’s original jurisdiction, land title cases, and admiralty and maritime cases), divorce and custody matters, and criminal cases under $4000 or imprisonment for up to three years or both. The District Courts also hear appeals from the Community Courts.  

The Community Courts are statutory courts of record for a local unit of government. There are 24 Community Courts. Each Community Court has a Presiding Judge and Associate Judges, if any, are appointed. Appointments are for 4-year terms. The Community Courts hear civil cases where the amount in controversy is less than $200. The Community Courts also hear misdemeanor criminal cases where the penalty does not exceed $400 or 6 months imprisonment or both.  

Like the matai in American Samoa, the iroij along with customary and traditional law still retain significant influence over the RMI executive, legislative, and judicial branches. A provision of the Constitution for the Marshall Islands establishes a 4th branch of government or a “Council of Chiefs” which is to consult with the legislative body, the

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36 27 MIRC Part IV.
37 27 MIRC Part V.
Nitijela, to ensure that legislation conforms to customary or traditional law.  

Furthermore, the Marshall Islands Constitution also establishes a Traditional Rights Court (TRC) which is a constitutional court of record that resolves disputes over customary titles, land rights, and other legal interests utilizing customary law and traditional rights. Decisions of this court can be of particular significance to businesses acquiring or leasing real property for their businesses since acquisitions of real property may be voided under customary law. The TRC consists of three or more judges selected to include a fair representation of all classes of land rights: Iroijlaplap (high chief); where applicable Iroijedrik (lower chief); Alap (head of commoner/worker clan); and Dri Jerbal (commoner/worker). The Cabinet appointed the current three judge Traditional Rights Court panel to four-year terms in May 2005 which expired in May 2009. The RMI Judicial Service Commission is in the process of reviewing and recommending candidates for appointment or re-appointment to the TRC to the Cabinet.

An interesting Constitutional feature of the Traditional Rights Court is that it has ancillary jurisdiction to proceedings in other courts and its jurisdiction can be invoked as a matter of right if a substantial question of custom or tradition arises that would be within the jurisdiction of the Traditional Rights Court.

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38 See Constitution of the Marshall Islands, 1979, Article III which creates the Council of Iroij and Article X, § 2 that requires the legislative body to enact legislation consistent with or as a supplemental to the rules of customary law or take into account traditional rights. Once the legislative body, the Nitijela, has declared customary law, the High Court has not been inclined to substitute its judgment for that of the legislature. For example, see the High Court December 1, 1993 order in Kabua Kabua v. Kabua Family Defendants, C. A. No 1984-98 and C.A. No. 1984-102 (consolidated), slip op. at pp.23-29

A High Court Judge may even appoint one or more Traditional Rights Court assessors to sit with the High Court at trial in an advisory capacity to consult with the High Court regarding legal issues implicating customary law or traditional rights.

Although these Traditional Rights Court judges may give their conclusions regarding traditional rights or customary law to the presiding High Court judge, the Traditional Rights Court assessors act only in an advisory capacity and do not actually participate in the High Court decision. Decisions of the TRC are to be given substantial weight, but TRC decisions are not binding on the High Court unless the certifying court concludes that justice so requires. The Marshall Islands Supreme Court has held that this means the certifying court is to review and adopt the decision of the TRC unless that decision is clearly erroneous or contrary to law. \textit{Abija v. Bwijmaron}.\footnote{2 MILR (Rev) 6, 15 (1994).}

**Republic of Palau: Judicial Branch**

Article X of the Palau Constitution indicates that the judicial branch of the Republic of Palau shall consist of “a Supreme Court, a National Court, and such inferior courts of limited jurisdiction as may be established by law.”

The Supreme Court is currently divided into two divisions: Trial and Appellate. The trial division is a court of general jurisdiction hearing both civil and criminal cases. The Court of Common Pleas, a court of limited jurisdiction, and the Land Court are inferior courts below the Supreme Court. The National Court provided for by the Constitution is currently inactive.
Federated States of Micronesia: Judicial Branch

Under Article XI of the Micronesia Constitution, the judicial branch in Micronesia consists of the FSM Supreme Court and inferior courts established by statute. Although the constitution provides for up to one Chief Justice and no more than five associate justices, it is currently comprised of a Chief Justice and three Associate Supreme Court Justices.

Each Supreme Court justice is a member of the trial division and appellate division, except that sessions of the trial division are held by only one justice. The justice who heard the case in the trial division is precluded from sitting on that case in an appellate capacity. In those instances where the trial court decision is appealed, a visiting judge, usually from one of the four State Supreme Courts, will be appointed to sit by designation. The Supreme Court Justices are appointed for life by the President and confirmed Congress.

No inferior national courts have been created under Article XI of the FSM Constitution. Under their respective state constitutions, the four state governments have

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41 The Legal Information System for the Federated States of Micronesia has created a website located at www.fsmlaw.org which describes among other things the FSM and state governments and their judiciary, provides court rules, decisions and digests, and also supplies a useful link to the FSM Constitution, Revised Code, and selected regulations. The reader can now access all FSM Constitutional provision, statutes, and cases cited in this text by going to the www.fsmlaw.org website.
44 Since the first edition was published, the FSM Supreme Court obtained additional funding to add an Associate Supreme Court Justice. The current members of the FSM Supreme Court are Chief Justice Andon Amaraich, and Associate Justices Martin Yinug, Dennis Yamase, and Ready Johnny. The newest Associate Justice is Justice Ready Johnny.
46 Id.
similar co-equal branches of government and each state has its own separate state judiciary which operates in a similar fashion to the national system. If the state constitution permits, an appeal from the state’s highest court may be heard by the appellate division of the national Supreme Court. \(^{48}\) Currently, only Kosrae and Chuuk Constitutions allow for such an appeal.

An interesting feature of the Compact of Free Association subsidiary agreements between Micronesia and the United States provides that any FSM national court judgment against the United States can, if unpaid, be filed and confirmed by the United States Federal Circuit Court of Appeals. An example of a litigant appealing a Micronesian national court decision involving Compact funds and claims against the United States to the U.S. federal appellate courts can be found in *Nahnken of Nett v. United States* \(^{49}\) in which the appellant failed to obtain a judgment against the United States and who subsequently appealed the FSM decision to the 9th Circuit Court of Appeals.

**United States Pacific Political Entities: Judicial Branch**

The state of Hawaii and all of these United States territories except American Samoa apply and follow American substantive law. As it particularly relates to this text, they apply the Anglo-American common law tradition in contract and sales law, employ the *Restatement (Second) of Contracts* and other texts as persuasive authority, and, in the case of the State of Hawaii, Guam and the Commonwealth of the Northern Mariana

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\(^{49}\) 126 F 3d 1433 (9th Cir. 1997)
Islands, have statutorily adopted the original version of the Uniform Commercial Code, which will be addressed in general terms throughout this text.

The government and judicial structure of Hawaii, Guam, and the CNMI are similar to the continental United States with three branches of government: executive, legislative, and judicial. The Hawaiian judicial branch is divided between Superior Courts or general jurisdiction trial courts and appellate Supreme Courts. There is no intermediate court of appeals in Hawaii, Guam or the CNMI. Appeals from the Hawaiian Supreme Court go directly to the United States Supreme Court. Previously, appeals from Guam and the CNMI were filtered before going to the U.S. Supreme Court by the U.S. Court of Appeals for the 9th Circuit. With the January 1, 2005 abrogation of 9th Cir. R. 6-1 and 9th Cir. R.6.2, appeals of decisions from the Guam and CNMI Supreme Courts may now be directly appealed to the U.S. Supreme Court.

Appeals from the High Court in American Samoa are unique and a bit trickier. In part, this is attributable to the fact that the High Court of American Samoa possess unique jurisdiction over some issues which would be considered federal issues in any other state or territory. Recently, some matters involving a U.S. Constitutional question, question of federal law, or diversity jurisdiction arising out of American Samoa and some recent criminal matters involving human trafficking have been filed in the U.S. District Court in Hawaii, appealed to the U.S. 9th Circuit and then to the U.S. Supreme Court. Historically, federal civil claims and most federal criminal matters arising out of

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50 9th Cir. R.6-1  Appeals form Final Decisions of Supreme Court of Commonwealth of the Northern Mariana Islands abrogated January 1, 2005.
51 9th Cir. R.6-2 Petition for Writ of Certorari to Review Final Decisions of Supreme Court of Guam abrogated January 1, 2005.
American Samoa are to be filed in U.S. District Court in Washington D.C. and appealed to the U.S. Court of Appeals in D.C. and the U.S. Supreme Court. Alternatively, if it is a territorial matter filed in the trial division of the American Samoa High Court and appealed to the appellate division of the High Court, appeals from the American Samoa High Court go directly to the Secretary of Interior. If the litigant is not satisfied by the decision of the Secretary of the Interior, the party may then sue the Secretary of Interior in the U.S. District Court for the District of Columbia for “failing to administer American Samoa in accordance with the United States Constitution or federal law.” Appeals for the U.S. District Court in the District of Columbia may be appealed to the U.S. Court of Appeals for the District of Columbia and the U.S. Supreme Court. There are ongoing Congressional discussions regarding how to resolve the convoluted and unique jurisdictional issues presented by the current situation in American Samoa.  

**INTERRELATIONSHIP BETWEEN THE CONSTITUTION, STATUTORY RULES OF DECISION AND CUSTOMARY LAW**

The next section of the text will explore the interrelationship between Constitutional provisions, statutory rules of decision, and traditional rights and customary law in each jurisdiction.

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Federated States of Micronesia

Article XI of the Micronesia Constitution, which addresses creation of the judicial branch, also contains a Judicial Guidance provision that requires:

Court decisions shall be consistent with this Constitution, Micronesian customs and traditions, and the social and geographical configuration of Micronesia. In rendering a decision, a court shall consult and apply sources of the Federated States of Micronesia.\(^{53}\)

Consequently, Micronesian courts are to give equal consideration in the decision making process to the Constitution, Micronesian custom and tradition, statute or prior decision of the court, and the social and geographical configuration of Micronesia.

When analyzing the constitution, Micronesian courts are required by Article XI, §11 to first look to the words of the Constitution and go no further if the Constitution resolves the issue.\(^{54}\) If that review does not resolve the issue, the courts can look to other sources of Micronesian law including the Journal of the Micronesian Constitutional Convention.\(^{55}\)

If ambiguity or doubt still exists, the Micronesian courts may look to decisions of the U.S. Supreme Court and other U.S. federal courts at the time the Micronesian Constitution was ratified in 1979 to determine its intent since the Micronesian Constitution of the Federated States of Micronesia, Article XI, § 11 (1979) as amended in 1991. The second sentence of the Judicial Guidance Clause was added in 1991.


\(^{54}\) See, for example, *FSM v. Tipen*, 1 FSM Intrm 79, 82 (Pon. 1982); *Suldan v. FSM (II)*, 1 FSM Intrm 339,342 (Pon. 1983); *Ponape Federation of Coop Ass’ns v. FSM*, 2 FSM Intrm 124,127 (Pon 1985) *Nena v. Kosrae*, 5 FSM Intrm 417, 422 (Kos. S. Ct. Tr. 1990)

Constitution is patterned on the U.S. Constitution.\textsuperscript{56} The FSM Supreme Court has indicated, however, that it does not “slavishly” follow interpretations of similar language by the United States and may look to the law of other nations, especially other similarly situated Pacific island nations, to determine whether approaches there may prove more useful in determining meaning of particular provision with the Micronesian Constitution.\textsuperscript{57}

In addition to looking to other jurisdictions other than the United States in addressing Constitutional matters, the Micronesian courts look to other jurisdictions in interpreting substantive law as well. For example, in a 2008 FSM Supreme Court case, \textit{Billimon v. Refit},\textsuperscript{58} Justice Dennis Yamase cited two cases from Palau as persuasive authority in assessing whether a Chuuk government employee’s personal action form independently established contract rights. In concluding that the PAF did not modify the term of Plaintiff’s employment and make him a permanent Chuuk Public Service System employee, Justice Yamase cited \textit{Towai v. Palau},\textsuperscript{59} and \textit{Kingon v. Palau},\textsuperscript{60} as “instructive and persuasive because the Republic of Palau inherited from the Trust Territory the same

\textsuperscript{56} See, for example, \textit{Lonno v. Trust Territory(I)}, 1 FSM Intrm 53, 69-70 (Kos 1982); \textit{In re Iriarte (I)}, 1 FSM Intrm 239, 249 (Pon.1983); \textit{Jonas v. FSM} 1 FSM Intrm 322,327 fn 1 (App 1983); \textit{Suldan v FSM (II)} supra at 345; \textit{Ponape Chamber of Commerce v. Nett}, 1 FSM Intrm 389, 394 (Pon. 1984); \textit{Etpison v. Perman}, 1 FSM Intrm 405,414 (Pon. 1984); \textit{Laion v. FSM} 1 FSM Intrm 503,523 (App 1984); \textit{Ponape Transfer & Storage v. Federated Shipping}, 4 FSM Intrm 37, 41 (Pon. 1989); \textit{Paul v. Celestine} 4 FSM Intrm 205,208 (App. 1990);  
\textsuperscript{57} See, for example, \textit{Lonno v. Trust Territory(I)}, supra, at 69, fn 11, and 71; \textit{FSM v Tipen}, supra at 83; \textit{Aisek v FSM Foreign Investment Board}, 2 FSM Intrm 95,98 (Pon. 1985); \textit{Federal Business Dev. Bank v. S.S. Thorfinn}, 4 FSM Intrm 367, 371 (App 1990).  
\textsuperscript{58} 16 FSM Intrm 209 (Chk. 2009)  
\textsuperscript{60} 2 Pal Intrm 72, 74-75 (App 1990).
personnel action forms that Chuuk did, and because the first FSM Supreme Court Chief Justice was a member of the appellate panel that decided *Towai*, the first case.”

The Federated States of Micronesia have also adopted a rule of decision statute, 1 FSMC §203, which indicates that the rules of the common law as expressed in the American Law Institute’s Restatement of Laws shall be the rule of decision in the courts of Micronesia. This rule of decision statute is a vestige of the Trust Territory Code, particularly 1 TTC 103. The statutory adoption of the Restatement of Laws by the FSM as the rule of decision is a unique regional development.

In regard to Constitutional interpretation, where the language of the FSM Constitution differs from the U.S. Constitution, it is presumed that the framers of the Micronesian Constitution intended to take another path. Where distinctions exist between the FSM Constitution and the U.S. Constitution, Micronesian courts are free to depart from foreign precedent and develop their own body of law consistent with the Constitution, Micronesian custom and tradition, and the social and geographic configuration of Micronesia.

Tension exists between the Micronesian Constitution’s Judicial Guidance Provision and the rule of decision statute requiring application of the American Law Institutes’ Restatements of Laws as was noted in *Rauzi v. FSM*.

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61 16 FSM Intrm at 212, fn1. Justice Yamase’s law clerk, Larry Wentworth, indicated in a April 17, 2009 e-mail that the first edition of this text has been a valuable resource and contributed to the growth of cross jurisdictional use of applicable contract law in the region “because [the Billimon decision] cites two Palau cases which would not have been cited if I hadn’t read your book where they were mentioned and suggested to [Justice Yamase] that they might be helpful.”


63 See, *Luda v. Maeda Road Construction Co. Ltd.*, 2 FSM Intrm 107, 112 (Pon 1985)

64 2 FSM Intrm 8 (Pon. 1985)
In *Rauzi*, the court observed that 1 FSMC § 203,65 with its sweeping mandate that the Restatements and other common law rules as applied in the U.S. be the ‘rules of decision,’ would draw the courts in a direction other than required by the Constitution’s Judicial Guidance Provision. The *Rauzi* court noted that FSM Const. Article XI, § 11 identifies the fundamental guiding principle of all Micronesian court decisions and that the judicial guidance provision requires that judicial decisions must be consistent with the Constitution, Micronesian custom and tradition, and the social and geographical configuration of Micronesia and not the Restatements of the American Law Institute or the decisions of the U.S. Courts concerning the common law as specified in statute. 66

**Republic of Palau**

Article V of the Constitution of the Republic of Palau addresses the relationship between the Constitution, statute, and customary law and traditional rights. As mandated by the Palau Constitution, statutes and customary law are considered equivalent but in

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65 1 FSMC § 203 states:

The rules of the common law, as expressed in the restatement of the law approved by the American Law Institute and, to the extent not so expressed, as generally understood and applied in the United States, shall be the rules of decision in the courts of the Trust Territory in applicable cases, in the absence of written law under section 201 of this chapter or local customary law applicable under section 202 of this chapter to the contrary and except as otherwise provided in section 205 of this chapter; provided, that no person shall be subject to criminal prosecution except under the written law of the Trust Territory or recognized customary law not consistent therewith.

case of conflict between statute and customary law, traditional rights are ultimately superior to statute.\textsuperscript{67}

Section 2 of Article V of the Constitution of Palau specifically states:

Statutes and traditional law shall be equally authoritative. In case of conflict between statute and traditional law, the statute shall prevail only to the extent that it is not in conflict with the underlying principles of the traditional law.\textsuperscript{68}

Like Micronesia, the rule of decision for the courts of Palau is established by statute.\textsuperscript{69} According to the rule of decision statute, the rule of decision for the courts of the Republic of Palau is the common law as expressed in the Restatement of Laws as published by the American Law Institute as understood and applied in the United States.

The statutory elevation of the Restatements to the level that the Restatements are the rule of decision in Palau and the FSM is a unique regional development and a remnant of the Trust Territory Code, 1 TTC §103. This regional adoption is unique because in the United States the Restatements of Law are not the rule of decision and are just one of


\textsuperscript{68} Constitution of Republic of Palau, Article V. § 2 (1979).

\textsuperscript{69} 1 PNC § 303 states:

The rules of the common law, as expressed in the restatements of the law approved by the American Law Institute and, to the extent no so expressed, as generally understood and applied in the United States, shall be the rules of decision in the courts of the Republic in applicable cases, in the absence of written law applicable under section 301 of this chapter or local customary law applicable under section 302 of this chapter to the contrary, and except as otherwise provided in section 305 of this chapter; provided that no person shall be subject to criminal prosecution except under the written law of the Republic or recognized local customary law not inconsistent therewith.
many sources of persuasive authority often advocating minority views or developing
trends.\textsuperscript{70}

The rule of decision statute, 1 PNC §303, is limited, however, and applicable only
to the extent that the rule of decision statute does not conflict with principles of
traditional law and the constitutional mandate of Article V, Section 2.

As observed in numerous cases,\textsuperscript{71} the courts of Palau are bound by the rule of
decision statute, 1 PNC § 303, to apply the common law of the United States as expressed
in the Restatements of Law in the absence of written law or local customary law to the
contrary.

However, where local or customary law or written statute exists or conflicts with
the Restatement of Laws, or where there is a conflict between the rule of decision statute,
1 PNC §303, and Article V of the Constitution requiring application of the customary or
traditional law, the Constitutional provision is superior and prevails and customary or
traditional law is to be considered superior to the rule of decision statute and the
American Law Institutes’ Restatements of Law.

\textsuperscript{70} This sentence was recently cited by the Asian Development Bank (ADB) in Chapter V. Issues Related to
Palau’s Legal System and Property Rights, p. 28 in ADB’sTechnical Assistance Report on Palau which can
be found at www.adb.org/documents/reports/PSA/PAL/chap05.pdf. Because the Restatement of Laws
often advocates minority, rather than majority, views and developing trends, Chief Judge Carl Ingram
indicated that the Marshalls Islands deleted the rule of decision statute from subsequent code revisions but
it is also why Justice Alexandro Castro of CNMI said in a conversation at the PJC Conference in 2005 that
he favors the Restatements and their minority positions which may be better suited for these small island
nations than what is happening on main street in the U.S.A.

\textsuperscript{71} For example, see such recent cases as Jiangsu, et al v. Ho, et al. 7 ROP Intrm 268, 272 fn 5 (1998);
Republic of Marshall Islands

Similar to Micronesia and the Republic of Palau, customary law is expressly recognized as a formal source of law in Article X, § 1 and § 2 of the Constitution of the Marshall Island. However, the scope and impact of traditional law in the Marshall Islands is significantly narrower than found in its Pacific island nation counterparts.

Article X of the Constitution of the Marshall Islands explicitly preserves traditional rights particularly as it relates to traditional rights of land notwithstanding those protected in the Bill of Rights or to transfers or contracts for the sale, mortgage, lease, license or otherwise of land rights.72

Another provision of the Constitution for the Marshall Islands establishes a 4th branch of government, a Council of Chiefs or Iroij, which is to consult with the legislative body, the Nitijela, to ensure that legislation conforms to customary or traditional law.73

72 The Constitution of the Marshall Islands, 1979, Article X, §1, subsection 1, provides:

Nothing in Article II shall be construed to invalidate the customary law or any traditional practices concerning land tenure or any related matter in any part of the Marshall Islands, including, where applicable, the rights and obligations of the Iroijlaplap, Iroijedrik, Alap and Dri Jerbal.

The Constitution of the Marshall Islands, Article X, §1, subsection 2, states:

Without prejudice to the continued application of the customary law pursuant to Section1 of Article XIII, and subject to the customary law or to any traditional practice in any part of the Marshall Islands, it shall not be lawful or competent for any person having any right in any land in the Marshall Islands under the customary law or any traditional practice to make any alienation or disposition of that land, whether by way of sale, mortgage, lease, license or otherwise, without the approval of the Iroijlaplap, Iroijedrik where necessary, Alap and the Senior Dri Jerbal of such land, who shall be deemed to represent all persons having an interest in that land.

73 See Constitution of the Marshall Islands, 1979, Article III which creates the Council of Iroij and Article X, § 2 that requires the legislative body to enact legislation consistent with or as a supplemental to the rules of customary law or take into account traditional rights. Once the legislative body, the Nitijela, has declared customary law, the High Court has not been inclined to substitute its judgment for that of the legislature.
Article XIII of the Marshall Islands Constitution perpetuates existing law until repealed, revoked and subject to any amendment which was in force on or after the effective date of the Constitution. One particular provision in effect at the time of the Constitutional adoption in the Marshall Islands was 1 TTC §103 which provided that the rules of the common law as expressed in the Restatement of Laws as approved by the American Law Institute shall be the rule of decision in the Marshall Islands. This provision statutorily mandated application of the Restatement of Laws as the rules of decision in the Marshall Islands until the Code was amended in 1988 and the equivalent of 1 TTC §103 was deleted effective January 1, 1989. Because the Restatement of Laws often advocates developing trends and minority, rather than majority, views, Chief Judge Carl Ingram indicated that the Marshalls Islands deleted the rule of decision statute from subsequent code revisions but it is also why Justice Alexandro Castro of CNMI said in a conversation at the PJC Conference in 2005 that he favors the Restatements and its minority positions which may be better suited for these small island nations than what is happening on mainstreet U.S.A.

Despite the statutory repeal, an interesting issue arises as to whether the Restatements are perpetuated in light of cases such as Likinbod and Alik v. Kejlat which indicate that the Constitution’s framework of governance has through the judiciary continued the common law, i.e. the Restatements of Laws, in effect at the time of adoption as the governing law in the Marshall Islands, subject to customary law, traditional practice or constitutional or statutory provisions to the contrary.

For example, see the High Court December 1, 1993 order in Kabua Kabua v. Kabua Family Defendants, C. A. No 1984-98 and C.A. No. 1984-102 (consolidated), slip op. at pp.23-29.

When interpreting constitutional or substantive law, the courts of the Marshall Islands frequently look to decisions of courts of other countries. In *RepMar v. Sakaio*, the Supreme Court noted that when interpreting and applying the Constitution, the courts of the Marshall Islands are required by Article I, § 3(1) to look to, but shall not be bound by, decisions of courts of countries similar in relevant respect.

In regard to statutory interpretation, the Marshall Islands Supreme Court indicated in the case *In the Matter of P.L. Nos. 1993-56 and 1994-87*, that when challenging the validity of a statute under the Marshall Islands Constitution, the court can refer to, but is not bound by, the decisions of the United States courts if the challenged statute and the Constitutional provisions are similar in nature.

In *Kabua v. Kabua*, the Supreme Court expanded the scope of inquiry beyond the United States indicating that if the constitution or constitutional provisions of other countries are not sufficiently similar, a court in the Marshall Islands may consider constitutions of states that are part of a federation, like their Pacific island nation neighbors, that has adopted common law if the constitutional provisions in those states are similar in relevant respect to the provisions of the Marshall Islands’ Constitution.

In *Likinbod and Alik v. Kejlat*, the Marshall Islands Supreme Court addressed the relationship between the common law and traditional law with the Constitutional framework. The court indicated that the common law tradition continued within the framework of governance by the Constitution and that the Constitution perpetuates the

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75 1 MILR (Rev.) 182 (October 18, 1989).
76 2 MILR 27, 35 (February 3, 1995).
77 1 MILR (Rev.) 247, 251 (December 20, 1991).
78 2 MILR (Rev.) 65 (April 21, 1995).
common law which would include the substantive law of contract in effect as the
governing law as long as customary law, traditional practice, the constitution or statute
are not in conflict. 79

In 1988, the Marshall Islands issued a re-codification effective January 1, 1989 of
its national code and repealed by omission 1 TTC §103 with its reference to the
American Law Institute’s Restatement of Law. 80 The Marshall Islands Code was
modified again in 2003. It continued to repeal by omission the equivalent of 1 TTC §103.
The 2003 revisions modified the section numbering style to conform to the new code
format. Despite these statutory omissions, cases such as Likinbod and Alik v. Kejlat 81
appear to hold that the Restatement of Laws would still be applicable, if not mandated,
although not by statute as the “rule of decision,” but because the “framework of
governance” provided by the Constitution under Article XIII continues the common law,
i.e. the Restatements, in effect as the governing law at the time the Constitution was
adopted in the absence of customary law, traditional practice or constitutional or statutory
provisions to the contrary.

When analyzing the applicability of customary law within the constitutional
framework, a two step analysis is required. While delineating the two step process in
Lobo v. Jejo, 82 the Marshall Islands Supreme Court observed that custom and tradition
have the force of law if adopted by the court or statute. The Marshall Islands Supreme
Court stated:

79 Id at 66
80 See 1 MIRC §2(b) (viii); §3(1);§6(1)(a)(1); §6(2); §12(1) and (2)
81 2 MILR (Rev. 65, 66 (April 21 (1995)
82 1 MILR (Rev.) 224 (January 2, 1991). See also, Zaion, et. al., v. Peter and Nenam, 1 MILR Rev. 228,331
(January 24, 1991)
Every inquiry into custom involves two factual determinations. The first is: is there a custom with respect to the subject matter of the inquiry? If so, the second is: what is it? Only when the ascertained custom is incorporated in a statute or has formed the basis of a final court decision does it become law in the modern sense.\(^{83}\)

**United States Territories and Political Entities: American Samoa**

A unique feature of the Bill of Rights in the Constitution of American Samoa\(^ {84}\) states:

It shall be the policy of the Government of American Samoa to protect persons of Samoan ancestry against against alienation of their lands and the destruction of the Samoan way of life and language, contrary to their best interests. Such legislation as may be necessary may be enacted to protect the lands, customs, culture, and traditional Samoan family organization of persons of Samoan ancestry and to encourage business enterprises by such persons. No change in the law respecting the alienation or transfer of land or any interest therein, shall be effective unless the same be approved by two successive legislatures by two thirds vote of the entire membership of each house and by the Governor.\(^ {85}\)

Because of this unique constitutional provision mandating that it be government policy to preserve Samoan custom and tradition, the judicial decisions of the associate justices of the High Court who are usually matai or customary chiefs have special import or cultural significance particularly when deciding land title disputes.

**The Sources of Regional Contract and Sales Law**

Contract and sales law in the Northern Pacific region is an amalgam of common law, legislation, and traditional or customary law. Contract law is generally considered to be a common law matter evolving from judicial decisions. Because of perceived inadequacies in the common law relating specifically to contracts for the sale of goods, the Sale of Goods Act was promulgated in England in 1893 and the Uniform Commercial

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\(^{83}\) 1 MILR (Rev.) at 226  
\(^{84}\) Rev. Cons. of Amer. Samoa, §3  
\(^{85}\) Id.
Code was subsequently formulated in the United States. Sales law in the Northern Pacific region is generally governed by statutes patterned after the original English Sale of Goods Act in the Marshall Islands, or by the Uniform Commercial Code in the state of Hawaii, Guam, and the Commonwealth of the Northern Mariana Islands. American Samoa has its own unique and abbreviated Commercial Code which is not patterned upon either the English Sale of Goods Act or the UCC. In the absence of such statutes, such as in the Federated States of Micronesia, contract and sales law is to be governed by the common law.

Although there has been a statutory effort to rescind Spanish, German, and Japanese law in Micronesia, it is still applicable and has residual effect particularly regarding contracts for the sale, lease or transfer of land. Otherwise, the Northern

87 Guam adopted the UCC in its entirety on January 1, 1977 and it is cited 13 GCA §10101 et seq.
88 5 CMC §1-101 et seq.
89 ASCA 27.1501 et seq.
90 1 FSMC § 204 provides:

All laws, regulations, orders and ordinances heretofore enacted, issued, made, or promulgated by Spanish, German, or Japanese authority which are still in force in the Trust Territory are hereby repealed except as provided in section 205 of this chapter; provided, however, that nothing in this code shall change the effect of local custom which may have been included within the scope of the laws, regulations, orders, or ordinances enacted, issued, made or promulgated as aforesaid.

This statute is anthropologically significant in that it expressly acknowledges that local custom and tradition may have integrated with foreign imposed law, regulations, orders or ordinances imposed by the Spanish, German or Japanese authorities that previously controlled the region.

91 1 FSMC § 205 states:

The law concerning ownership, use, inheritance, and transfer of land in effect in any part of the Trust Territory on December 1, 1941, shall remain in full force and effect to the extent that it has been or may hereafter be changed by express written enactment made under authority of the Trust Territory.
Pacific region draws heavily upon English and American precedent, statutes governing contract and sales, and the common law of contract. Contract and sales law is beginning to establish its own unique identity, in part, as it is anthropologically being assimilated into local traditional or customary law.

The Common Law

In the absence of statutory provisions, particularly those governing contracts for the sale of goods, contract law is governed by the common law. The next section will review the various regional sources of the common law.

Republic of the Marshall Islands

The Supreme Court of the Marshall Islands is obliged to follow the common law in the absence of any constitutional provision, legislative act, or any custom or traditional practices of the Marshallese people.

As mandated by the rule of decision provision in the Marshall Islands Constitution, the Marshall Islands primarily rely on the Anglo-American common law tradition as expressed in the American Law Institutes Restatements or as generally understood in the former Trust Territories.

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92 In some instances, there is even an effort to distinguish between U.S. and English versions in the Pacific territories, see for example American Samoan Code Annotated, ASCA 27.2503 Adoption of Uniform Negotiable Instruments Law which states “The Uniform Negotiable Instruments Law as proposed by the National Conference of Commissioners on Uniform State Laws and as construed by a majority of the courts in the United States, rather than the common law of England, shall govern those commercial transactions to which it is applicable.”

93 RepMar v. Waltz 1 MILR (Rev.) 74, 77 (March 2, 1987); Likinbod and Alik v. Kejlat, 2 MILR (Rev.) 65 (April 21, 1995). See also, 1TTC 103.

94 Constitution of the Marshall Islands, Art. XIII perpetuates 1980 TTC 103 for the Former Trust Territory which incorporates American law as expressed in the American Law Institutes Restatement or as generally understood in the former Trust Territories.
The rule of decision statute mandating application of the American Law Institutes Restatement was effective through January 1, 1989 because it was repealed by omission in the re-codification of the Marshall Islands Code in 1988. This statutory de-emphasis of the American Law Institute’s Restatement of Laws in the Marshalls differs from the Federated States of Micronesia and the Republic of Palau which have statutorily perpetuated the prior Trust Territory rule of decision statute, 1 TTC§ 103. The Restatement of Laws are still persuasive authority as noted in cases such as Likinbod and Alik v. Kejlat\(^{95}\) which provide that under the Constitutional framework, the common law applicable at the time the Constitution was adopted, i.e the Restatements of Law, continues in effect in the absence of customary or traditional law, or constitutional or statutory provisions to the contrary. Since the Restatements were the common law at the time of Constitutional adoption, they are perpetuated.

Although there is a strong American common law tradition, there is also a significant English statutory and common law influence as well.\(^{96}\) For example, Marshall Islands Sale of Goods Act of 1986 is patterned identically after the English Sale of Goods Act of 1893 with just minor linguistic alterations.\(^{97}\) Suprisingly, the version of the English Sale of Goods Act adopted in the Marshall Islands in 1986 is almost identical to

\(^{95}\) 2 MILR (Rev.) 65 (April 21, 1995)
\(^{96}\) Captain John Marshall of England was the first European to “discover” those islands which bear his name and English influence is perpetuated today through case law and application of the Marshall Islands Sale of Goods Act of 1986. An additional source of this English influence was the direct result of a Sri Lankan trained under the English tradition being retained as legislative counsel during the formative years of the Republic. For another example, see Balos v. Tennekone, 1 MILR (Rev) 137 (1989) where the parties sought a writ of prohibition barring High Court Chief Justice Tennekone from hearing a case addressing the constitutionality of a statute based upon the Ceylonese Commission of Inquiry Act that he had drafted when he was legislative counsel.
the 1893 original and does not even reflect the significant amendments which the English adopted nearly a decade earlier.

Further, there appears to be some substantive law diffusion occurring in the development of contract and sales law and its alternatives in the Marshall Islands. This diffusion is best reflected in a 2004 Marshall Islands Supreme Court case that applied a mix of American, Canadian, and English common law in a case rejecting claims of tortious interference with contract, and tortious interference with prospective contract and business relations and economic advantage. 98

Several factors contribute to this diffusion. First High Court Chief Judge Carl Ingram was legally trained in the United States while former Associate High Court Judge Richard Hickson was legally trained in Australia. Many of the lawyers practicing in the jurisdiction have also trained in varying traditions and multiple jurisdictions: the United States, the University of South Pacific, Australia, the Philippines, New Guinea etc…. Second, the Constitution of the Marshall Islands contributes to this diffusion of contract and sales law by permitting the appointment of Judges from outside the Republic of the

98 In Pacific International, Inc v. United States of America, 2 MILR 244 (May 10 2004), the Supreme Court of the Marshall Island held that the operation of military bases is a purely government function and sovereign in nature citing United States of America v. Public Service Alliance of Canada, (1992) 2 S.C. R. 50, 91 D.L.R. (4th) 449, 1992 Carswell Nat 1005 (with respect to a military base in Canada leased by the United States, the Supreme Court of Canada stated, “I can think of no activity of a foreign state that is more inherently sovereign than the operation of such a base.” As such, the United States government must be granted the unfettered authority to manage and control employment activity at the base.); Holland v. Lampen-Wolfe (2000) 3 All E.R. 833, [2001] I.L. Pr. 49, 2000 WL 976034 (HL) ([t]he maintenance of the base itself was plainly a sovereign activity.) As Hoffman L.J. (Now Lord Hoffman) said in Littrell v. United States (No.2), this looks about as imperial an activity as could be imagined”); and Cafeteria Workers v. McElroy 367 U.S. 886, 896 (1961) (“the governmental function…here was…to manage the internal operation of an important federal military establishment. In that proprietary military capacity, the Federal Government, as has been pointed out, has traditionally exercised unfettered control.”) Consequently, the Supreme Court held that the United States government and the United States Army were immune from suit and that alleged, in part, tortious interference with contract, and tortious interference with prospective contractual and business relations and economic advantage.
Marshall Islands to sit as visiting Supreme Court Justices by designation of the Cabinet.\textsuperscript{99} This appointment process lends itself to a regional blend or diffusion of the development of the common law in the Marshall Islands.


The \textit{Pacific International} case is particularly interesting from a diffusion perspective in that United States federal judges sitting by assignment were citing Canadian and English precedent in support of the ultimate conclusion in the case while formulating the common law for the Marshall Islands which may be considered by some other U.S. Federal judges to be taboo if this had been done in a comparable U.S case.\textsuperscript{103}

\textsuperscript{99} Constitution of the Marshall Islands, 1979, Article VI, §1, subparagraph 10.
\textsuperscript{100} 2 MILR 120 (August 26, 1998)
\textsuperscript{101} 2 MILR 127 (September 7, 1998)
\textsuperscript{102} 2 MILR 244 (May 10, 2004)
\textsuperscript{103} Id. Although \textit{Pacific International}, supra, is not a constitutional law case and constitutional and contract cases in the United States in its formative days frequently cited English precedent, in several recent decisions, U.S. Supreme Court Justice Antonin Scalia has been recently critical of the use of foreign precedent, English precedent excepted, and argues that this is an abandonment of national sovereignty in the interpretation of substantitive constitutional law in exchange for an “internationalist” approach being adopted by federal courts and some of his colleagues on the United States Supreme Court. See Justice Scalia’s dissents in \textit{Atkins v. Virginia}, 536 U.S. 304 (2002) and \textit{Lawrence v. Texas}, 539 U.S. 558 (2003). In
This diffusion of the substantive law is not unique to contract law or to the Marshall Islands, and one sees judges from other jurisdiction serving as visiting judges in the appellate courts of other island nations in the region. These regional cross assignments usually are a result of conflict or necessity due to the lack of available regional judicial resources.

**Republic of Palau**

Under the rule of decision statute, the Republic of Palau also relies upon the Anglo-American common law of contract as set forth in the American Law Institute’s *Restatement (Second) of Contracts*.\(^{105}\) As observed in numerous cases,\(^{106}\) the courts of Palau are bound by statute to apply the common law of the United States as expressed in the Restatements of Law in the absence of written law or local customary law to the contrary.\(^{107}\)

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*Atkins, supra* at 347-8, Justice Scalia observed: “Equally irrelevant are the practices of the ‘world community,’ whose notions of justice are (thankfully) not always those of our own people. ‘We must never forget that it is a Constitution for the United States of America that we are expounding….’ Where there is not first a settled consensus among our own people, the views of other nations, however enlightened the Justices of this Court may think them to be, cannot be imposed upon Americans through the Constitution.” Id at 347-8. (Quoting *Thompson v. Oklahoma*, 487 US 815, 868-9, n.4 (1988). See also, *Lawrence v. Texas*, 539 U.S. at 598. (Scalia, J. dissenting) (“Constitutional entitlements do not spring into existence because some states chose to lessen or eliminate criminal sanctions on behavior. Much less do they spring into existence, as the Court seems to believe, because foreign nations decriminalize conduct.” Id.).


\(^{105}\) 1 PNC §303.

\(^{106}\) For example, see recent cases such as *Jiangsu, et al v. Ho, et al*. 7 ROP Intrm 268, 272 fn 5 (1998); *Winterthur Swiss v. Socio Micronesia*, 8 ROP Intrm 169 (2000).

\(^{107}\) 1 PNC § 303.
Where local or customary law or written statute exists or conflicts, the Palau Constitution requires that local or customary law or statute would take precedent over American common law of contract and sales as currently expressed in the *Restatement (Second) of Contracts*.\(^{108}\)

There is also evidence of potential substantive law diffusion in Palau and the FSM by virtue of judicial cross assignment. In *Towai v. Palau* \(^{109}\) and *Kingon v. Palau* \(^{110}\), which were cited in 2008 by the FSM Supreme Court in *Billimon v Refit* \(^{111}\), it was noted that a FSM Supreme Court Justice served by assignment on the Palau Court that decided *Towai* and that in those cases the employment form at issue was a standard form used in both island nations.

**Federated States of Micronesia**

Likewise, the Federated States of Micronesia is statutorily required to apply the Anglo-American common law of contract as set forth in the American Law Institutes’ *Restatement (Second) of Contracts*\(^{112}\) in the absence of any contrary statutes, decisions of the constitutional courts of Micronesia, or custom and tradition within Micronesia which would then take precedent.\(^{113}\)

\(^{108}\) Republic of Palau Constitution, Article V, § 2.
\(^{109}\) 1 Pal Intrm 658 (App. 1989).
\(^{111}\) 16 FSM Intrm 209 (Chk 2008).
\(^{112}\) 1 FSMC § 203.
\(^{113}\) Micronesia Constitution of 1979, Article XI § 11. In *Semens v. Continental Airlines*, 2 FSM Intrm 131 (Pon. 1985), the court looked to the intention of the parties to determine whether the contract was to be governed by customary law. In the absence of such an express intent, the court applied the common law of the United States. See also, *FSM v. Ocean Pearl*, 3 FSM Intrm. 87, 90-91 (Pon. 1987) the court indicated that the common law decisions of the United States are an appropriate source of guidance for the FSM Supreme Court for contract issues which are unresolved by statutes, decisions of constitutional courts or custom and tradition within the FSM.
Although there has been an effort to repeal Spanish, German, and Japanese laws in effect in Micronesia to the extent that they have not already been integrated into local custom, the effect of prior colonization still lingers and FSM statute requires that Spanish, German, and Japanese laws in effect as of December 1, 1941 which involve contracts for the ownership, sale, lease, or transfer of land currently remain in effect until statutorily modified.

Further, as in Palau and the Marshall Islands, there appears to be some substantive law diffusion occurring in the development of contract law in the FSM in part as a result of the first edition of this text which was distributed to members of the judiciary and made cases cited in the text readily available among jurisdictions. In the 2008 FSM Supreme Court case, Billimon v. Refit, Justice Dennis Yamase cited two cases from Palau as persuasive authority in assessing whether a Chuuk government employee’s personal action form (PAF) independently established contract rights. In concluding that the PAF did not modify the term of Plaintiff’s employment and make him a permanent Chuuk Public Service System employee, Justice Yamase cited Towai v. Palau, and

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114 1 FMSC § 204.
115 1 FSMC § 205. See also Etscheit v. Adams, 6 FSM Intrm 365 (Pohnpei 1994) in which Supreme Court Justice Andon Amaraich sitting as a trial judge eloquently addresses the socio-cultural anthropological impact of Spanish, German, and Japanese culture and its conflict with Micronesian culture in this complex land partition case arising out of a land purchase in 1903 at a public auction conducted by the German government who had acquired the land from Spain several years earlier. The contract and deed contained standard German primogeniture provisions. To complicate matters, the purchaser died during the period of Japanese occupation, transferring the property to his heirs. The Japanese government largely ignored these German patrilineal primogeniture provisions and allowed ownership and division of land by both men and women. These German provisions, however, are contrary to local Micronesian matrilineal custom and the court concluded that these German rules of patrilineal primogeniture should not be applied to the land in question.
116 16 FSM Intrm 209 (Chk. 2008).
Kingon v. Palau,\(^{118}\) as “instructive and persuasive because the Republic of Palau inherited from the Trust Territory the same personnel action forms that Chuuk did, and because the first FSM Supreme Court Chief Justice was a member of the appellate panel that decided Towai, the first case.”\(^{119}\)

**Regional Legislation**

In addition to the common law, contract and sales law is also governed by various pieces of regional legislation. In those instances where it exists, legislation governing the sale of goods supplants the common law of contract.

**Republic of Marshall Islands**

In the Marshall Islands, the law of contract is also governed by the American Law Institute’s *Restatement of Contracts* as mandated by the former Trust Territory Code which had an effective termination date of May 1, 1979,\(^{120}\) the Sale of Goods Act of 1986,\(^{121}\) the Unfair Business Practices Act,\(^{122}\) the Usury Act,\(^{123}\) and the Consumer Protection Act.\(^{124}\)

The *Restatement (Second) of Contracts* continued as the rule of decision in the Marshall Islands until January 1, 1989 when it was repealed by omission from the 1988

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\(^{118}\) 2 Pal Intrm 72, 74-75 (App 1990).

\(^{119}\) 16 FSM Intrm at 212, fn1. Justice Yamase’s law clerk, Larry Wentworth, indicated in a 2009 e-mail that the first edition of this text has been a valuable resource and contributed to the growth of cross jurisdictional use of applicable contract law in the region “because [the Billimon decision] cites two Palau cases which would not have been cited if I hadn’t read your book where they were mentioned and suggested to [Justice Yamase] that they might be helpful.” April 17, 2009 e-mail from Larry Wentworth to Daniel P. Ryan.

\(^{120}\) Constitution of the Marshall Islands, Art. XIII perpetuates 1 TTC 103 for the Former Trust Territory which incorporates American law as expressed in the American Law Institute’s Restatement or as generally understood in the former Trust Territories.

\(^{121}\) 23 MIRC, Cap 1.

\(^{122}\) 20 MIRC, Cap 3.

\(^{123}\) 20 MIRC Cap 7

\(^{124}\) 20 MIRC, Cap 4
re-codification. The *Restatement (Second) of Contracts* remains persuasive authority because the common law in effect at the time of Constitutional adoption is perpetuated under the constitutional framework as noted in *Likinbod and Alik v. Kejlat*. In conversations with High Court Chief Judge Carl Ingram, he indicated that one of the reasons that 1 TTC §103 was omitted from the re-codifications was that the members of the Marshall Islands judiciary where not particularly enthused as to having the Restatements mandated as the sole source for the rules of decision particularly because the Restatements either took minority views or adopted developing trends. By deleting this statutory limitation, it opened the door for the RMI judiciary to consult other sources of persuasive authority as well.

According to regional sources, the Sale of Goods Act of 1986 for the Marshall Islands has no legislative history and was drafted by legislative counsel from Sri Lanka, a former British colony. Although the Marshall Islands may be influenced by the American common law of contract and sales, in reviewing the Sale of Goods Act of 1986 it is readily apparent that the Marshall Islands’ Sale of Goods Act of 1986 is patterned identically after the English Sale of Goods Act of 1893 with only minor linguistic

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125 2 MILR (Rev) 65 (April 12, 1995)
126 February 7-11, 2005 at the Pacific Island Legal Institute.
127 On the other hand, Associate Supreme Court Justice Alexandro C. Castro of the Commonwealth of the Northern Mariana Islands recently indicated at the Pacific Judicial Conference in Koror, Palau on June 6-8, 2005 that the Restatement is preferred in the region because of its minority positions and that these minority positions are sometimes better suited for these island nations than they would be on Main Street USA.
128 Correspondence from Chief Justice Carl Ingram, High Court, Republic of the Marshall Islands, dated 10/12/04
deviations and does not contain any of the subsequent revisions or amendments to the act.\textsuperscript{129}

Subsequent to publication of the first edition of this text and in response to an Asian Development Bank Technical Assistance project, the Marshall Islands adopted the Secured Transaction Act of 2007\textsuperscript{130} which is similar to the revised Article 9 of the UCC and allows for online recording of security interests in goods, and real and personal property. There are several practical problems with this legislation with the most significant being that the Nitijela did not reconcile the Secured Transaction Act of 2007 with the 1986 RMI Sale of Goods Act. The Secured Transaction Act of 2007 provides for security interests in goods, real and personal property. Most property in the RMI is communally owned and may only be alienated subject to customary and traditional law even with the passage of the 2006 Land Recording and Registration (Amendment) Act of 2006\textsuperscript{131} which still makes it difficult for an individual or business entity which wishes to contract for the purchase of land to get clear title in which to obtain a security interest provided for under the Secured Transaction Act. Second, personal property, like automobiles or construction equipment, do not last long in the Pacific’s harsh salt environment so an extended security interest (60 months or more) may not be worth much more than the paper or hard drive on which it is printed or recorded. Last, a third type of property in which one may obtain a security interest is in goods. In the RMI, the sale of goods is governed under the provisions of the English Sale of Goods Act of 1893

\textsuperscript{129} English Sale of Goods Act, 56 & 57 Vic.C.71 (1893). An example of such a deviation would be the deletion of English pounds in the statute of frauds provision.
\textsuperscript{131} PL 2006-59, 24 MIRC 4.
which the Marshall Islands adopted nearly verbatim as the 1986 Sale of Goods Act. These earlier provisions were replaced by the drafters of the UCC because they perceived that the English Sale of Goods Act of 1893 was inadequate to address sophisticated commercial transactions. In fact, England even revised its Sale of Goods Act in 1977 to address deficiencies in the earlier 1893 version but for some unknown reason the RMI adopted the 1893 version in 1986. For the Marshall Islands to adopt an enhanced version of UCC Article 9 in the Secured Transaction Act of 2007 without revising or replacing the inconsistent provisions of 1986 Sale of Goods Act at the same time is perplexing.

**Micronesia and Palau**

In the absence of legislation comparable to the UCC or English Sale of Goods Act, the Republic of Palau and the Federated States of Micronesia are primarily common law jurisdictions as it relates to the law of contract and sales. In fact, Micronesia when given the statutory opportunity to adopt the equivalent of UCC Article 2 governing the sale of goods chose to exempt out those provisions from adoption and reserved what would have been Article 2 for future development.

The substantive law of contract and sales was previously governed by the former Trust Territory Code which has been supplanted by the adoption of national codes in each respective jurisdiction.\(^{132}\) As it relates to contract law, the former Trust Territory Code mandated both of these jurisdictions to apply the American Law Institutes’ Restatement

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\(^{132}\) 1 FSMC § 203 in Micronesia and 1 PNC § 303 in Palau perpetuate 1 TTC 103 for the Former Trust Territory which incorporates American law as expressed in the American Law Institutes Restatement or as generally understood in the former Trust Territories. Although the Federated States of Micronesia has nationally adopted 1 TTC §103 as 1 FSMC §203, the individual States of Yap and Kosrae have effectively repealed this provision by adoption of codes that do not include this provision. In the State of Chuuk, this provision has not yet been repealed or deleted and still has some vitality as long as its application is not inconsistent with Chuuk custom or tradition or with the Chuuk Constitution or statute.
of Contracts as the statutory rule of decision. This Trust Territory statute, 1 TTC §103, has been adopted by both the FSM and Palau and remains in effect today.

Although they have miscellaneous pieces of legislation in place, Palau and Micronesia have not enacted any legislation directly governing the sale of goods equivalent to the Sale of Goods Act utilized in the Marshall Islands, Article 2 of the UCC applicable in the United States (including Hawaii), its territories (Guam and the Commonwealth of the Northern Mariana Islands), an abbreviated Commercial Code similar to that utilized in American Samoa, or comparable international standards promulgated by the United Nations Conference of the International Sale of Goods (CISG) or the UNIDROIT Principles of Contract Law. In the absence of such legislation, the common law of contract as set forth in the Restatement (Second) of Contracts prevails in Palau and Micronesia as long as it is not in conflict with local custom or tradition.

Title 33 of the Micronesia Code which addresses Commercial Law tracks the UCC provisions but reserves for future development a number of UCC chapters which would directly govern contracts for the sale of goods including Chapter 2 for Sales and Chapter 3 for Commercial Paper. Although these particular chapters have been reserved for future development, Micronesia has adopted a portion of the UCC which has some minimal bearing upon sales or contract law. Specifically, Micronesia has adopted UCC Chapter 8 which addresses Investment Securities and originally adopted a rudimentary and truncated version of UCC Chapter 9 governing Secured Transactions. This haphazard adoption initially created some irony in that UCC Article 9 provides for

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133 33 FSMC § 801 et. seq.
134 33 FSMC § 901 et. seq.
security interests in goods but since the FSM failed to adopt those UCC provisions governing the sale of goods, i.e Article 2, and there was no system for recording security interests contained in the statute so virtually all “secured interests” in goods were “secret liens” and thus unenforceable against third parties.\textsuperscript{135} Subsequent to the initial publication of these materials in February 2005 and in response to an Asian Development Bank (ADB) Technical Assistance project, the 14\textsuperscript{th} FSM Congress repealed part of Chapter 9 and adopted Secured Transaction Act, Title 33, Chapter 10 of the FSM code in November 2005.\textsuperscript{136} The 2005 FSM Secured Transaction Act is similar to an enhanced and revised Article 9 of the UCC, eliminates the problem of “secret liens” that existed, and allows for online recording of security interests in goods, and real and personal property.\textsuperscript{137} It is perplexing why the ADB recommended repealing old Article 9 and did not simply replace it with revised Article 9. To date, there have only been two cases both decided in 2009 involving the new Secured Transactions Act of 2005 since its enactment in which FSM banks have sought foreclosure on liens that they claimed were perfected under the new act.\textsuperscript{138}


\textsuperscript{136} 33 FSMC §§1001-1071. The old Chapter 9 is posted on the \texttt{www.fsmlaw.org} website and the code sections on the website have not been updated since 2005 to include the 2005 revisions repealing part of Chapter 9 and listing the new Chapter 10.

\textsuperscript{137} PL 14-34 (2005); 33 FSMC §§1001-1071. This 2005 legislation repealed Title 33, §§921-933 in their entirety by renaming Chapter 9 “Real Property Security Investments,” by enacting a new Chapter 10 named “ the Secured Transactions Act” by enacting new sections 1001 through 1071 setting forth a law of secured transactions, to further amend title 53, as amended, by amending section 607 to make social security liens subject to the Secured Transactions Act, to further amend title 54, as amended, by amending sections, 135, 152.224, and 226 to make tax liens subject to the Secured Transaction Act, and other purposes.

Like the new secured transaction legislation in the RMI, there are several practical problems with the new FSM legislation with the most significant being that the FSM has not adopted the equivalent of UCC Article 2 in conjunction with the Secured Transaction Act of 2005. The Secured Transaction Act of 2005 provides for security interests in goods, real and personal property. Most property in the FSM is communally owned with ample case law involving foggy boundary lines and which may only be alienated subject to customary and traditional law in the FSM which still makes it difficult for an individual or business entity which wishes to contract for the purchase of land to get clear title in which to obtain or record a security interest. Second, personal property like automobiles or construction equipment do not last long in the Pacific’s harsh salt environment and the 300 plus inches of rain the FSM receives on an annual basis so an extended security interest (60 months or more) may not be worth much more than the paper or hard drive on which it is printed or recorded. Last, a third type of property in which one may obtain a security interest is in goods. In the FSM, Article 2 of the UCC governing the sale of goods was reserved so contract and sales law is governed by the common law or Restatement (Second) of Contracts under the statutory rule of decision. The common law has always been considered deficient to handle commercial transactions which is why the English adopted the English Sale of Goods Act in 1893, why the English amended the Sale of Goods Act in 1977, and why the drafters of the UCC adopted the UCC and Revised UCC because of perceived deficiencies in the English Sale of Goods Act. For the FSM to adopt an enhanced version of UCC Article 9 in the Secured Transaction Act of 2005 while leaving commercial transactions to be
governed by the common law without adopting provisions governing the sale of goods or commercial transactions at the same time simply is inexplicable.

In addition to the common law of contract and to the extent applicable, the law of contract and sales law in Micronesia and Palau are also governed piecemeal by various pieces of legislation including the Consumer Protection Act, the Anticompetitive Practices or Unfair Business Practices Act, and the Usurious Interest Act. The individual States of Pohnpei in Micronesia and the Republic of Palau have also adopted the Statute of Frauds. My FSM judicial brothers including FSM Chief Justice Andon Amaraich, former Pohnpei Supreme Court Justice Judah C. Johnny, and former Kosrae Chief Judge Yosiwo George, Chief Judge Aliksa Aliksa, Pohnpei Chief Justice Ben Rodriguez and others have indicated that there is a strong cultural or

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139 Palau Consumer Protection Act, 11 PNCA § 201 et seq; Micronesia Consumer Protection Act, 34 FSMC § 101 et seq
140 Micronesia Anticompetitive Practices Act, 32 FSMC § 301 et seq.
141 Palau Unfair Business Practices Act, 11 PNCA § 301 et seq.
142 Palau Usurious Interest Act 11 PNCA § 301 et seq.; Micronesia Usury Act, 34 FSMC § 201,et. seq. A Micronesian case raising a usury defense is Richmond Whole Meat v. Kolonia Consumer Coop Ass’n, 7 FSM Intrm 387 (Pohnpei 1996) in an $30,874.38 open account stated claim in which plaintiff Richmond provided product to defendant and defendant was supposed to pay. The dispute over a difference of $20.80 escalated to $1039.99 with compounding interest. The Plaintiff moved for summary judgment which the trial court granted in part and denied the motion in part indicating that then only issue for trial are the amount of the one invoice in dispute and what interest the Plaintiff may claim. Id at 389-90.
143 The Micronesian State of Pohnpei has adopted the Statute of Frauds in Pon. S.L. No. 2L-38-80. However, Yap and Kosrae have not adopted the Statute of Frauds. Further, there is no Statute of Frauds recognized in Chuuk and has been expressly rejected as being inconsistent with Chuuk tradition and culture. Marcus v. Truk Trading Corp. 10 FSM Intrm 387, 389 (Chk 2001). See also Marcus v. Truk Trading, 11 FSM Intrm 152 (Chk 2002)
144 See for example, 39 PNC §501 et seq.
145 The term “brothers” is used because of the relationship that has developed over the years with my judicial colleagues in the FSM who started calling me Judge “Kosraen” instead of “Judge Ryan” after current Chief Judge Aliksa B. Aliksa began to do so. My observations regarding the Statute of Frauds are based on a number of conversations over the years with FSM Supreme Court Justices Andon Amaraich, Chuuk Justices Wanis Simina, Machine O’Sonis, Keske Marar, and Camillo Noket, Kosrae Judges Yosiwo George and Aliksa B. Aliksa, Pohnpei Supreme Court Justices Judah Johnny, Nelson Joseph, Nickontro Johnny, Ben Rodriguez, Ioanis Kanichy, and Yap Supreme Court Justice Mugunbay who have reiterated
anthropological reason why UCC Article 2’s Statute of Frauds was not adopt as part of Title 33 of the FSM National Code and left to the individual FSM states to adopt if they chose to do so and most have not. A Micronesian’s word is their bond regardless of the amount or nature of the contract and enforcement for those who do not perform is not only a matter to be resolved in Court but also may be a customary or traditional law matter to be resolved between families or clans. For one who breaches, it can result in a judgment recognized in a court of law but also cultural osterization and the realistic equivalent of being “voted off the island” like on the popular television show “Survivor: Micronesia” or “Survivor: Palau.”

United States State, Territories and Commonwealths

In addition to the common law, the Northern Mariana Islands, Guam, and the State of Hawaii have comparable legislation governing contract and sales law. This text will provide general statutory citations for easy reference but not address in length the particular standard provisions of the UCC, Statute of Frauds, and Consumer Protection in Guam, CNMI and Hawaii which are not anthropologically unique and mirror those provisions in the continental United States. However, legislation governing contracts and sales in American Samoa is different than in any other United States state, territory, or commonwealth.

the stong oral tradition that permeates Micronesian culture and how the Statute of Frauds is unnecessary in light of custom and tradition.
Contract and sales law in the Commonwealth of the Northern Mariana Islands is governed by the Uniform Commercial Code,\textsuperscript{146} a Statute of Frauds,\textsuperscript{147} and Consumer Protection Statute.\textsuperscript{148}

Similarly, Guam has also adopted the Uniform Commercial Code,\textsuperscript{149} a Statute of Frauds,\textsuperscript{150} and Consumer Protection Statute\textsuperscript{151} which regulate contracts in that particular U.S. territory.

The State of Hawaii also utilizes the Uniform Commercial Code\textsuperscript{152} and has adopted the Statute of Frauds\textsuperscript{153} and a Consumer Protection Act.\textsuperscript{154}

Because American Samoa is “unincorporated” and outside provisions of U.S. Consumer Protection laws, American Samoa is unique and has adopted its own Consumer Protection Act creating a Commission to investigate local consumer complaints\textsuperscript{155} and also addresses but does not define “goods” subject to the Consumer Protection and other acts.\textsuperscript{156} Title 27, Chapter 8 entitled “Goods” only requires that parts for retail home entertainment be supplied and adequate service departments be maintained.\textsuperscript{157} The only other provision under the statutory section entitled “Goods” was for kegs of beef which was repealed.\textsuperscript{158}

\textsuperscript{146} 5 CMC §1101 et. seq.
\textsuperscript{147} 2 CMC §4912
\textsuperscript{148} 4 CMC §5101 et. seq.
\textsuperscript{149} 13 GCA §10101 et. seq.
\textsuperscript{150} 13 GCA §1206
\textsuperscript{151} 5 GCA §32101 et. seq.
\textsuperscript{152} HRS §490-10
\textsuperscript{153} HRS §656-1
\textsuperscript{154} HRS §487
\textsuperscript{155} ASCA 27.0401 et seq.
\textsuperscript{156} ASCA 27.0801.
\textsuperscript{157} ASCA 27.0801.
\textsuperscript{158} ASCA 0820 repealed by PL 16-82§1.
American Samoa also has a limited four paragraph Warranties Act\textsuperscript{159} that provides for warranties of merchantability and fitness for a particular purpose;\textsuperscript{160} recovery by merchant against manufacturer;\textsuperscript{161} statement of applicable warranties-penalty;\textsuperscript{162} and a provision enumerating basic consumer remedies.\textsuperscript{163}

The abbreviated American Samoa Commercial Code also contains a Statute of Frauds\textsuperscript{164} which only addresses sales of good in excess of $500 but which does not address other typical relationships one sees in commercial transactions. For example, there are no provisions addressing contracts for the sale of land, surety relationships, contracts in excess of one year, or other provisions that one sees frequently in commercial transactions. There is a strong anthropological reason that provisions regarding the sale of land are not included in the American Samoa Statute of Frauds and that is because 90\% of the land in American Samoa is controlled by the matai and communally owned land which can only be alienated subject to customary or traditional law or if approved by the Governor.\textsuperscript{165} Because a Samoan’s word is their bond no writing is necessary to enforce these traditional and customary law restrictions on alienation of

\begin{itemize}
\item[\textsuperscript{159}] ASCA 27.0701 et seq.
\item[\textsuperscript{160}] ASCA 27.0701.
\item[\textsuperscript{161}] ASCA 27.0702.
\item[\textsuperscript{162}] ASCA 27.0703.
\item[\textsuperscript{163}] ASCA 27.0704.
\item[\textsuperscript{164}] ASCA 27.1530
\item[\textsuperscript{165}] ASCA 37.0204. There are three types of land in American Samoa: matai land (90\%), freehold land, and individually owned native land. Freehold land or land included in grants before annexation in 1900 may be alienated to a person who has less than 50\% native blood. However individually owned native land or matai land may be alienated only to persons with more than 50\% native blood, or such land may be alienated to a person of non-native blood (less than 50\% Samoan blood) only if the person (1) was born in American Samoa, (2) is a descendant of a Samoan family, (3) lives with Samoans as a Samoan, (4) has lived in American Samoa for more than 5 years, and (5) has officially declared an intent to remain in American Samoa for life. Even after all of these provisions have been met, alienation of matai or communal land also requires consent of the Governor. ASCA 37.0204.
\end{itemize}
matai land but they also make it extremely difficult to contract to acquire land as part of any commercial transaction in any manner other than by long term lease.

American Samoa’s abbreviated version of a Commercial Code\textsuperscript{166} contains only 6 paragraphs (limit on sale price; validity of mortgage; bill of sale; filing instrument of satisfaction; contracts sufficiency of writing; contracts formal requirements; and contracts enforceability) and is far different than the far more extensive UCC or even the Marshall Islands’ Sale of Goods Act of 1986 which are also applicable in the region. The Commercial Code of American Samoa addresses the sale of goods in a limited manner and also contains rudimentary and truncated provisions regarding security interests which permits the potential creation of “secret liens” unenforceable by 3\textsuperscript{rd} parties. It should also be noted that ASCA §27.2503 adopts the Uniform Negotiable Instrument Law “as proposed by the National Conference of Commissioners on Uniform State Laws and as construed by a majority of the courts in the United States rather than the common law of England, shall govern those commercial transactions to which it is applicable.” The problem with this statutory provision is that the majority of states have adopted the UCC and their courts no longer interpret or construe the Uniform Negotiable Instruments Act. ASCA Section 1501 of the Commercial Code indicates that credit transactions cannot be more than current cash selling price and that interest on credit transactions cannot exceed 8% per annum.\textsuperscript{167} In an effort to prevent potential “secret liens,” Section 1510 provides that no mortgage, bill of sale, conditional sales contract, deed of trust or conveyance of personal property is valid as to persons who do not have actual knowledge (third parties)

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\textsuperscript{166} ASCA 27.1501 et. seq. \\
\textsuperscript{167} ASCA 27.1501.
unless accompanied by personal delivery. The only exceptions to Section 1510 are: (1) if the document is in writing signed by the person bound and witnessed by at least one witness; (2) if the document is filed within 10 days with the Territorial Registrar; or (3) if the document truly states the consideration upon which it is based or the debt or liability which it was intended to secure, and contains a description of the specific article, articles, or land sold or mortgaged. Once an obligation secured under ASCA 27.1510 is satisfied, the holder of the security interest shall file a satisfaction with the Territorial Registrar releasing his interest in the property affected. The Statute of Frauds is found at ASCA 27.1530 and applies to the sale of goods in excess of $500. The American Samoa Statute of Frauds indicates that a writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable beyond the quantity of goods shown in the writing. Absent, however, from the American Samoa Code are any other gap filling terms like those found in the UCC. Section 1531 addresses the confirmatory memo situation and indicates that between merchants (consumers exempted) if within a reasonable time a writing in confirmation of the contract and which is sufficient against the sender is received and the party receiving it has reason to know of its contents, the confirming memo satisfies the requirements of

168 ASCA 27.1510.
169 ASCA 27.27.1510. This statute is intended to prevent creation of a general mortgage and reinforces the prohibition against mortgages on after acquired real property and fixtures as well as security interests in personal property. See, Shantilal Brothers Ltd. V. KMST Wholesale 15 ASR 2d 115 (1990) Further, the purpose of ASCA 27.1510 requiring recording of non-possessory liens is: (1) to protect those who might otherwise extend credit to others in the mistaken belief that the borrowers’ possessions are likely to be available as security for any unpaid debts; and (2) to foil fraudulent assertions by judgment debtors that property in their possession actually does not belong to them but has been purchased by or hypothecated to friends or relatives. Development Bank v. Reed 5 ASR2d 135 (1987)
170 ASCA 27.1511.
171 ASCA 27.1530.
ASCA 27.1530 unless there is a written objection filed within 10 days of receipt.\textsuperscript{172} The sixth and last section of the American Samoan Commercial Code addresses the enforceability of contracts that do not meet the Statute of Frauds requirements set forth in ASCA 27. 1530.\textsuperscript{173} Section 1532 addresses specially manufactured goods; admissions in pleadings, testimony or in court; or those instances where payment has been made or accepted or where goods have been received and accepted.\textsuperscript{174}

\textbf{Interrelationship between Regional Customary or Traditional Rights and Contract and Sales Law}

The interrelationship between customary law, traditional rights and contract and sales law in this region will also be explored in this text. There are a number of leading socio-cultural anthropological texts which have engaged in cross-cultural comparative studies of legal systems but there have been very few which have focused on the Northern Pacific island region. An example of a leading work of this genre would include the 19th Century narrative by Sir Henry Sumner Maine entitled \textit{Ancient Law}.\textsuperscript{175} His “status to contract” quote cited previously is frequently employed to describe 19\textsuperscript{th} century mid Victorian views of societal progress.\textsuperscript{176} His work spans ancient history focusing

\begin{flushright}
\textsuperscript{172} ASCA 27.1531.  \\
\textsuperscript{173} ASCA 27.1532.  \\
\textsuperscript{174} ASCA 27.1532.  \\
\textsuperscript{175} Maine, H.S. \textit{Ancient Law} (3rd ed. John Murray 1866). The version utilized in this text has a new introduction by Dante Scala and was published by Transaction Publishers in 2003. Maine’s text was originally published in 1861 by John Murray in London, England.  \\
\textsuperscript{176} Maine, H.S., \textit{Ancient Law}, 170 (3rd Ed. John Murray 1866). Maine stated: “The word Status may be usefully employed to construct a formula expressing the law of progress thus indicated, which, whatever be its value, seems to me to be sufficiently ascertained. All the forms of Status taken notice of in the Law of persons were derived from, and to some extent are still coloured by, the powers and privileges anciently residing in the Family. If then we employ Status, agreeably with the usage of the best writers, to signify these personal conditions only, and avoid applying the term to such conditions as are the immediate or remote result of agreement, we may say that the movement of the progressive societies has hitherto been a movement from Status to Contract. Id.
\end{flushright}
primarily of the development of law under a number of historical societies but heavily focusing upon the laws and codes developed under the Roman Empire which he described as “the empire of ideas.” He contrasted this with what he classified as “the empire of primitive notions.”

Maine believed Roman law achieved this elevated status because it continued to improve over time while “all the rest of human thought and action materially slackened its pace, and repeatedly threatened to settle down into stagnation.” Roman law expanded within the reaches of the Empire and correspondingly expanded Western thought with it. Maine claims Rome surpassed the Greeks because, “it [Roman law] was jurisprudence, and jurisprudence only, which stood in the place of poetry and history, of philosophy and science” and continuing, he noted how “Politics, Moral Philosophy, and even Theology, found in Roman law was not only a vehicle of expression, but a nidus in which some of their profoundest enquiries were nourished into maturity.”

Maine declared: “I know nothing more wonderful than the variety of sciences which Roman law, Roman Contract-law more particularly, has contributed modes of thought, courses of reasoning, and a technical language.”

Maine discusses how in status based societies individuals were tightly bound by communal, primordial bonds or “status” to traditional groups such as the family or clan and then compared through the use of examples those ancient cultures to modern ones.

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177 Id at 24.
178 Id at 103.
179 Id at 289.
180 Id at 24.
181 Id at 341-42
182 Id at 340
183 Id at 340
based on contract in which autonomous individuals are free to make “arms length” impersonal temporary contracts and freely form associations without restraint.

Maine’s intent in writing *Ancient Law* was to increase awareness or conceptualization of the internal mechanics of developing societies and provide an improved understanding as to how law develops over time. Maine argued that the failure to understand the temporal process in relation to corresponding legal development created “false” dichotomies. One of the most important of these “false” dichotomies which he wished to dispel was the alleged division between the ancient and modern which he described as an “imaginary barrier.” In fact, Maine noted that some ancient civilizations performed functions which had no modern equivalent. Maine believed that many “modern” scholars of his day stopped their analyses at this modern “imaginary barrier” and that there was nothing of value to learn from the “ancients” and went no further. However, Maine considered his penetration of the “imaginary barrier” to be “the recovery of a lost perfection-the gradual return to a state from which the race has lapsed.”

Maine wished to breach this “false” dichotomy presenting a complex analysis of legal evolution. Instead of adopting an “ancient” versus “modern” view, Maine believed that a more appropriate and accurate dichotomy would be to distinguish between “status-based” societies and “contract-based” societies. A fledgling status based society employs custom and usage which is initially well suited, however, with further development,

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184 Id at 189.
185 Id. at 71.
“usage that is reasonable generates usage which is unreasonable.”\textsuperscript{186} For Maine, one of the hallmarks of an advanced contract based society occurred when law was no longer regarded as a result of a divine gift to the king unconnected by any unifying principle resulting in “separate, isolated judgments.”\textsuperscript{187} Progress was made in civilizations when law no longer was a collection of customs left to the memory of “a caste, an aristocracy, a priestly tribe, or a sacerdotal college”\textsuperscript{188} but when marked with the creation of a code of law like Rome’s Twelve Tables or subsequently developed Justinian Code in which written, published tablets, laws, or codes replaced the uncodified common law recollections of the elite as the carriers of law.\textsuperscript{189}

In addition to Maine’s work other examples of leading early works in this genre include a study of the assimilation (or lack of assimilation) of American law upon Native American culture in \textit{The Cheyenne Way}\textsuperscript{190} by Karl N. Llewellyn, who in addition to his interest in legal anthropology was coincidentally one of the drafters of the Uniform Commercial Code, and E. Adamson Hoebel; \textit{Crime and Custom in Savage Society}\textsuperscript{191} by Bronislaw Malinowski; and Donovan and Anderson’s \textit{Anthropology & Law}.\textsuperscript{192} Hogbin’s \textit{Law and Order in Polynesia: A Study of Primitive Legal Institutions}\textsuperscript{193} is a very early anthropological study of legal institutions in South Pacific region. In 1969, David Allen compiled a comparable anthropological text evaluating the concept of assimulation and

\textsuperscript{186} Id at 39.
\textsuperscript{187} Id at 4-5.
\textsuperscript{188} Id at 11-13.
\textsuperscript{189} Id. at 14-15, 45-57.
\textsuperscript{191} Malinowski, Bronislaw, Crime and Custom in Savage Society, (1926).
\textsuperscript{192} Donovan, James & Anderson III, H. Edwin, Anthropology & Law (Berghahn 2003)
\textsuperscript{193} 113 Hogbin, H.I., Law and Order in Polynesia: A Study of Primitive Legal Institutions (1934).
Asian contract law which included a survey of several countries including Australia, India, Indonesia, Iran, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, and Thailand.\textsuperscript{194}

Although the relationship between anthropology and law have been described by some as a “balanced reciprocity,”\textsuperscript{195} the relationship between customary law and traditional rights do not necessarily correspond with the substantive law of contract. As noted by Sir Henry Sumner Maine, conflicts occur between traditional rights and customary law and the substantive concepts of contract law. Where there is conflict, the traditional concept of contract law is either adopted in lieu of local customary or traditional law, is assimilated with local custom or tradition creating a unique regional blend, or rejected. Societies based on custom and traditions, like many current Pacific Islands nations, have been described by Maine as “status based” societies where rights and duties are defined by a person’s place in society rather than by agreement. Maine believed that as societies’ progress, there can be an anthropological metamorphosis or assimilation that will occur. This evolutionary process was described by Maine in \textit{Ancient Law}, as “a movement from Status to Contract.”\textsuperscript{196} Similarly, in \textit{The Cheyenne Way},

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\textsuperscript{195} Donovan, James & Anderson III, H. Edwin, \textit{Anthropology & Law}, (Berghahn 2003) adopt a theory of “balanced reciprocity.” It is defined as follows: Balanced reciprocity means that neither discipline is independent of, parasitic upon, or subordinate to, the other. Anthropology, to realize its own vision, needs a collateral discipline of jurisprudence; law, in order to achieve its goal of justice and social order, requires the theoretical grounding and empirical conclusions of anthropology. Id at 2.
\textsuperscript{196} Maine, H.S., \textit{Ancient Law}, 170 (3rd Ed. John Murray 1866). Maine stated: The word Status may be usefully employed to construct a formula expressing the law of progress thus indicated, which, whatever be its value, seems to me to be sufficiently ascertained. All the forms of Status taken notice of in the Law of persons were derived from, and to some extent are still coloured by, the powers and privileges anciently residing in the Family. If then we employ Status, agreeably with the usage of the best writers, to signify these personal conditions only, and avoid applying the term to such conditions as are the immediate or
\end{flushleft}
Llewellyn and Hoebel, while discussing the necessary integration of any legal system in order to be successful and the informal pressures on and integration of the individual, observe:

The extension of the sphere and importance of observable law in the more highly developed societies is not in itself an index of social progress. It is merely an index of a greater complexity of the society and hence of the norms or imperatives to be observed, and hence, finally, of an increasing difficulty in obtaining universal adherence to such norms. Conversely, this means that the less call there is for law as law, and upon law as law (relative to the degree of complexity of a society), the more successful is that society in attaining a smooth social functioning.\textsuperscript{197}

In \textit{Contract Law in the South Pacific},\textsuperscript{198} Jennifer Corrin Care expands upon Maine’s prior “status to contract” analysis and the earlier general anthropological work previously done in the Southern Pacific region by Hogbin.\textsuperscript{199} Professor Care explores the anthropological relationship between customary law and contract law in those eleven nations that comprise the University of the South Pacific region\textsuperscript{200} and creates a useful chart listing some of the distinctions found between customary relationships and contractual relationships in the comparative table below:

<table>
<thead>
<tr>
<th>Customary Dealings</th>
<th>Contractual Dealings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Status based</td>
<td>Rights based</td>
</tr>
<tr>
<td>Obligatory</td>
<td>Voluntary</td>
</tr>
<tr>
<td>Group focus</td>
<td>Individual Focus</td>
</tr>
<tr>
<td>Benefits and burdens may be imposed</td>
<td>Privity of contract applies</td>
</tr>
</tbody>
</table>

remote result of agreement, we may say that the movement of the progressive societies has hitherto been a movement from Status to Contract. Id.

\textsuperscript{197} Llewellyn, Karl & Hoebel. E. Adamson, \textit{The Cheyenne Way: Conflict and Case Law in Primitive Jurisprudence}, 239 (Univ. of Oklahoma Press 1941)

\textsuperscript{198} Care, Jennifer Corrin, \textit{Contract Law in the South Pacific}, 12-13 (Cavendish 2001).

\textsuperscript{199} Hogbin, H.I., Law and Order in Polynesia: A Study of Primitive Legal Institutions (1934).

\textsuperscript{200} The member countries of the University of the South Pacific region are the Cook Islands, Fiji Islands, Kiribati, Marshall Islands, Nauru, Niue, Solomon Islands, Tokelau, Tonga, Tuvalu, Samoa, and Vanuatu.
This prior anthropological research by Professor Care is significant in that her work encompasses, in part, the Republic of the Marshall Islands located in the Northern Pacific region and may be extrapolated to the other Micronesian islands and to American Samoa.

Anthropologically, there is both evidence of integration and deliberate divergence in regard to contract and sales law in the Northern Pacific region. These cases will be discussed at various points in the text. To the extent that these Pacific island nations diverge due to the impact of customary or traditional law in the areas of contract formation, performance, and enforcement, this text will identify and attempt to explain the differences between the concepts of customary and traditional law and contract law.

Despite the potential for conflict and differences between concepts of traditional rights or customary law and traditional notions of contract law in the Pacific, the two concepts do appear to be anthropologically integrating and assimilating or, at a minimum, self help is not a recognized sanction.

<table>
<thead>
<tr>
<th>on group members</th>
<th>Contracts must be entered into by legally recognized persons or bodies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dealings may be between groups or communities with no formal legal status</td>
<td>Regulate social relationships</td>
</tr>
<tr>
<td>Regulate business relationships</td>
<td>Binding in honor</td>
</tr>
<tr>
<td>Binding in law</td>
<td>Enforceable by the community</td>
</tr>
<tr>
<td>(Ultimately) enforceable by the courts</td>
<td>Flexible</td>
</tr>
<tr>
<td>Flexible</td>
<td>Certain</td>
</tr>
<tr>
<td>Personal</td>
<td>Impersonal</td>
</tr>
<tr>
<td>Self help may be a recognized sanction</td>
<td>No right to damages</td>
</tr>
<tr>
<td>Injured party has the right to damages if loss has been suffered</td>
<td></td>
</tr>
<tr>
<td>Ceremonial formalities may be required</td>
<td>Written formalities may be required.</td>
</tr>
</tbody>
</table>

201 Id.
achieving a “balanced reciprocity,” as these island nations move from status based relationships toward societies governed by contractual relationships.

Larger issues or anthropological questions which will not be addressed in this text are whether Maine’s contract based society is “better” than a status based society which also has many appealing qualities or whether the UCC or Restatement of Laws are to be considered “superior” to tribal, traditional, or customary law, and if so, what standards are employed to elevate it to “superior” status. Rhetorically, Palau does just the opposite elevating custom and traditional law above all other law except the Constitution. Justice Oliver Wendell Holmes has argued that in some instances authority or possessing raw power may make law “superior” or, alternatively, is there some internal logic or inherent truth which creates legitimacy making the law “superior” to custom and tradition. Similar to Justice Holmes, Michel Foucault clearly moves beyond Maine’s and Care’s anthropological Victorian conceptualization of progressive societies moving from “status” to “contract” in his book, *Discipline and Punish, The Birth of a Prison.*

The works cited previously were cross-cultural studies and, although not intended to be a work in anthropology and the law, Foucault’s work is still significant in this genre. In *Discipline and Punish,* he opined that the “disciplines” and not the “contract” were the foundation for law and the hallmark of the progressive for modern post Enlightenment society:

> The real, corporeal disciplines constituted the foundation of the formal, juridical liberties. The contract may have been regarded as the ideal foundation of the law and political power; panopticism continued the technique, universally

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widestread, of coercion. It continued to work in the depth of the juridical structure of society, in order to make the effective mechanisms of power function in opposition to the formal framework it had acquired. The ‘Enlightenment,’ which discovered the liberties, also invented the disciplines.\(^{203}\) (Emphasis added)

For Foucault, the Enlightenment and the discovery of the concept of liberty was the defining moment in history providing a break from the Ancients. In explaining how the disciplines form a different relationship than those based upon contractual obligations, Foucault observes:

The disciplines ought to be regarded as a sort of counter-law. They have the precise role of introducing insuperable asymmetries and excluding reciprocities. First, because the discipline creates between individuals a ‘private’ link, which is a relation of constraints \textit{entirely different from contractual obligation}; the acceptance of a discipline \textit{may be underwritten by contract}; the way in which it is imposed, the mechanism it brings into play, the non-reversible subordination of one group of people to another, the ‘surplus’ power that is always fixed on the same side, the inequality of position of the different ‘partners’ in relation to the common regulation, \textit{all these distinguish the disciplinary link from the contractual link, and make it possible to distort the contractual link systematically from the moment it has as its content a mechanism of discipline.} We know, for example, how many real procedures undermine the legal fiction of the work of contract: workshop discipline is not the least important.\(^{204}\) (Emphasis added.)

So are Maine’s contract based societies or Foucault’s enlightened societies based on the disciplines the more progressive? These broader anthropological questions and issues are intended to raise the issues to a conscious level for the reader but are outside the confines of this text and will not be resolved here. This text will be limited to highlighting cases where local customary and traditional laws conflict or have integrated

\(^{203}\) Id at 222
\(^{204}\) Id.a t 222-223.
Anglo-American contract and sales principles to produce a unique amalgam of contract and sales law in the Northern Pacific region.

**Republic of the Marshall Islands**

Customary law is expressly recognized as a formal source of law in the Marshall Islands.205 To the extent that customary law is recognized as a formal source of law, it may be considered superior to the common law of contract or sales in matters of a local or traditional culture. The Traditional Rights Court exclusively applies custom and tradition to resolve disputes within its jurisdiction and a Traditional Rights Court judge may sit with a High Court judge in an advisory capacity if custom or traditions are relevant issues in a civil action. There are a number of Marshall Islands cases in which contracts, particularly for the sale or transfer of land, have been declared void because they have violated traditional rights.206

The implication of traditional rights and customary law is more constitutionally limited in the Marshall Islands than in its neighboring Pacific Island nations. The language of the Marshall Islands Constitution particularly restricts the impact of traditional law to contracts for the sale, lease or transfer of land. Although limited, the relationship between customary law and the law of contract and sales is still significant particularly to local construction contracts involving land development and for foreign investors interested in acquiring or leasing real property as part of their investment in the

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206 For example, see *Tobeller v. David*, 1 MILR (Rev) 81 (April 6, 1987) and a more recent case *Jack v. Hisaiah and Hisaiah*, 2 MILR (Rev) 206 (December 23, 2003).
Marshall Islands. The Land Recording and Registration (Amendment) Act of 2006\textsuperscript{207} was enacted after the first edition of this book was published in an effort to rectify this situation but the problem of commercially alienating communally owned land with ambiguous property lines consistent with traditional or customatry law still exists.

To the extent that the courts in the Marshall Islands apply custom and tradition to cases involving contract creation, interpretation, enforcement or breach of contract, local custom and tradition is equivalent to and has the force of law.\textsuperscript{208}

Where contract and sales law and customary and traditional law intersect, two inquiries must be made in the Marshall Islands:

Every inquiry into custom involves two factual determinations. The first is: is there a custom with respect to the subject matter of the inquiry? If so, the second is: what is it? Only when the ascertained custom is incorporated in a statute or has formed the basis of a final court decision does it become law in the modern sense.\textsuperscript{209}

Where the contractual matter is not of a local or traditional nature, the Sale of Goods Act of 1986, the common law of contract in effect at the time of Constitutional adoption as set forth in the \textit{Restatement (Second) of Contracts}, or comparable international standards would apply since the rule of decision statute has been repealed through subsequent omission.

\textsuperscript{207} PL 2006-59, 24 MIRC 4.
\textsuperscript{208} Examples of this occurring most frequently are in contracts or leases involving the sale and transfer of real property. See for example, \textit{Jack v. Hisaiah and Hisaiah}, 2 MILR 206 (December 23, 2002); \textit{Hermios v. Minister of Internal Affairs} 2 MILR 127 (September 7, 1998); \textit{Gushi Bros. v. Kios}, 2 MILR 120 (August 26, 1998) and \textit{Tobeller v. David} 1 MILR (Rev.) 81 (April 6, 1987).
Federated States of Micronesia

Likewise, customary law and traditional rights apply and play a significant role in the judicial decision making process in the FSM. Anthropologically, there are several significant cases which highlight the interrelationship between customary and traditional law and the law of contract and sales in Micronesia: *Semens v. Continental Airlines (I)*,\(^{210}\) *Adams v. Etscheit*,\(^{211}\) and *Nakamura v. Moen Municipality*.\(^{212}\) A recent FSM Supreme Court case decided in 2008, *Billimon v. Refit*,\(^{213}\) cites two cases from Palau and may be considered anthropological evidence of cross cultural, albeit Micronesian, diffusion.

The interrelationship between the Constitutional Judicial Guidance Clause in Article XI, §11, the statutory requirements of 1 FSMC § 203, and contract law were initially addressed in *Semens v. Continental Air Lines, Inc. (I)*\(^{214}\) which established the framework for all cases which have followed.

The *Semens* court indicated that where traditional or customary law conflicts with the rule of judicial decision statute requiring the Micronesian courts to apply the American Law Institute’s Restatement of Laws which would include the *Restatement (Second) of Contracts*,\(^{215}\) the Constitution mandates that traditional law and customary rights are both a source of law and would be considered superior.\(^{216}\)

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\(^{210}\) 2 FSM Intrm 131 (Pon 1985).
\(^{211}\) 6 FSM Intrm 365 (Pon 1994) reversed on other grounds, 6 FSM Intrm 580 (App. 1994).
\(^{212}\) 15 FSM Intrm 213 (Chk S. Ct. App 2007).
\(^{213}\) 16 FSM Intrm 206 (Chk 2008).
\(^{214}\) 2 FSM Intrm 131 (Pon. 1985). See also, *FSM v. Ocean Pearl*, 3 FSM Intrm 87, 90-91(Pon 1987) (Common law decisions of the United States are an appropriate source of guidance for the FSM Supreme Court for contract issues unresolved by statutes, decisions of constitutional courts, or custom and tradition within the FSM. Like *Semens*, the *Ocean Pearl* court concluded that the activity involved was not the kind that historically would fall within the principles of custom and tradition. Id at 91.)
\(^{215}\) 1FSMC 203.
The *Semens* case arose out of a personal injury accident which occurred at the airport in Pohnpei in which Plaintiff claimed personal injury damages incurred while working for a subcontractor unloading cargo from a Continental Airlines plane.

In establishing a hierarchy of law, the *Semens* court initially observed that the Constitution was the supreme law of the land. According to the court, the next source of law in the hierarchy was not the common law of contracts but traditional or customary law and that, before going as required by the rule of decision statute to the common law decisions from the United States which would be authoritative for the Supreme Court regarding tort and contract issues, the court must determine that the issues are not to be resolved by 1) local custom or tradition within Micronesia, 2) by statutes, or 3) by prior decisions of the Micronesian constitutional courts.\(^{217}\)

The court indicated:

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\text{[C]ommon law decisions of the United States are an appropriate source of guidance for this court for contract and tort issues unresolved by statutes, decisions of constitutional courts here, or custom and tradition within the FSM. Review of decisions of courts of the U.S. or any other jurisdictions, must proceed however against background of pertinent aspects of Micronesian society and culture.}^{218}\]

The *Semens*, court noted that even where the parties have not asserted that any principle of custom or tradition applies, the court still has a constitutional duty or obligation to consider custom and tradition sua sponte.\(^{219}\) Specifically, the court stated

\(^{217}\) 2 FSM Intrm at 140; See also, *FSM v. Ocean Pearl*, 3 FSM Intrm 87, 90-91 (Pon. 1987).
\(^{218}\) Id at 140. See also, *Black Micro v. Santos* 7 FSM Intrm 311 (Pon. 1995) which was a collection case in which the FSM court found that the U.S. common law rule regarding the assignment of debts is appropriate source of guidance and appropriate for application in the FSM and in this case when assessed against a background of pertinent aspects of Micronesian society and culture for issues unresolved by statutes, decisions of the FSM constitutional courts, or by FSM custom or tradition. Id at 314-15
\(^{219}\) Id at 140.
that “even where the parties have not asserted that any principle of custom or tradition applies, the court has an obligation of its own to consider custom and tradition.” 220

Although the court has a sua sponte duty to inquire, the Semens court indicated that the level of traditional or customary law inquiry is reduced if the business activity is not local or traditional in nature and the place of employment itself is markedly non-local or international in character.221

The Semens court stated:

Where business activities which gave rise to the lawsuit are not of a local or traditional nature, and the work setting and the work itself are of a markedly non-local, international character, the court need not conduct an intense search of applicable customary laws and tradition when none have been brought to its attention by the parties.222

Under the facts and circumstances of that particular case, the Semens court stated that the court did not need to conduct an intense search for applicable custom or traditional rules if none have been asserted by the parties.223

However, if the activity is local or traditional in nature, the Semens court indicated that customary law and traditional rights are so significant in the decision making process that a court must raise the issue on its own initiative even if it has not been raised by those involved in the litigation.224

220 Id.
221 Id. See also, FSM v. Ocean Pearl, 3 FSM Intrm 87, 91(Pon 1987).
222 2 FSM Intrm at 140
223 Id
224 Id.
Lastly, the court observed that the Judicial Guidance Clause requires the imposition of a “reasonably intelligent Micronesian” standard as opposed to a more objective standard or legal principle utilized in the international business community. The legal standard crafted by the *Semens* court superficially appears to favor Micronesians over others similarly situated in the international business community. The *Semens* court noted:

A message of the Judicial Guidance Clause is that a court, when interpreting a contract, may not simply assume that reasonably intelligent Micronesians will perceive the same meaning as would reasonably intelligent Americans… Courts may not blind themselves to pertinent aspects of Micronesian society, such as less facility in the English language, less exposure to business concepts, and the paucity of legal resources, which might cause a reasonably intelligent Micronesian to perceive a meaning differently than would a person from some other nation.

The continued use of the “reasonably intelligent Micronesian” standard by the courts may be intended as a protectionist measure by the judiciary to recognize the nuances of traditional or customary law but may also be construed as demeaning and interpreted that the Micronesian courts believe that their fellow Micronesians are not as sophisticated or intelligent as the international business community. The Micronesian courts may wish to reconsider the continued use of the “reasonably intelligent Micronesian” standard.

Nevertheless, the *Semens* case established the current framework in which to resolve a conflict between the Constitution, the statute requiring imposition of the common law of contract or sales in the United States, and traditional rights which has

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225 1 FSMC §203
226 2 FSM Intrm at 149.
been cited numerous times in other Micronesian cases. However, because the activity involved was not traditional or local in nature, the Semens court was able to circumvent such a conflict.

The court was not able to avoid conflict between the substantive law and local customary or traditional law in *Etscheit v. Adams*\textsuperscript{227} which is a second case of significant anthropological import. The trial court decision in *Etscheit* addresses a number of contract issues such as conditions precedent, unjust enrichment, and implied contracts which will be addressed subsequently in the text but at this juncture it is noteworthy to discuss the case for its anthropological value.

The *Etscheit* case which arises out of a 1903 land purchase is anthropologically significant in that a conflict is alleged to exist between the German rule of primogeniture which requires that property pass to the first born son despite writings or wills indicating to the contrary, how the German rule of primogeniture was subsequently treated by the Japanese and Americans, whether the Japanese and American rules differed during subsequent involuntary and voluntary transfers, what is the local customary and traditional law, and the impact of local customary or traditional law on the issues in the case.

This case is a time capsule of Micronesian history over the last 100 years and the anthropological and substantive law issues arising in the *Etscheit* case span the German, Japanese, and American occupations of Micronesia. The *Etscheit* court was required to address these issues as they relate to each period of occupation because significant events

\textsuperscript{227} 6 FSM Intrm 365 (Pon. 1994) reversed on other grounds, 6 FSM Intrm 580 (App. 1994).
occur during each period of occupation. It is a microcosm and synthesizes in one case some of the historical impact of colonial influences of the German, Japanese, and American occupations in the region. Ultimately, the court concludes, however, that local or customary law which is superior under the Constitution is inconsistent with the German rule of primogeniture.

Dominique Etscheit, a Micronesian of Spanish ancestry, purchased land in Pohnpei from the controlling German Government at a public auction in 1903. The deed did not contain any limitations on alienation. In 1911, the German Government implemented land reforms over a three year period in which all deeds from the German Government contained a primogeniture provision restricting transfer of property to the first born son which was consistent with continental German law at the time. These land reforms ended in 1914 when the Japanese took control of the islands during World War I. In 1919, the Japanese Government, which then controlled the islands, seized the Etscheit property in a forced sale. While still under Japanese control, Dominique died in 1925 leaving a will naming his wife, Florentine, as his sole heir and indicated that she could freely dispose of the estate but that when Florentine died that all land still in existence was to be distributed among his five children with one son receiving a double share because he was blind.

In 1927, two years after Dominique died, the Japanese Government returned the property it had seized in the forced sale to the bereaved family of Dominic Etscheit on behalf of “Flore Etscheit.” During World War II, the land was again confiscated without compensation by the Japanese only to be once again returned in 1957 by the Trust
Territory Government to Florentine Etscheit who was still alive thirty two years after her husband had died.

Before the land had been officially returned in 1957 by the Trust Territory, Florentine quit claimed the property to her five children in 1956 without specifying portions. Florentine died in 1973 leaving no will. Ultimately, there was a dispute among the surviving heirs as to their rights to the property.

Plaintiffs in *Etscheit* sought summary judgment based upon the German law of primogeniture contained in all German deeds citing examples of Japanese enforcement of the 1911 German deed restrictions and case law from the Trust Territory in which Trust Territory Courts run by the United States enforced the German rule of primogeniture. The defendants sought summary judgment dismissing this claim stating that the German rule of primogeniture was not applicable to the Etscheit land in that such a restriction was not expressly contained in the 1903 deed for the property.

Citing and employing the framework established in *Semens v. Continental Airlines*, the *Etscheit* court reviewed in length the rules of primogeniture imposed in German deeds, then reviewed Japanese and American treatment (or lack of treatment) of the German deed restrictions limiting transfer of land to the eldest son despite contrary terms in a contract to purchase real property or in one’s will.228

The *Etscheit* court noted that after the formal recognition of Japan’s mandate in 1920, the Japanese disregarded the German Land Title Code almost totally. The court noted that the Japanese even recognized the rights of females to hold title to land which

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228 6 FSM Intrm at 373-81
was a significant cultural divergence from the German rule of primogeniture and did not adhere to the inheritance patterns recognized by the Germans.\textsuperscript{229}

The court noted that when applied by the Japanese and Americans, the German rule of primogeniture was limited only to those instances where the rule was expressly included in the deed. After its lengthy review of the inconsistent application of rule of patrilineal primogeniture under German, Japanese and American occupations, the \textit{Etscheit} trial court concluded that the German rule of primogeniture was inconsistent with customary Pohnpeian title system which permitted women to own land but which was also primarily matrilineal.\textsuperscript{230}

An interesting aspect of the \textit{Etscheit} decision was the court’s reliance upon anthropological research in reaching its decision in this case. Citing District Anthropologist, John Fischer’s reports, the \textit{Etscheit} court observed that there was difficulty with anthropological assimilation of the German rule of primogeniture:

The German rule of primogeniture appears to be inconsistent with the customary Pohnpeian title system, which not only permitted women to own land, but which was according to Fischer, ‘primarily matrilineal….’ Fischer notes: ‘[Primogeniture] appears to have been chosen on some purely theoretical basis without much study of the social system of the Ponapeans. According to the older Ponapeans the inheritance provisions caused much contention while the society was adjusting to them….’ Given this, the primogeniture provisions on the standard form German deeds should be given narrow application under the FSM Constitution Article XI, Section 11, which states that decisions of this Court should be consistent with local custom. Certainly, this Court will not apply the primogeniture restrictions more broadly than the Germans, Japanese, and Trust Territory governments did.\textsuperscript{231}

\textsuperscript{229} Id at 376-7.
\textsuperscript{230} Id at 381. In reaching this conclusion, the \textit{Adams} trial court referred to two studies written by John L. Fischer who was District Anthropologist for Pohnpei during the Trust Territory period. Id. The Trust Territory government published one version of Fischer’s \textit{Land Tenure Patterns: Trust Territory of the Pacific Islands} in 1951 and a second version in 1958 which are virtually identical. Id at 394 fn.7, fn 8.
\textsuperscript{231} 6 FSM Intrm at 381
The *Etscheit* court also expressed cultural concerns that the rule of primogeniture discriminated against women by only allowing men to inherit and discriminated against younger male offspring by allowing only the eldest to inherent that the court observed was also inconsistent with concepts of fairness in the FSM and the FSM Equal Protection Clause.\(^{232}\)

For these reasons, the *Etscheit* trial court denied the Plaintiffs’ motion for summary judgment on the issue of primogeniture and granted summary judgment to defendants on the issue.\(^{233}\)

Another significant anthropological issue of *Etscheit* involved a counter-claim based upon the substantive property law concept of adverse possession.\(^{234}\) Plaintiffs sought to dismiss Defendant claim to the land at issue under a theory of adverse possession. Although adverse possession was recognized under the former American Trust Territory, plaintiffs argued that adverse possession is not fully recognized in Pohnpei and should not be applied because of different rules of land ownership existing during the various colonial administrations and because it was contrary to Pohnpeian custom where landowners are encouraged to allow others to work on their land.\(^{235}\) Although the trial court did not see fit to set aside the prior Trust Territory cases, particularly in a case where the defendants did not factually meet the 20 year requirement

\(^{232}\) Id at 381. *FSM Constitution, Article* IV, §4.
\(^{233}\) 6 FSM Intrm at 382.
\(^{234}\) Id 389-90
for adverse possession, the *Etscheit* court did express cultural reluctance to adopt the foreign concept of adverse possession especially when involving family noting:

However, the Court believes that, to the contrary, the defendants’ rule is the inequitable one. Under the defendants’ rule landowners who, in keeping with Pohnpeian custom, see *Pohnpei Public Lands Bd. Of Trustees v. Yeneres*, PCA No. 31-90, Order (Pon. Sup. Ct. March 3, 1992), did not object to others making use of their land for living or farming could be penalized by having their land taken from them, even if during most of the period there was no way of knowing that such generosity could be used against them.\(^{236}\)

The *Etscheit* court addressed a third anthropological issue noting that a forfeiture provision in a stipulated preliminary injunction was also void because it was contrary to Pohnpeian custom and tradition.\(^ {237}\)

The *Etscheit* case is an example of the implementation of the constitutional framework created by *Semens* to resolve the conflict between foreign legal concepts and local custom and traditional rights. *Etscheit* differs from the *Semens* case in that traditional rights and local custom apply and ultimately prevail as being superior to foreign legal concepts.

\(^{236}\) Id at 390.
\(^{237}\) Id at 391. In denying the motion for summary judgment, the Adams court noted that where the preliminary injunction was void because the judge who issued it was disqualified and the case in which it was issued was dismissed fact questions still existed as to whether the stipulated preliminary injunction was enforceable as an independent contract. Id at 391-2.
Additional contract and anthropological issues raised in *Etscheit* will be subsequently addressed in the text’s discussion of conditions precedent and unjust enrichment.

One also sees the intervention of customary law and tradition in Micronesia as a defense to invalidate what would otherwise appear to be a valid contract. For example, in the 2007 case, *Nakamura v. Moen Municipality*, the court noted that under Chuukese custom and tradition, no writing is needed to effect *any* contractual transaction including the transfer of land. However, as it relates to the transfer of land, lineage heads need lineage member consent in order to alienate lineage land. In response to a standing challenge, the court noted that under Chuukese tradition and custom a lineage is a personable entity similar to a corporation which has standing to sue and which is capable of owning, acquiring, and alienating land. An otherwise valid contract on its face can be invalidated if custom and tradition were violated. However, the court noted that it is possible for an agreement which was not authorized by all lineage members to be ratified through affirmative assent, acquiescence, or ratification, by the later conduct of those who did not initially authorize it. The case was remanded to the trial court to determine whether there was ratification.

Another case recently decided in 2008 by the FSM Supreme Court appears to be anthropological evidence of substantive law diffusion occurring in the development of contract law in the FSM in part as a result of the first edition of this text. In a 2008 FSM

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238 15 FSM Intrm 213 (Chk. S. Ct. App. 2007)
239 Id at 217
240 Id at 218
241 Id at 218
242 Id at 219
Supreme Court case *Billimon v. Refit*, Justice Dennis Yamase cited two cases from Palau as persuasive authority in assessing whether a Chuuk government employee’s personal action form (PAF) independently established employment contract rights. In concluding that the PAF did not modify the term of Plaintiff’s employment and make him a permanent Chuuk Public Service System employee, Justice Yamase cited *Towai v. Palau*, and *Kingon v. Palau*, as “instructive and persuasive because the Republic of Palau inherited from the Trust Territory the same personnel action forms that Chuuk did, and because the first FSM Supreme Court Chief Justice was a member of the appellate panel that decided *Towai*, the first case.”

**Republic of Palau**

In Palau, Article V, § 2 of the Palau Constitution recognizes the existence of traditional rights or customary law and that customary law may, in some circumstances, be superior to statute.

Where traditional or customary law conflict with the rule of judicial decision statute that requires the Palau courts to apply the *Restatement (Second) of Contracts*, the Constitution mandates that traditional law and customary rights are superior. It states:

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243 16 FSM Intrm 209 (Chk. 2009)
244 1 Pal. Intrm 658, 662-63(App 1989)
245 2 Pal Intrm 72, 74-75 (App 1990)
246 16 FSM Intrm at 212, fn1. Justice Yamase’s law clerk, Larry Wentworth, indicated in a April 17, 2009 e-mail that the first edition of this text has been a valuable resource and contributed to the growth of cross jurisdictional use of applicable contract law in the region “because [the Billimon decision] cites two Palau cases which would not have been cited if I hadn’t read your book where they were mentioned and suggested to [Justice Yamase] that they might be helpful.” April 17, 2009 e-mail from Larry Wentworth to Daniel P. Ryan.
248 1 PNC § 303.
Statutes and traditional law shall be equally authoritative. In case of conflict between a statute and a traditional law, the statute shall prevail only to the extent it is not in conflict with the underlying principles of the traditional law.\(^{249}\)

The difficulty in application of this “equally authoritative” standard is that it potentially establishes the potential for deadlock when assessing priority between statute and traditional law. However, the second sentence of Article V clearly delineates that traditional law superior to statute in the event of conflict. Consequently, where traditional rights conflict with a statute mandating application of the *Restatement (Second) of Contracts*, traditional law prevails under the Constitution.

**INTERNATIONAL CONTRACT STANDARDS AND MODEL LEGISLATION\(^{250}\)**

There have been a number of efforts to unify contract law particularly with respect to the sale of goods on a national and international level with the adoption of such standards as the English Sale of Goods Act, Revised English Sale of Goods Act, the Uniform Commercial Code, the Revised Uniform Commercial Code, the United Nations Sales Convention and the UNCITRAL Model for E-Commerce, and the *UNIDROIT Principles of Contract Law*. These laws or model rules are intended to unify law governing commercial transactions, to make such transactions seamless regardless of jurisdiction, and to expedite commercial practice. The rules do not replace all rules of

\(^{249}\) Constitution of Republic of Palau, Article V §2.  
\(^{250}\) The historical background contained in the following section is a summary of a more extensive treatment which can be found in numerous sources including Murphy, Speidel and Ayers, *Studies in Contract Law*, 6th ed. (Foundation Press 2003); Calamari and Perillo, *Calamari and Perillo on Contracts*, 5th ed. (West 2003); Farnsworth, Young and Sanger, *Contracts Cases and Materials*, 6th ed. University Casebook Series, (Foundation Press 2001); and in E. Allen Farnsworth and William Young, *Selections for Contracts*, (Foundation Press 2003). As an aside, Professor Farnsworth was a Reporter for the *Restatement (Second) of Contracts*. 
common law rules of contract law or equity or those principles recognized under custom or traditional rights.

When discussing regional case law, this text will also include references to applicable and significant provisions the United Nations Sales Convention (CISG) and UNCITRAL Model for E-Commerce. Micronesia and the Republics of the Marshall Islands and Palau are members of the United Nations even though they have not yet adopted these Model Laws or ratified the CISG Convention to date. Because these nations are member nations and the potential for future adoption exists, these model laws will be reviewed in this text and compared to existing regional contract and sales law. An additional reason for CISG inclusion is that the United States with its Pacific territories and state and other major regional trade partners have adopted the UN Sales Convention governing international contracts for the sale of goods between member nations.

Because these Northern Pacific jurisdictions heavily rely upon the common law of contract and sales from the United States and the common law of the United States is influenced or codified by the Uniform Commercial Code, the Revised Uniform Commercial Code, and the Restatement (Second) of Contracts, this text will also address and include those provisions to the extent they influence regional contract and sales law in the Northern Pacific.

The UNIDROIT Principles of Contract Law will also be addressed in this text. For purposes of obtaining a better understanding of the interrelationship of these international standards to the common law of contracts and to the contract and sales law of the Northern Pacific region, a brief historical background for each of these international standards, model rules or legislation is provided.
**Uniform Commercial Code**

The predominant statute governing sale of goods in the United States is the Uniform Commercial Code (UCC) which has been adopted in 49 of 50 states including Hawaii, the Territory of Guam, and the CNMI. The only U.S. state which has not adopted the UCC is Louisiana and the territory of American Samoa.

Efforts to develop the Uniform Commercial Code began in the United States shortly after England adopted its Sale of Goods Act governing the law of sales in 1893. The adoption of this act in England was soon followed by adoption of the act in the commonwealth colonies and territories which were then part of the British Empire at the time including Australia, New Zealand, and many of the independent island nations in the Pacific region. The Act is still prevalent in the region today including in the Marshall Islands.

In the United States, the National Conference of Commissioners for Uniform State Laws responded to the promulgation of the English Sale of Goods Act by assigning the task of producing a comparable statute to Professor Samuel Williston. The result of Professor Williston’s efforts was the Uniform Sales Act which was produced in 1906 and ultimately adopted by thirty states. As an aside, Professor Williston also served as the Reporter for the first Restatement of Contracts which was later published in 1932.

Both the English Sale of Goods Act and the Uniform Sales Act were good first efforts but deficient in that they failed to adequately address problems arising out of the sale of goods where the common law still controlled. Over the next fifty years, a number

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of additional attempts were made to revise, amend or replace the Uniform Sales Act in
the United States. In 1945, the American Law Institute ultimately combined its efforts
with the National Conference of Commissioners for Uniform State Laws to draft the
Uniform Commercial Code (UCC) which was ultimately completed in 1952.

Professor Karl Llewellyn, who was also author of the anthropological text *The
Cheyenne Way*, was Chief Reporter of the UCC and was assisted in this task by Soia
Mentschikoff, as Associate Chief Reporter. Pennsylvania was the first state to adopt the
UCC in April 1953 with an effective date of July 1, 1953. By 1961, thirteen states had
adopted the 1958 version of the UCC.

In 1961, a Permanent Editorial Board was established which adopted further
revisions into the 1962 Official Text of the UCC. Except for Louisiana and the District of
Columbia, this version has ultimately been adopted by all states in the United States
including the State of Hawaii. In the Northern Pacific region, Guam and the
Commonwealth of the Northern Mariana Islands have also adopted versions of the
Uniform Commercial Code. For simplicity sake, this text will cite the general UCC or
Revised UCC provision instead of each individual state or territory statutory number.

The Federated States of Micronesia has statutorily adopted only a part of the UCC
applicable in the United States and its territories except American Samoa. Specifically,
Micronesia excluded Article 2 governing sale of goods and initially adopted a

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252 For example, a Federal Sales Act was proposed in Congress in 1940 but the National Conference of
Commissioners on Uniform State Laws successfully lobbied for its postponement.
253 Hawaii adopted the UCC effective January 1, 1967 and Hawaii’s version can be found at HRS 490-10 et
seq.
254 Guam adopted the UCC with an effective date of January 1, 1977 and can be found at 13 GCA 10-101
et. seq.
255 The Uniform Commercial Code adopted by the Mariana Islands can be found at 5 CMC1101 et seq.
rudimentary and truncated version of Article 9 applicable to Secured Transactions, Sales of Accounts and Chattel Paper, that did not provide a vehicle for recording those security interests and has reserved those sections which would have been equivalent to Article 2 addressing Sales.\textsuperscript{256} In 2005, part of FSM Article 9 was preserved and renamed and a new Secured Transaction Act was adopted in the FSM which provided for Internet filing and recording of security interests.\textsuperscript{257} Palau has not adopted the \textit{UCC} or its equivalent. In lieu of the \textit{UCC}, the Republic of the Marshall Islands has adopted the Sale of Goods Act of 1986 which is virtually identical to the English Sale of Goods Act of 1893.\textsuperscript{258} Although it does not have the equivalent of UCC Article 2, the Marshall Islands adopted the Secured Transaction Act of 2007 which like the statute adopted by the FSM allows for Internet filing and recording of security interests and is similar to those provisions contained in Revised Article 9 of the UCC.\textsuperscript{259} American Samoa has its own abbreviated Commercial Code which is unlike the UCC or any other in the region.

Revisions continue to the \textit{UCC} with some significant modifications in 2003 to Articles 1 and 2. The 2003 revisions to Article 1 and Article 2 make three primary changes: (1) the adoption of gender neutral language to replace the pronoun “he” which was prevalent in prior versions, (2) replacement of the word “writing” with the term “record” in order to reflect the development and to accommodate e-commerce, and (3) adoption of several enhanced consumer protection provisions. Although Hawaii, Guam,
and the Commonwealth of Northern Mariana Islands have adopted the UCC they have not yet adopted the most recent 2003 revisions.

The primary objective of the UCC in the United States is to complement the common law and provide a statutory text which includes many of the rules relating to the sale of goods omitted by the Sale of Goods Act and Uniform Sales Act which had been left largely to the common law. Where it has been legislatively adopted, the UCC has generally supplanted the common law of contract and sales and has the force of law in those states in the United States including Hawaii and territories such as Guam and the Northern Mariana Islands which have adopted it statutorily.

Instead of referring to the individual statute or code numbers for Hawaii, Guam, and the Northern Mariana Islands throughout the text, the text will simply cite the generic numbers of various provisions of the UCC which are applicable to the sale of goods in those jurisdictions.

**UN Sales Convention**

The United Nations Sales Convention for the Sale of International Goods of 1980 (CISG) is the international equivalent of the UCC and governs contracts for the international sale of goods between entities or individuals of more than seventy-one member nations that were signatories in 2005.\(^{260}\) Under CISG, the parties have freedom

to negotiate, exclude or vary from its provisions.\textsuperscript{261} In addition to recognizing freedom to negotiate and contract, *CISG*, more importantly, does not displace rules of national common law or statute that relate to “the validity of the contract or of any of its provisions or of any usages.”\textsuperscript{262} For example, the UCC or English Sale of Goods Act would still apply to internal contractual disputes involving the sale of goods where applicable.

Work on *CISG* began as early as the 1930’s when the Institute for the Unification of Private Law in Rome under direction of the League of Nations began work on a uniform law for international sales. This work was disrupted by World War II. After the war, the Dutch Government continued the earlier efforts at drafting international standards governing sales contracts and convened a conference at The Hague in 1964. The end product of this 1964 conference was the approval of a Uniform Law on the International Sale of Goods (ULIS) and a companion uniform law on the formation of international contracts for the sale of goods. Although not adopted by the United States, ULIS was adopted by eight nations giving it effect in international transactions between entities or individuals of those ratifying countries.

During the ratification process of ULIS, the United Nations renewed the prior efforts of the League of Nations and the Institute for the Unification of Private Law which had been interrupted by World War II creating a United Nations Commission on International Trade Law (UNCITRAL) in 1966. Because of some concerns that member nations like the United States had with certain provisions of ULIS, the intent of

\textsuperscript{261} *CISG* Article 6
\textsuperscript{262} *CISG* Article 4(a)
UNCITRAL, which is comprised of representatives from thirty six (36) member nations, was to reconcile and unify international contract and sales law and to eliminate any legal barriers to the free flow of trade among member nations. In an effort to accomplish this objective, UNCITRAL has subsequently convened a number of conventions and has also drafted several model laws.263

The UNCITRAL Working Group on Sales was created in 1969 to consider making changes to ULIS which would make it more generally acceptable to various civil law and common law countries. Over the next 11 years, the Working Group formulated a draft that was ultimately presented at a diplomatic conference in Vienna in 1980. After lengthy negotiation, CISG was adopted by the sixty-two countries participating in the convention. CISG took effect on January 1, 1988 when it was adopted by 10 member nations.264 The intent of the CISG Convention was to establish “a comprehensive code of legal rules governing the formation of contracts for the international sale of goods, the obligations of the buyer and seller, remedies for breach of contract, and other aspects of the contract.”265


CISG Articles 1-13 generally address the scope of application and contain general provisions. CISG Articles 14-24 address various issues involving contract formation. CISG Articles 25-88 address the sale of goods, the obligations of the seller, obligations of the buyer, passing of risk, and obligations common to both buyer and seller. The final provisions of CISG contained in Articles 89-101 address the ratification process, how and when the convention comes into force, and how signatory nations can reserve and file declarations.

On October 9, 1986, the United States Senate ratified *CISG* upon request of the President. When dealing with trade partners in other signatory member nations, American exporters and importers have been subject to the terms of *CISG* since January 1, 1988 and since it has the force of federal law it supersedes under the Supremacy Clause the UCC that 49 of 50 states have adopted. Among those states that have adopted the UCC, the UCC still controls domestic intrastate and interstate sale of goods in the United States. The UCC would potentially also apply to international transactions in non-signatory countries depending on whether the contract has a forum selection clause. As for contracts for the international sale of goods between U.S. entities and entities in other signatory nations, CISG terms will apply unless, under CISG Article 95, the contract’s choice of law clause specifically provides for non-CISG terms or applies the law of a non-signatory state.

As of July 2008, approximately seventy-one (71) member nations have ratified *CISG* including China, Australia, New Zealand, and the United States which are major
trade export and import partners in the Northern Pacific region. Japan, which is also one of the major trade export and import partners in the region, originally did not sign CISG but has since deposited its instrument of accession and the Convention will enter into force in Japan on August 1, 2009. Despite the fact that all of their major trade partners are signatories, the Republic of the Marshall Islands, the Federated States of Micronesia, the Republic of Palau, the United Kingdom, and many other member nations also have not yet ratified CISG. At a 2005 conference in Majuro, RMI, former Chief Justice Yosiwo George of the Kosrae State Court who served as United Nations Ambassador for the FSM from 1992 to 1995 noted that many of the countries that ratified CISG did so before the FSM, the Republic of Palau, and the Republic of the Marshall Islands became member nations in the early to mid 1990’s and that perhaps the failure of these island nations to adopt CISG is attributable to benign neglect. On the other hand, it may not be a legislative priority in these Pacific Island nations like it is not a priority in Great Britain.

Although CISG has been praised as facilitating international commerce through the use of plain business language which allows judges an opportunity to make CISG

266 As of July 2008, the list of CISG ratifying countries: Argentina, Australia, Austria, Belarus, Belgium, Bosnia/Herzegovina, Bulgaria, Burundi, Canada, Chile, China (PRC), Columbia, Croatia, Cuba, Cyprus, Czechoslovakia, Denmark, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Gabon, Georgia, Germany, Ghana, Greece, Guinea, Honduras, Hungary, Iceland, Iraq, Israel, Italy, Japan (8/1/2009), Kyrgyzstan, Latvia, Lesotho, Liberia, Lithuania, Luxembourg, Macedonia, Mauritania, Mexico, Mongolia, Montenegro, Netherlands, New Zealand, Norway, Paraguay, Peru, Poland, Republic of Korea, Republic of Moldova, Romania, Russian Federation, St. Vincent and the Grenadines, Serbia, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Syrian Arab Republic, Turkey, Uganda, Ukraine, United States, Uruguay, Uzbekistan, Venezuela, and Zambia. For information on ratification, accession, approval, acceptance, succession and entry into force dates, see http://www.uncitral.org/English/status/status-e.htm.

267 Pacific Islands Legal Institute, Majuro, Marshall Islands, February 7 -11, 2005.

268 Moss, Why the United Kingdom has not ratified the CISG, 1 Journal of Law and Commerce 483 (2005)
workable in a number of sales situations, others have described CISG as a variety of vague standards and compromises resulting from a political process that appear to be inconsistent with commercial interests and which allow judges to develop diverse and inconsistent meaning. Critics point to two cases which highlight inconsistent interpretation of the same CISG provision, one in which the German Supreme Court found that it was not the duty of the seller under CISG to ensure that goods meet German public health regulations and another decision by a French court which found that an Italian cheese seller/exporter had a duty under CISG to ensure compliance with French public health regulations. There has also been criticism of Canadian courts which frequently use local legislation and case law to interpret and resolve ambiguity and gaps in CISG. On the other hand, an article appearing in a 2000 New Zealand journal praised CISG noting “the drafting style is lucid and the wording simple and uncluttered by complicated subordinating clauses and the general sense can be grasped on the first reading without the need to be a sales expert.”

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Nevertheless, because of the possibility of future adoption in the Pacific island nations and its use by major regional trade partners, significant sections of CISG will be referenced and included throughout this text.

**UNCITRAL Model for E-Commerce**

In addition to CISG, UNCITRAL has published a number of Model Laws to facilitate international trade including the popular Model Law on Electronic Commerce which was introduced in 1996.\(^{275}\) As the use of e-commerce expands, UNCITRAL thought it necessary to establish procedural rules and regulations which may be promulgated by the adopting country or state. As internet use and e-commerce expands in the Pacific Island region as reflected in the RMI Ship Registry and the new Secured Transaction legislation in the FSM and RMI, these model laws may be beneficial to the region due to its geographic isolation and would potentially facilitate and promote commerce.

Further, a number of trade partners of the Northern Pacific region have adopted legislation implementing the Model Law on Electronic Commerce including Australia in 1999, the Philippines in 2000, and New Zealand in 2002. Many individual states (for example, Hawaii 2000), provinces, bailiwicks and territories have also adopted legislation equivalent to the Model Law on Electronic Commerce.\(^{276}\)

\(^{275}\) UN General Assembly Resolution 51/162, 12/16/1996. An additional Article 5 was adopted in 1998. See, [http://www.unictral.org/english/texts/electcom/ecommerceindex.htm](http://www.unictral.org/english/texts/electcom/ecommerceindex.htm).

\(^{276}\) In addition to CISG, UNCITRAL texts include: International Commercial Arbitration and Conciliation, Security Interests, Insolvency, International Payments, International Transport of Goods, Electronic Commerce, and Procurement and Infrastructure Development. The UNCITRAL website indicates that as of June 2008, legislation implementing the 1996 Model Law on Electronic Commerce has been adopted in
The Model Code is divided into two parts. The first part addresses issues of e-commerce in general. The second part is intended to address specific areas of e-commerce but currently only addresses carriage of goods and transport documents.

The intent of the Model Law is:

[T]o facilitate the use of modern means of communication and storage of information, such as electronic data interchange (EDI), electronic mail and telecopy, with or without the use of such support as the Internet. It is based on the establishment of a functional equivalent for paper-based concepts such as ‘writing’, ‘signature’ and ‘original’. By providing standards by which the legal value of electronic messages can be assessed, the Model Law should play a significant role in enhancing the use of paperless communication. In addition to general norms, the Model Law also contains rules for electronic commerce in specific areas, such as carriage of goods. With a view to assisting executive branches of Governments, legislative bodies and courts in enacting and interpreting the Model Law, the Commission has produced a Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce.\(^{277}\)

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Australia, Brunei, Cape Verde, China, Columbia, Dominican Republic, Ecuador, France, Guatemala, India, Ireland, Jordan, Mauritius, Mexico, New Zealand, Pakistan, Panama, Philippines, Republic of Korea, Singapore, Slovenia, South Africa, Sri Lanka, Thailand, United Arab Emirates, Venezuela, and Vietnam. The Model Law has been adopted in a number of individual bailiwicks and territories such as the Bailiwick of Guernsey, Bailiwick of Jersey, the Isle of Man, all Crown Dependencies of the United Kingdom of Great Britain and Northern Ireland, in Bermuda, Cayman Islands, the Turks and Caicos Islands, the overseas territories of the United Kingdom of Great Britain and Northern Ireland and in the Hong Kong Special Administrative Region of China. The Uniform Law Conference of Canada prepared the Uniform Electronic Commerce Act in 1999 based upon the Model Law which has subsequently been adopted in a number of provinces and territories including Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Nunavut, Ontario, Prince Edward Island, Saskatchewan, the Yukon, and the Province of Quebec. In the United States, the National Conference of Commissioners on Uniform State Laws adopted the Uniform Electronic Transaction Act in 1999 based on the Model Law and which has been adopted by Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, Wisconsin, Wyoming and the District of Columbia. Illinois adopted the Model Law in 1998.


Although the Marshall Islands, the Federated States of Micronesia, and Palau are member nations of the United Nations, there has been no effort to adopt either CISG or the Model Law on Electronic Commerce in the region. The Model Law for E-Commerce may be a significant economic development tool and of future interest to member island nations such as Micronesia, the Marshall Islands and Palau. In addition to the Model Law for E-Commerce, other UNCITRAL model legislation may benefit economic development in the region. As internet use increases in the region, the geographic realities of isolation, and the full effects of e-commerce begin to have an impact in these countries, there will be either pressure to adopt the Model Code legislatively or, alternatively, the judiciary will have to take an ad hoc common law approach in a case by case basis to address the substantive issues addressed by the Model Code in which the Model Code may serve as a reference tool for conflict resolution.

In 2001, United Nations also adopted a resolution promoting the adoption of the Model Law on Electronic Signatures which is intended to supplement Article 7 of the Model Law on E-Commerce by establishing a presumption, that electronic signatures shall be treated the same as hand written signatures if they meet certain criteria of

279 The Federated States of Micronesia became a member nation of the United Nations on September 17, 1991.
280 The Republic of Palau became a member nation of the United Nations on December 15, 1994
technical reliability.\textsuperscript{282} In 2005, the United Nations also promulgated the Convention on the Use of Electronic Communications in International Contracts\textsuperscript{283} which has been adopted as of June 2009 by the Central African Republic, China, Columbia, Honduras, Iran, Lebanon, Madagascar, Montenegro, Panama, Paraguay, Phillipines, Republic of Korea, Russia, Saudi Arabia, Senegal Siera Leone, Singapore, and Sri Lanka.

In response to such e-commerce efforts as the UNCITRAL Model Rules, the Revised Uniform Commercial Code which is widely utilized in the United States has taken similar steps to facilitate e-commerce by modifying its original provisions by changing the “writing” requirement to a “record” requirement and by adding new provisions that particularly address the sale of goods through e-commerce.\textsuperscript{284} As noted previously, a number of states in the United States, however, have legislatively adopted the equivalent to the Model Rules for E-Commerce and the necessity of adopting the Revised UCC has been minimized and would be potentially redundant at this point.

\textsuperscript{283} The UN General Assembly adopted A/Res/60/21 on November 2, 2005.
\textsuperscript{284} For example, Revised UCC 1-201(31) defines “Record” as “information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. The authors of the Revised UCC also add additional provisions after UCC 2-313. These new UCC provisions are entitled: UCC 2-313A “Obligation to Remote Purchaser created by Record Packaged with or Accompanying Goods” and UCC 2-313B “Obligation to Remote Purchaser created by Communication to the Public.” These new provision are intended to extend seller’s warranty to “records” sent through e-commerce. See also, UNCITRAL Model for E-Commerce, Article 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”
The American Law Institute was formed in 1923. The first Restatement of Contracts was published in 1932. Professor Williston, author of the earlier Uniform Sales Act, was the Reporter and was responsible for preparing the drafts.

In 1962, the American Law Institute began its efforts in preparation of a Restatement (Second) of Contracts which was ultimately completed in 1980. The Reporters for the Restatement (Second) of Contracts were Professor Robert Braucher and Professor E. Allen Farnsworth.

The Restatements are intended to set forth black letter rules or general principles of contract law with supporting authority, comments or examples. The Restatements generally do not have the force of statute or law and serve as “common law ‘persuasive authority’ with a high degree of persuasion.”

Although utilized predominantly as one persuasive authority among many in the United States and its territories, the Republics of Palau, the Marshall Islands (until January 1, 1989), and the Federated States of Micronesia have elevated its status and the courts of those jurisdictions are or were required by statutory rules of decision to employ the Restatement (Second) of Contracts, when applicable, as persuasive authority in case law.

285 An exception is the Virgin Islands Code (Title 1, Section 4) which provides that “The rules of the common law, as expressed in the restatements of law approved by the American Law Institute…, shall be the rules of decision…in cases to which they apply, in absence of local laws to the contrary.”

286 Judge Herbert Goodrich, Restatement and Codification, David D. Field Centenary Essays 241, 244-45 (1949). See also, a recent Oregon Supreme Court case distinguishing between Restatement and statutory authority, Brewer v. Erwin, 600 P.2d 398, 410 n. 12 (Or. 1979).

287 There are numerous cases from the Northern Pacific jurisdictions which this text will include which specifically cite and rely upon particular provisions of the Restatement (Second) of Contracts. The text will include those significant cases and provisions of the Restatement (Second) of Contracts. In a recent
As an aside, there is some irony arising from the fact that the legal realists and anthropologists like Llewellyn who helped draft the Restatements were concerned with local practice. However, the rule of decision statutes requiring application of the Restatements in Palau, Micronesia and formerly in the Marshall Islands is mandated and would appear to supplant local practice. To the extent that they do not conflict with local custom or tradition, the rule of decision statutes potentially appease and accommodate concerns of the legal realists and anthropologists but one wonders whether this is what the legal realists envisioned when initially drafting the Restatements.

The statutory adoption of the Uniform Commercial Code and the promulgation of state and federal consumer protection acts in the United States arguably supplant and minimize the necessity of the Restatements, the *Restatement (Second) of Contracts*, and the common law of contract. However, there are many who argue that the Restatements and the common law continue to have their independent significance and value.\(^{288}\) This is particularly true since many contracts are non-goods contracts such as contracts for personal services and construction contracts where the Restatement would continue to play a critical role in determining formation, interpretation and enforcement.

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\(^{288}\) For example, Professor Braucher states: “The effort to restate the law of contracts in modern terms highlights the reliance of private autonomy in an era of expanding government activity…Freedom of contract, refined and redefined in response to social change, has power as it always had.” Braucher, *Formation of Contract and the Second Restatement*, 78 Yale L. J. 598,615-16 (1969)
**UNIDROIT Principles of Contract Law**

Based in Rome, the International Institute for the Unification of Private Law (UNIDROIT)\(^{289}\) was founded in 1926 under charter of the League of Nations. It began work on drafting international standards governing sales which was interrupted by World War II. **UNIDROIT** began work on the Principles of International Commercial Contracts in 1971 and these Principles were ultimately published in 1994.\(^{290}\) In 2004, a new edition of the UNIDROIT Principles of International Commercial Contracts was adopted and officially endorsed in 2007 by UNCITRAL at its 40\(^{th}\) session. The 2004 edition contains 5 new chapters, an expanded preamble, new sections on inconsistent behavior, and release by agreement. The old 1994 sections were also updated and adapted to meet the needs of electronic contracting.

The amended UNIDROIT Principles of 2004 consist of the Preamble (1994 version, with the addition of paragraphs 4 and 6 as well as the footnote) and 185 articles divided into ten chapters, namely Chapter 1: “General Provisions” (1994 version, with the addition of Arts. 1.8 and 1.12); Chapter 2, Section 1: “Formation” (1994 version) and Section 2: “Authority of Agents” (new); Chapter 3: “Validity” (1994 version); Chapter 4: “Interpretation” (1994 version); Chapter 5, Section 1: “Content” (1994 version, with the addition of Art. 5.1.9) and Section 2: “Third Party Rights” (new); Chapter 6, Section 1: “Performance in General” (1994 version) and Section 2: “Hardship” (1994 version); Chapter 7, Section 1: “Non-performance in General” (1994 version), Section 2: “Right to

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\(^{289}\) The home webpage and all documents for UNIDROIT may be found at [www.unidroit.org](http://www.unidroit.org)

\(^{290}\) For a general discussion of the development of the **UNIDROIT** Principles, see Farnsworth and Young, *Selections For Contracts*, (Foundation Press 2003); *Farnsworth on Contracts*, Section 1.8a (2\(^{nd}\) ed. 1998); and Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts* (2\(^{nd}\) ed. 1997).
Performance” (1994 version), Section 3: “Termination” (1994 version) and Section 4: “Damages” (1994 version); Chapter 8: “Set-off” (new); Chapter 9, Section 1: “Assignment of Rights” (new), Section 2: “Transfer of Obligations” (new) and Section 3: “Assignment of Contracts” (new); and Chapter 10: “Limitation Periods” (new).

The UNIDROIT Principles draw from many sources of contract and sales law including CISG, the UCC, the Restatement (Second) of Contracts, and generally recognized principles of civil law and common law systems. The relationship between the UNIDROIT Principles of Contract Law and CISG is similar to the relationship between the UCC and the Restatement (Second) of Contracts. The UNIDROIT principles are comparable in effect to the Restatement (Second) of Contracts in that they serve only as persuasive authority. The UNIDROIT Principles of International Commercial Contracts are intended to serve as a corresponding or supplemental document to the United Nations Sales Convention (CISG) but do not have the force of law.

The UNIDROIT Principles parallel CISG in many respects but are broader in scope going beyond contracts for the sale of goods and CISG in the areas of pre-contractual liability, excuse for nonperformance based on hardship, specific performance and liquidated or stipulated damages. The UNIDROIT Principles also differ from CISG in that the UNIDROIT Principles recognize concepts such as freedom of contract.

291 Except in those jurisdictions like Palau and the FSM where the Restatements have been statutorily elevated to rules of decision.
293 UNIDROIT Articles 1.1 and 1.5.
enforcement or observation of contract,\textsuperscript{294} fairness,\textsuperscript{295} and good faith\textsuperscript{296} which will be subsequently addressed in this text.

The \textit{UNIDROIT} Principles are broader in application than \textit{CISG} which is narrowly limited to the international sale of goods. While \textit{CISG} is applicable and limited to the international sale of goods, the \textit{UNIDROIT} Principles would be more relevant in resolving disputes arising under international service or other international contracts. To the extent \textit{UNIDROIT} Principles of Contract Law are significant and applicable; they will also be included in the text.

\textbf{Text Outline}

Part I of this text will address bargain relationship focusing on the topics of offer, acceptance, and mutual assent. Part II will address the subject of consideration and its alternatives such as sealed documents, moral obligation and promissory estoppel. Part III will discuss avoidance of contracts including topics such as lack of legal capacity to contract. Part IV will review defects in the bargaining process, including concepts such as mistake, ambiguity, fraud, frustration, fraud, duress and undue influence, unconscionability, and illegality. Part V will discuss performance of the contract including proper form and general rules of contract interpretation, the parole evidence rule and statute of frauds. Part VI will address condition, duty to perform, duty of good faith and general issues giving rise to breach. Part VII will address contract remedies and discuss consequential damages and equitable relief. Part VIII will address third party

\textsuperscript{294} \textit{UNIDROIT} Article 6.2.1.
\textsuperscript{295} \textit{UNIDROIT} Articles 3.10 and Article 2.20.
\textsuperscript{296} \textit{UNIDROIT} Article 1.7.
beneficiary contracts and rights. Part IX concludes that the Northern Pacific region which includes Micronesia, the State of Hawaii, the American territories of Guam, the Commonwealth of the Northern Mariana Islands and American Samoa, and the Republics of Palau and the Marshall Islands either follow or are heavily influenced by the Anglo-American common law tradition and statutes governing contract and sales, have made efforts to adopt recognized uniform international contract standards particularly the Restatement (Second) of Contracts, but that the customary law and traditional rights still have a significant impact upon the development of contract and sales law creating a unique amalgam of substantive law in the Northern Pacific region.
**PART I: THE BARGAIN RELATIONSHIP**

**CONTRACT: DEFINITION, ESSENTIAL ELEMENTS, GENERAL TERMS AND REQUIREMENTS**

**Definition**

There are numerous variations of the definition of contract but, in sum, a contract is a legally binding agreement made between two or more people who intend it to have a legal effect and for which the law will provide a remedy in the event of a breach. Because of the rule of decision statutes currently in effect in some of the Northern Pacific island nations, formerly applicable in the Marshall Islands, and mandated by the former Trust Territory Code for the region that was discussed previously, the *Restatement (Second) of Contracts* definition of contract has been generally adopted in the Northern Pacific region. For example, in *Ponape Construction v. Pohnpei*, the FSM trial court cites *Restatement (Second) of Contracts*, § 1 which defines a contract as “a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” In addition to the general definition of contract set forth in the *Restatement (Second) of Contracts*, there are several essential elements which need to be present in order to form a valid contract.

**Essential Elements**

In order to form a valid contract, there needs to be mutual assent or mutuality between the parties which encompasses the concepts of offer, acceptance, and

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297 6 FSM Intrm 114 (Pon. 1993), aff’d 7 FSM Intrm 613 (App. 1996)
298 Id at 129,fn 9 citing *Restatement (Second) of Contracts* §1 (1981)
consideration. In Goyo Corp. v. Christian, the FSM trial court recently and succinctly defined the concept of contract and its essential elements. The Goyo court stated:

A contract is a promise between two parties for the future performance of mutual obligations, which the law will enforce in some way. For promises to be enforceable, there must be an offer and an acceptance, definite terms, and consideration for the promise (that which the performance is exchanged for). When one party fails to perform their promise, there is a breach of contract.

There are three types of contract which will be explored in this text: express, implied or a “quasi” contract implied in law or fact.

**Bilateral Contracts**

A bilateral contract exists where both parties have made mutual promises to render specific performances to each other. Traditionally, contracts in which there is an exchange of mutual promises supported by consideration is bilateral. In a traditional bilateral contract, acceptance may be made by a mutual promise to perform or the start of

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299 12 FSM Intrm 140 (Pon 2003)
300 Id at 146. In Goyo, supra, the court found that a promissory note and a security agreement are enforceable contractual agreements between the parties. Id. This definition was initially appears in Ponape Constr. Co. v. Pohnpei, 6 FSM Intrm 114, 123 (Pon. 1993), aff’d 7 FSM Intrm 613 (App. 1996) which was a case arising out of some emergency repair work done to the Dekehtik causeway. See also, O’Byrne v. George, 9 FSM Intrm 62, 64 (Kos. S. Ct. Tr. 1999) which involved an enforceable oral residential construction contract. See also, Tulensru v. Utwe 9 FSM Intrm 95 (Kos. S. Ct. Tr. 1999) which indicated also indicated that a contract is a promise between two parties for the future performance of mutual obligations which the law will enforced in some way and for the promise to be enforceable there must be an offer, acceptance, definite terms, and consideration. Id at 98. The court found that the verbal agreement in which the plaintiff agreed to provide two loads of fill materials from his quarry for each day of hauling for the defendant’s various municipal projects was an enforceable contract that contained an offer, acceptance, and consideration. Id. The court observed that intention of the parties at the time of contract is the controlling factor in contract interpretation. Id. Also, contracts are not to be interpreted on the basis of subjective uncommunicated views or secret hopes of one party but on an objective basis according to the reasonable expectations or understanding of the parties at the time of contract. Id. Although subsequent conduct can constitute waiver, the court found that the parties’ verbal agreement was not modified by any of the parties’ later action when the plaintiff failed to his burden of proof. Id. The court also indicated that it is for the trier of fact to determine whether a contract existed. Id. The court concluded that when both parties have fulfilled their obligations under the contract, there is no breach. Id. See also, Malem v. Kosrae, 9 FSM Intrm 233, 236 (Kos. S. Ct. Tr. 1999) (contract involving the construction of catch basins for the Malem Elementary School.)
performance. There is a preference to construe contracts as being bilateral rather than unilateral. *Restatement (Second) of Contracts* §32 indicates that in instances where there is doubt or ambiguity, an offer will be construed as inviting the offeree to accept by either return promise or performance whichever the offeree chooses. \(^{301}\)

**Unilateral Contracts**

A contract may also be unilateral. A unilateral contract exists where one party makes an offer to perform and the other party accepts creating a contract by rendering the specified performance rather than by making a return promise. For a unilateral contract, an offer stipulates that it may or must be accepted by return performance. Unilateral contracts are generally limited to two circumstances: 1) those instances where the offerer clearly indicates that performance is the only manner of acceptance, or 2) where an offer to the general public clearly contemplates performance.

**Contract Formation and Enforcement**

When analyzing mutual assent, contract formation and enforcement, the courts will employ an objective test employing a “reasonable person” standard analyzing what one person would be led to believe by the words and conduct of another person. The courts will also employ an objective test to determine whether the parties intended to be legally bound and whether they intend to formalize their agreement. These objective standards generally raise questions of fact for the trier of fact unless a reasonable person could reach only one conclusion. In that particular instance, the determination would be a question of law for the judge.

\(^{301}\) *Restatement (Second) of Contracts* §32
A contract may be formed when promises are supported by either: 1) consideration, 2) a seal, 3) an antecedent obligation, or 4) unbargained for or promissory reliance.

As far a validity of contracts, a contract may be enforceable, void, voidable, or unenforceable.

When assessing whether a valid contact has been formed and is enforceable, the courts will examine whether there has been: 1) an offer, 2) an acceptance, 3) objective mutual assent, and 4) consideration between capable and competent parties.

**Mutual Assent: The Offer, Promise, Undertaking or Commitment, and Acceptance**

When evaluating an offer, there are three particular aspects which generally need to be evaluated: 1) the nature of the commitment by the offeror and whether there is an objective manifestation to enter into a contract, 2) the commitment to the identified offeree and whether the offeree has knowledge of the offer, and 3) whether the offer contains sufficient certain and definite terms.

An offer is defined as an expression of a promise, undertaking, or commitment to enter into a contract. *Restatement (Second) of Contracts* §24 defines an offer as “the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to the bargain is invited and will conclude it.”302

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302 Restatement (Second) of Contracts §24
Preliminary negotiations are not considered an offer. The offer may be in writing or oral.

One of the earlier oral contract cases in Micronesia is *Phillip v. Aldis.* In *Phillip,* defendant made an oral offer to rent a vehicle from plaintiff who then drove the vehicle over to the defendant’s place of employment. The defendant confirmed their earlier oral agreement by signing the lease agreement and driving plaintiff back to his place of employment. The *Phillip* court found that all elements of a valid contract had been satisfied.

In another Micronesian case, *Ponape Construction Co. v. Pohnpei,* the court recognizes a mix of oral and written assertions between the parties regarding the emergency repairs of the Dekehtik causeway as a “contract.” The causeway had eroded undermining power poles and the road linking two islands in Pohnpei State. The government issued permits to two companies to begin dredging work to repair the causeway and, as part of the bargain, gave the companies permission to use some of the dredged material for commercial purposes. The companies accepted the offer of the

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303 Restatement (Second) of Contracts §26  
304 3 FSM Intrm 33 (Pon. S.Ct. Tr. 1987)  
305 Id at 36. Another example of an oral contract is *Kinere v. Kosrae,* 6 FSM Intrm 307 (App. 1993) in which the State of Kosrae orally agreed to provide a landowner construction materials left over from the construction of the Finkol bridge if the landowner would relocate his house to make way for construction to a new landfill the State would create adjacent to the property. The FSM Supreme Court found an enforceable contract but did not find any breach. Id at 309. See also *O’Byrne v. George,* 9 FSM Intrm 62 (Kos. S. Ct. Tr. 1999) which involved an enforceable oral residential construction contract.  
306 6 FSM Intrm 114 (Pon 1993), aff’d 7 FSM Intrm 613 (App. 1996). On appeal, the FSM Supreme Court noted that where the existence of a contract is at issue, it is the responsibility of the trier of fact to determine if it did exist. 7 FSM Intrm at 620. On appeal, the standard of review for findings of fact is whether the trial court’s findings are clearly erroneous. Id at 620. The FSM Supreme Court also noted that interpretations of contract terms are matters of law to be determined by the court, and are reviewed on appeal de novo. Id at 621. See also, *Wolphagen v. Ramp,* 8 FSM Intrm 241 (Pon 1998); affirmed 9 FSM Intrm 191, 194 (App. 1999);  
307 6 FSM Intrm at 123
State forming a valid and enforceable contract by commencing the work.\textsuperscript{308} The Government argued that the “contract” was indefinite and vague because it did not establish a deadline for completion.\textsuperscript{309} Both the trial and appellate court rejected that argument indicating that even though the agreement did not have a deadline it was implied that it was meant to run concurrent with an Army Corps of Engineers dredging permit that expired December 31, 1994.\textsuperscript{310}

A significant oral contract case in Palau is \textit{Kamiishi v. Han Pa Const. Co.}\textsuperscript{311} In \textit{Kamiishi}, Kamiishi and Han Pa orally agreed over the course of several meetings to numerous construction projects that Han Pa Construction would perform for Kamiishi who represented the Ashibi Restaurant. Han Pa completed 12 of 13 projects and Kamiishi paid $76,000. At this point, Kamiishi ordered the defendant to stop work. Han Pa sued and claimed that it was entitled to $130,618.42 and that Kamiishi ordered him to stop because he didn’t have any more money to pay for the work. Kamiishi say he discharged plaintiff because of inferior materials, poor workmanship, failure to complete work as requested and that Kamiishi’s equipment improperly operated.\textsuperscript{312} Kamiishi counterclaimed for the cost of hiring another contractor to correct and finish the work. The trial court found no contract existed because of lack of documentation and there was no meeting of the minds because of a language barrier: Kamiishi spoke only Japanese and Mr. Ha only spoke passable or average English. Since there was no contract, the trial court dismissed the counter-claim and Han Pa was equitably awarded $48,562.57 in

\begin{itemize}
\item \textsuperscript{308} Id. 7 FSM Intrm at 620-1.
\item \textsuperscript{309} 6 FSM Intrm at 123, 7 FSM Intrm at 620-1
\item \textsuperscript{310} 6 FSM Intrm at 123, 7 FSM Intrm at 621.
\item \textsuperscript{311} 4 ROP Intrm 37 (1993)
\item \textsuperscript{312} Id at 38-9
\end{itemize}
quantum meruit for material and labor. The Palau Supreme Court reversed and remanded. Relying upon the *Restatement (Second) of Contracts*, the Palau Supreme Court took a more objective view as it related to the meeting of the minds requirement and noted that the language barrier and lack of documentation were irrelevant and observed that the trial court abdicated its role as finder of fact and its decision was contrary “to the well-established principle that contracts may be formed by oral promises or the conduct of the parties.”

**Mutual Assent**

In addition to an offer, there must be mutual assent. *Restatement (Second) of Contract* §20 provides that there is no manifestation of mutual assent if the parties attach materially different meanings to their manifestations and neither party is aware of the meaning of the other (innocent) or each party knows or each party has reason to know the meaning attached by the other (non-innocent). A second significant aspect of the Palau Supreme Court’s decision in *Kamiishi* was its discussion of the concept of “mutual assent” in relation to offer and acceptance. The trial court had considered “meeting of the minds” or mutual assent to be a separate requirement in addition to offer and acceptance. This approach is technically incorrect. Adopting the positions set forth by Professor Williston and by the *Restatement (Second) of Contracts* that apply an objective test and do not require an “actual” meeting of the minds to create an enforceable contract, the

313 Id at 41-42
314 Restatement (Second) of Contracts §20
Palau Supreme Court noted: “The correct approach is to infer manifestation of mutual assent from the offer and acceptance, absent any mistake or ambiguity.”

The Kamiishi decision is consistent with a case frequently cited as one of the leading cases addressing manifestation of mutual assent in the United States, Lucy v. Zehmer. Zehmer, although subjectively insincere in his offer, actually wound up selling the family farm to defendant Lucy for $50,000 and the court found Lucy was entitled to specific performance.

Zehmer, intending jest, drafted and executed a written agreement selling the farm to Lucy thinking that there was no way that Plaintiff could come up with the money. Plaintiff accepted the offer but defendant refused to accept $5 from plaintiff to consummate the deal and he walked off thinking it was a joke while plaintiff put the paper in his pocket thinking he had a deal for $50,000. Despite the defendant’s subjective intent to jest, the Court applied an objective test indicating that the law imputes to a

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315 4 ROP Intrm at 40-41. The Kamiishi court stated:

The treatment set forth in the Restatement (Second) of Contracts (1981) offers guidance in determining whether a contract has been formed. As a basic principle, ‘the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.’ Restatement,17. The key phrase in terms of the case at hand is ‘manifestation of mutual assent,’ which the Restatement equates with an ‘agreement.’ Id. 3. The Restatement makes very clear that the word ‘agreement’ does not imply mental agreement, which may or may not exist when parties manifest assent to a transaction. Id.3, cmt. a. What is required for manifestation of mutual assent is that ‘each party either make a promise or begin or render performance.’ Id 18. The manifestation may come in the form of written or spoken words or by acts or the failure to act. Id. 20. Williston, another widely recognized authority on contracts, makes it clear that a contract does not require a meeting of the minds: ‘In some branches of the law, especially in the criminal law, a person’s secret intent is important. In the formation of contracts it was long ago settled that secret intent was immaterial, only overt acts being considered in the determination of such mutual assent as that branch of the law requires. During the first half of the nineteenth century there were many expressions which seemed to indicate the contrary. Chief of these was the familiar cliché, still reechoing in judicial dicta, that a contract requires the ‘meeting of minds’ of the parties.’ Williston on Contracts, 22 (3rd ed. 1957) (footnotes omitted). Williston also points out that the requisite assent is almost always manifested by means of offer and acceptance. 4 ROP Intrm at 40-41.

316 84 SE 2d 516 (Vir. 1954)
person an intent corresponding to the reasonable meaning of their actions and words.

Plaintiff was entitled to specific performance enforcing the agreement.

A similar approach regarding the issue of mutual assent was recently taken by the FSM trial court in *Goyo Corp. v. Christian*\(^{317}\) where the court observed:

> Contracts are not interpreted on the basis of subjective, uncommunicated views or secret hopes of one of the parties. Instead, courts interpret and enforce agreements on an objective basis, according to the parties’ reasonable expectations or understanding based upon the circumstances known to the parties and their words and actions, at the time of the agreement was entered into.\(^{318}\)

A prominent oral contract case in the Marshall Islands taking a slightly different view but which also addresses the concept of mutual assent adopting a more stringent standard than generally required is *Guaschino v Reimers and Reimers*.\(^{319}\) In *Guaschino*, Guaschino attempted to obtain a written contract from Ramsey Reimers regarding the design and construction of Ramsey Reimer’s residence. The draft agreement sat on Ramsey Reimers’ desk for six years and was never signed. The Supreme Court of the Marshall Islands referred to the arrangement between Guaschino and Ramsey Reimer as “an oral construction undertaking with no meeting of the minds as to the details of

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\(^{317}\) 12 FSM Intrm 140 (Pon 2003)

\(^{318}\) Id at 146. See also *Kihara v. Nanpei*, 5 FSM 342,345 (Pon. 1992) which was a bond debt case where the Court observed: “However, contracts are not interpreted on the basis of subjective uncommunicated views, or secret hopes of one of the parties. Instead, courts interpret and enforce agreements on an objective basis, according to the reasonable expectations and understanding of the parties based upon the circumstances known to the parties and their words and actions, at the time the agreement was entered into.” Id at 345; *FSM v. Ting Hong Oceanic Enterprises*, 8 FSM Intrm 79,86 (Pon 1997) which was a case in which FSM sought civil and criminal penalties from Ting Hong because one of its ships failed to maintain daily catch logs in violation of its agreement with the Micronesia Maritime Authority where the court noted: “Contracts are not interpreted on the basis of subjective uncommunicated views, or the secret hopes of one of the parties, but on an objective basis.” Id at 86. See also, *Tulenru v. Utwe*, 9 FSM Intrm 95, 98 (Kos S. Tr. Ct. 1999)

\(^{319}\) 2 MILR 49 (March 8, 1995)
Guaschino’s responsibilities by virtue of it.” The Supreme Court of the Marshall Islands observed that oral contracts can be valid but there must be an actual “meeting of the minds.” Despite the absence of a complete “meeting of the minds,” the Guaschino court observed that the draft agreement prepared by Guaschino but never signed by Ramsey Reimers set forth in some detail the work that Guaschino undertook to do; referred to Guaschino as the “designer and project manager for the project;” and corroborated Reimers’ understanding of the oral agreement. In response to breach of contract and professional liability allegations by Reimers, Guaschino also argued that there was no valid contract for the construction of Robert Reimers’ house because that particular agreement with Guaschino had been signed by Ramsey Reimers and not Robert Reimers. The Supreme Court refuted this assertion because Guaschino acted on it and had substantially completed the house before being terminated. The court affirmed the damage award for the Reimers’ due to Guaschino’s breach of contract and tortious conduct except the Supreme Court, applying Restatement (Second) of Contracts, § 355, did not believe the award of punitive damages was appropriate in a breach of contract case that did not involve egregious tortious conduct.

320 Id. at 52. This view of the concept of mutual assent differs slightly from that stated by the Palau Supreme Court in Kamiishi v. Han Pa Const. Co., 4 ROP Intrm 37, 40-41 (1993), and the view adopted by the Restatement (Second) of Contracts, § 17.
321 2 MILR at 53
322 Id at 52-3
323 Id at 54
324 Id at 54
325 Id at 56-7. In reaching this conclusion, the Marshall Islands Supreme Court relied upon Restatement (Second) of Contracts, § 355 (1979) which provides that punitive damages may only be awarded if the conduct constituting the breach is also a tort for which punitive damages could be assessed.
Offers and Advertisements

The broader the communication media in which an offer is made, i.e. advertisement, the less likely the language will be construed as an enforceable offer and the more likely it will be considered an invitation to “treat,” make an offer, or deal. Although an offer may be communicated or published through mass media, the issue of mass media may not be applicable in certain regional markets, like the Pacific island region, where the ability to communicate to the general public through mass media may be limited.

An example of an invitation to treat can be found in *Fisher v. Bell* 326 where the display of a flick knife with a price tag did not amount to an offer and was considered an “invitation to treat” or to make an offer to the merchant. In an invitation to treat, no offer is being made at the display stage and a consumer’s selecting the item from the shelf is not an acceptance. No contract is made until the cashier tells the customer the total price and the customer accepts that offer by paying for the item.

Eight years later, the Queen’s Bench reaffirmed its reluctance to extend the concept of offer to advertisements classifying it again as an invitation to treat in *Partridge v. Crittenden.* 327 In Partridge, an advertisement in a periodical stated “Bramblefinch cocks, Bramblefinch hens 25s each.” It was determined by the court that this was an invitation to treat rather than an offer for sale. Consequently, the criminal offense of “offering” for sale a wild bird contrary to the 1954 Protection of Wild Birds Act (UK) could not be sustained by the prosecution.

326 3 All E.R 731, 1 QB 394 (1961)
327 1 W.L. R. 1204, 2 All ER 421 (1968)
An exception to the invitation to treat rule occurs if the advertisement is considered a specific solicitation, is sufficiently definite identifying parties, price and subject matter, or induces action on behalf of the consumer. For example, in *Carlill v. Carbolic Smoke Ball Co*, the defendant claimed in its advertising that they would pay £100 to anyone who used their smoke ball and then caught the flu. The advertisement said that it had deposited a £1000 to pay claimants who caught the flu. Plaintiff purchased a smoke ball, used it, and still caught the flu. The defendant claimed that its advertisement was mere puffing or an extravagant claim which was not intended to create a binding contract. The English Court of Appeal rejected this argument and indicated that the depositing of money indicated a willingness by defendant to be bound by the terms of the advertisement and that there was an enforceable contract when plaintiff accepted the offer by using the product.

**Firm Offers and the Sale of Goods**

In certain circumstances involving the sale of goods, the Uniform Commercial Code provides that a firm offer may be extended by a merchant that may not be revoked for a time specified. Under the *UCC 2-205*, a signed written offer by a merchant

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328 1 QB 256 (1893)
329 *UCC* 2-205. Firm Offers provides:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

*Revised UCC 2-205* that was submitted for consideration to the American Law Institute in May 2003 is identical to the original version of *UCC 2-205* except that it replaces the word “writing” with the word “record.” The intent of *Revised UCC 2-205* is to anticipate firm offers in wholly electronic form. See also,
giving assurance that it will be held open is construed to be a firm offer.\textsuperscript{330} A merchant’s firm offer will be irrevocable for the time stated in the offer and if no time is stated the offer will not be held open for a period to exceed 3 months.\textsuperscript{331} If the language of irrevocability is on the offeree’s form, it must be separately signed, initialed or acknowledged by the offeror in order to be effective. No consideration is necessary for a merchant’s firm offer.\textsuperscript{332}

\textbf{CERTAIN AND DEFINITE TERMS}

The offer must be certain and definite in its terms.\textsuperscript{333} \textit{Restatement (Second) of Contracts} § 33 provides that an offer or manifestation of intent cannot be accepted unless the terms are reasonably certain.\textsuperscript{334} The terms of a contract “are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy.”\textsuperscript{335} The certain and definite offer must be communicated to the offeree. Under \textit{CISG Article} 15(2), an offer is not effective until it reaches the offeree.\textsuperscript{336}

In evaluating the precise language of promise, undertaking, or commitment, one needs to focus on the actual language of the offer, objective indications of the intent of

\textit{UNCITRAL Model for E-Commerce, Article} 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”

\textsuperscript{330} Id.
\textsuperscript{331} Id.
\textsuperscript{332} Id.
\textsuperscript{333} See \textit{Jim v Alik}, 4 FSM Intrm 198 (Kos. S. Ct. Tr. 1989) in which the Kosrae court found an agreement to purchase a Subaru van to be too vague and uncertain and declared that no contract existed. Id at 200. Since no contract existed, the concept of restitution was applied and the reasonable rental cost of the vehicle was offset against the down payment made by Plaintiff. Id at 201. See also, \textit{Bank of Hawaii v. Helgenberger}, 9 FSM Intrm 260 (Pon 1999) where the trial court determined, in part, that a settlement agreement between defendants over proceeds held by plaintiff was too indefinite to constitute an enforceable contract. Id at 262
\textsuperscript{334} Restatement (Second) of Contracts §33
\textsuperscript{335} Id.
\textsuperscript{336} \textit{CISG} Article 15(1).
the parties, the surrounding circumstances in which the offer is made, the prior practice and relationship between the parties, the method of communication, industry custom, and certainty and definiteness of the terms. CISG Article 8 follows these general rules of interpretation.

Under the common law, an offer must contain all material terms and all material terms must be certain and definite. In Livaie v. Weilbacher, the FSM Supreme Court observed that a contract is a promise between two parties for the future performance of mutual obligations. For the promise to be enforceable, there must be an offer, acceptance, consideration, and definite terms. The trial court and appellate court concluded that no contract was formed due to lack of definite terms on numerous issues and awarded Livaie $1520 in restitution. Similarly, Restatement (Second) of Contracts §33 provides that if...
“one or more terms of a proposed bargain are left open or uncertain” it may reflect a lack of intent to make an offer or an acceptance.\textsuperscript{342}

The more contemporary approach under most international standards is that terms may be omitted and that reasonable terms will be implied in order to salvage and enforce the agreement between the parties. Even \textit{Restatement (Second) of Contracts} §204 recognizes that in those instances where the parties have sufficiently bargained to the extent that a contract has been formed but that an essential (but not material) term of the contract critical to a determination of rights and duties is omitted, the court can provide a reasonable term under the circumstances.\textsuperscript{343}

One term that must be included with certainty and definiteness in the offer under all standards, however, is the subject matter of the contract.

Where the terms of an offer or contract are unambiguous and certain, the construction and legal effect to be given to a contract is a question of law and will be reviewed de novo on appeal.\textsuperscript{344}

The Palau Supreme Court addressed this standard of review in \textit{Gibbons and Andrew v. ROP} \textsuperscript{345} where the court was reviewing unambiguous contract language to determine if it was a contract for services exempt from competitive bidding or a contract for goods requiring competitive bidding. The \textit{Gibbons} court observed:

That construction and legal effect to be given an unambiguous contract is a question of law to be decided by the court…; this is so even though the ultimate

\textsuperscript{342} Restatement (Second) of Contracts §33.
\textsuperscript{343} Restatement (Second) of Contracts §204
\textsuperscript{344} See Nanpei v. Kihara, 7 FSM Intrm 319, 323 (App.1995) which involved interpretation of language in a debt bond of $50,000. The court found the language clear and unambiguous. Id. See also, Wolphagen v. Ramp, 8 FSM Intrm 241 (Pon 1998); affirmed 9 FSM Intrm 191, 194 (App. 1999) (lease)
\textsuperscript{345} 1 ROP Intrm 634 (1989)
inquiry un the interpretative process is the intent of the parties –an issue ordinarily considered inherently factual….Because the unambiguous term of the contract are presumed to embody the intent of the parties, submission of questions of interpretation to the trier of fact is unnecessary.\(^\text{346}\)

In *Ngerketit Lineage v. Seid*,\(^\text{347}\) the Palau Supreme Court the addressed the interrelationship between the concept of certainty and mutual assent holding that the interpretation of an unambiguous contract is a question of law for the court and a party’s private or subjective understanding of what a contract means is immaterial when assessing mutual assent.\(^\text{348}\) The *Seid* court reiterated that a review of a lower court’s interpretation of a contract is a de novo review.\(^\text{349}\) The *Seid* case is consistent with the *Restatement (Second) of Contracts* which indicates that if terms of a proposed bargain are not certain or definite and are left open, there is no meeting of the minds and the manifestation of intention may not be intended as either an offer or acceptance.\(^\text{350}\)

When evaluating whether the terms of the offer are certain and definite, it is necessary that the parties be identified. Occasionally, there is an issue involving offeree identification. An offer is sufficient if the offer identifies a class to which the offeree belongs. There also has to be definiteness of subject matter.

In a real estate transaction, definiteness of subject matter would require disclosure of price and description and quantity of the land.

\(^{346}\) Id at 44 (Citations Omitted)
\(^{347}\) 8 ROP Intrm 44 (2000)
\(^{348}\) Id at 48
\(^{350}\) *Restatement (Second) of Contracts* § 33. See also *Adelhai v. Masang*, 9 ROP 35, 40(2001) (an individual’s promise to ‘discuss’ with heirs if successful in litigation regarding a parcel of property, not sufficiently certain and definite to meet requirements of valid contract.)
A construction contract would require identification of the parties, the project, and price.

An employment contract generally requires that the subject matter of the offer or duration of employment be specified. This requirement is intended to protect employees from wrongful discharge and written employment contracts frequently contain a provision indicating whether employees are at will or whether they can be discharged for just cause. Where there is a just cause provision, the contracts will often delineate the grounds which will constitute just cause or a basis for termination. In the absence of a specific term of employment, the offer of employment is still valid but is considered an offer for employment at will.\(^{351}\)

In order to be certain and definite, a contract for the sale of goods must also identify the subject matter of the contract which would be a particular quantity of goods. The exception to this rule is a requirements or output contract which does not require that a quantity of goods be specified. If a dispute of interpretation or quantity arises in conjunction with an output or requirements contract, the courts will usually generally employ a combination of reasonableness and good faith to find a sufficient offer and an enforceable contract.

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\(^{351}\) Whether at will status is affected or limited by oral assurances at the outset of hiring, employee handbooks or other materials, or in commendations or promotions received implying just cause for termination is addressed in cases such as *Toussaint v. Blue Cross & Blue Shield of Michigan*, 292 NW 2d 880 (Mich. 1980); *Pugh v. See’s Candies* 171 Cal. Rptr. 917 (1981). There are also numerous law review Articles on this topic as well.
The Absence of Certain and Definite Terms: Implying Reasonable Terms

Under the common law, an agreement is void if a material term is missing or indefinite. Although an offer would fail under the common law for failure to contain all certain and definite terms,352 modern standards particularly those dealing with the sale of goods such as the UCC or the English Sale of Goods Act adopted by the Marshall Island permit that reasonable terms may be implied by the court salvaging the offer and the contractual relationship. For example, UCC 2-204 provides several “gap fillers” for contracts involving the sale of goods and addresses the absence of such material terms as place of delivery, time for shipment or delivery, time of payment, or the failure to specify the assortment.

Time of Tender

Occasionally, the time of tender is not specified in the offer and becomes an issue of dispute. If the time for shipment or delivery is not indicated, a reasonable time will be implied. If no time of tender of performance is specified in the contract, a reasonable hour or time will be implied.353 In the Marshall Islands, Section 30(4) of the Sale of Goods Act, which is patterned on the English Sale of Goods Act, provides: “Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.” 354 For example, tender should be during business hours and not after hours. UCC 2-503(1) (a) has a similar requirement of tender at a reasonable hour. In addition to time, the place of delivery may be implied if it is not stated. If missing, the seller’s place of business will be implied as the place of delivery. If

352 For example, Restatement (Second) of Contracts §33(3)
353 In the Marshall Islands, a reasonable time of tender will be implied in the Sale of Goods Act 1986, 23 MIRC, § 30(4)
the contract involves identified goods and they are stored somewhere other than the
seller’s place of business, the storage location will be implied as the place of delivery.

**Time of Performance**
In addition to reasonable time for tender, the court can also imply a reasonable
time for performance if the contract does not contain any deadlines or time limits.\(^{355}\) In

_Esau v. Malem Mun. Gov’t_,\(^{356}\) the Kosrae Supreme Court recently observed:

Contracts frequently do not specify the time of performance and courts routinely
decide what is a ‘reasonable time’ for performance in those cases. _Iriarte V.
Micronesian Developers, Inc._ 6 FSM Intrm 322, 335 (Pon 1994). Therefore, if the
timing of performance for a party under a contract is in dispute, it is the Court’s
duty to determine what is a “reasonable time” for performance. See _James v. Lelu
Town_, 10 FSM Intrm 648 (Kos. S. Ct. Tr. 2002).\(^{357}\)

**Open Terms: Sale of Goods**
Reasonable open terms in a contract for the sale of goods will be also be provided
by the court under _UCC_ 2-204. _UCC_ 2-204 (3) states:

> [e]ven though one or more terms are left open a contract for sale does not fail for
indefiniteness if the parties have intended to make a contract and there is a
reasonably certain basis for giving an appropriate remedy.\(^ {358}\)

The sale of goods would require identification of the goods and a statement of the
quantity of the goods. As noted previously, there may arise some difficulty in
ascertaining definiteness with the quantity element in a requirement or output contracts in
which case the courts will imply and employ reasonableness and good faith.

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\(^{355}\) See _UCC_ 2-503.

\(^{356}\) 12 FSM Intrm 433 (Kos. S. Ct. Tr. 2004)

\(^{357}\) Id. at 435. In _Esau_, the Plaintiff failed to request the court to enforce the terms of the contract and set a
reasonable time for performance. As such, plaintiff was not entitled to recovery for purported consequential
damages as a result of the breach to complete the work. Id at 435. See also, _O’Byrne v. George_, 9 FSM
Intrm 62, 64-65 (Kos. S. Ct. Tr. 1999) (time of the essence not a material term to a residential construction
project where plaintiff could not indicate a specific crucial date for completion.)

\(^{358}\) Revised _UCC_ 2-204(3) submitted for consideration to the American Law Institute in May 2003 is
identical to the original _UCC_ 2-204(3) _Revised_ 2-204 alters subsection (1) and incorporates a new
subsection (4) that addresses interactions with and between “electronic agents.”
**Implying Price**

Even if an offer for the sale of goods omits a price, it is still a valid offer and *UCC* 2-305 permits the court to supply a reasonable price if omitted from a contract for the sale of goods.\(^{359}\) Similarly, the Sale of Goods Act in the Marshall Islands also permits to court to imply a reasonable price.\(^{360}\) Section 10(1) of the Sale of Goods Act of 1986, which permits the court to fix the price in the manner agreed or through prior course of dealing, provides:

The price in a contract of sale may be fixed by the contract or may be left to be fixed in a manner thereby agreed, or may be determined by the course of dealing between the parties.\(^{361}\)

If the court is unable to ascertain price by course of dealing or in the manner agreed to between the parties, a reasonable price will be implied by Section 10(2) of the Sale of Goods Act of 1986 which states:

Where the price is not determined in accordance with the foregoing provisions must pay a reasonable price. What is a reasonable price is a question of fact dependent on the circumstances of each particular case.\(^{362}\)

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\(^{359}\) *Revised UCC* 2-305 replaces some of the original language of *UCC* 2-305 with gender neutral language. *Revised UCC* 2-305.Open Price Term states:

(1) The parties if they so intend can conclude a contract for sale even tough the price is not settled. In such a case the price is a reasonable price at the time for delivery if (a) nothing is said as to price; or (b) the price is left to be agreed by the parties and they fail to agree; or (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded. (2) A price is to be fixed by the seller or by the buyer means a price to be fixed in good faith. (3)When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at the party’s option treat the contract as cancelled or the party may fix a reasonable price. (4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

\(^{360}\) Sale of Goods Act, 23 MIRC, Cap 1, § 10.
\(^{361}\) Sale of Goods Act of 1986, 23 MIRC Cap 1, §10(1)
\(^{362}\) Sale of Goods Act of 1986, 23 MIRC Cap 1, § 10(2)
The common law of Palau is similar to those statutory provisions in the Sale of Goods Act and in the UCC. In *Sumang v. Pierantozzi*, the Palau Supreme Court was asked to address the absence of a redemption price and whether that rendered the offer and an agreement between Plaintiff and Defendant so vague as to be unenforceable. Pierantozzi gave Sumang a $3000 loan which was secured by a deed to a parcel of land in Koror. When she was not paid, Pierantozzi filed suit to foreclose on the land securing the debt. Sumang offered to convey the disputed property in exchange for the dismissal of a lawsuit plus a six month period to negotiate a re-conveyance. Pierantozzi accepted and acted accordingly. Sumang claimed the lack of a specific redemption price was a failure to include an essential element in the warranty deed and rendered it so vague as to be unenforceable. The Palau Supreme Court observed that dismissal of the suit and subsequent negotiations are sufficient consideration. The agreement became a valid contract when the suit was dismissed and subsequent negotiations began despite the absence of a redemption price. As to the open price term, the court observed:

The absence of a redemption price does not prevent this court from verifying compliance with the terms of the agreement. The parties’ obligations were clear and there is no suggestion that they were not met.

**Definiteness: Output and Requirements Contracts**

UCC 2-306 addresses requirements or output contracts and they are usually sufficient if “good faith,” as required by UCC 1-201(19) and UCC 1-203, is read into

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363 7 ROP Intrm 36 (1998)
364 Id at 37.
365 UCC 2-306 and Revised UCC 2-306 submitted to the American Law Institute in May 2003 are identical. UCC 2-306. Output, Requirements and Exclusive Dealings states as follows:
Occasionally, there will be a need to refer to objective, extrinsic facts. Definiteness may also be determined if the contractual relationship is between going businesses as opposed to a new business. Further, it has been held that a matter is sufficiently identified if there is a reasonable range of choices.

**Definiteness: Employment Contracts**

In an employment contract, the duration of employment must be specified. If it is not or there are no other materials or representations made at the time the offer is extended and accepted, a contract for services is generally terminable at will by either party at any time.³⁶⁷

In *Ponape Transfer & Storage Inc. v. Wade*,³⁶⁸ the court used prior course of dealing and surrounding circumstances to imply a missing compensation term in an ambiguous employment contract that the former employee was entitled to be paid for unused holiday time after deducting taxes.³⁶⁹

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³⁶⁶ *UCC* 1-203 indicates that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” Good faith is defined in *UCC* 1-201(19) as “honesty in fact in the conduct or transaction concerned.” Revised *UCC* 1-201(20) submitted to the American Law Institute in May 2003 materially alters the definition of “good faith” by including a requirement of “fair dealing.” Revised *UCC* 1-201(20) defines “good faith” as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”

³⁶⁷ See, *Ngiratkel Etpison Co. (NECO) v. Rdialul*, 2 ROP Intrm 211, 221 (1991) (a case involving an exchange inventory of engines, parts and an OMC dealership in exchange for services to be provided.) See also, *Toussaint v. Blue Cross & Blue Shield of Michigan*, 292 NW 2d 880 (Mich. 1980); *Pugh v. See’s Candies* 171 Cal. Rptr. 917 (1981). There are also numerous law review Articles on this topic as well.

³⁶⁸ 5 FSM Intrm 354 (Pon. 1992)

³⁶⁹ Id at 356
The Relationship Between Intention of the Parties and Definiteness

As noted in *Ponape Transfer & Storage Inc. v. Wade*, the intention of the parties is the predominant consideration in deciding whether a vague or missing term is to be implied at common law.\(^{370}\) The *Ponape* court concluded that prior course of dealing and surrounding circumstances reflected the parties’ intent that compensation for unused vacation time would constitute an implied term of the employment contract.\(^{371}\) On the other hand, there was no factual support for defendant’s claim for shipping and transportation costs back to the point of hire in the course of dealing or surrounding circumstances between the parties.\(^{372}\)

In *Iriarte v. Micronesian Developers*, the parties had settled earlier litigation regarding defendant’s operation of a rock quarry adjacent to the Plaintiff’s property for a lump sum payment of $18,000 and 2% of defendant’s gross sales of crushed rock through March 31, 2011. The defendant paid the $18,000 and made monthly payment of the 2% of gross sales. When the plaintiff filed a subsequent suit, one of the allegations in response to defendant’s motion to dismiss based on the prior settlement agreement was that the prior settlement agreement was unenforceable and vague because it did not specify how the royalty payments were to be made.\(^{373}\) Citing earlier decisions in *Ponape*

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\(^{370}\) 5 FSM 354 (Pon. 1992) (Court implied a term that compensation was to be paid to employees for unused holiday time minus taxes.)

\(^{371}\) Id at 356

\(^{372}\) Id at 356

\(^{373}\) Id at 357

\(^{374}\) 6 FSM Intrm 332 (Pon 1994)

\(^{375}\) Id at 335
Transfer and Storage v. Wade\textsuperscript{376} and Panuelo v Pepsi,\textsuperscript{377} the Iriarte court looked to the intent of the parties. In granting defendant’s motion to dismiss, the Court observed:

Secondly, even if there were a dispute between the parties themselves about whether the royalty payments should be made in a lump sum, as opposed to month-by-month, that would probably not render the contract unenforceable vague. Contracts frequently do not specify the time of performance and the courts routinely decide what a ‘reasonable time’ for performance is in those cases where no time has been specified. See 1 Corbin on Contracts §96 (1960) Here the contract clearly stated the important terms - $18,000 paid in a lump sum and 2% of the defendant’s gross sales of rock products after that – and the plaintiffs have already begun to accept performance. The fact the agreement does not specify when the royalty payments are to be made suggests that the parties did not regard any specific point in time as essential. Id. Uncertainties of that type are seldom held to make a contract too uncertain to be enforced. Id. This court, although it has not ruled on the precise question presented here, has in the past declined to allow problems regarding the timing of performance, or the existence of vague terms, interfere with the enforceability of a contract.\textsuperscript{378}

In Nelper v Akinaga, Pangelinan & Sita,\textsuperscript{379} the parties had an agreement to permit defendant to build an access road across plaintiff’s property and agreed that there was to be compensation but did not reach a clear understanding on what that compensation would be. Instead of declaring the agreement void or unenforceable, the court focused on the intent of the parties, sought mutuality, and concluded that at a minimum there was an intent and agreement by plaintiffs to permit defendants to use the access road upon its completion.\textsuperscript{380} The court found the defendant liable to plaintiff for the cost to make the

\textsuperscript{376} 5 FSM Intrm 354,356 (Pon 1992)
\textsuperscript{377} 5 FSM Intrm 123, 127-8 (Pon 1991)
\textsuperscript{378} 6 FSM Intrm at 335. See also, O’Byrne v. George, 9 FSM Intrm 62, 64-5 (Kos. St. Ct Tr. 1999) (time not of the essence in oral residential construction contract where plaintiff could not cite specific crucial date for completion)
\textsuperscript{379} 8 FSM Intrm 528 (Pon 1998)
\textsuperscript{380} Id at 539.
road passable by car or truck but that the defendants are not responsible for current or future maintenance and did not agree to such. 381

**Relationship between Certainty and Anthropological Considerations**

When analyzing whether it was the intent of the parties to enter into a contract or whether a particular term was intended and is to be implied, an “objective” test is generally employed in most jurisdictions.

In Micronesia, however, this “objective” test to determine intent of the parties has a unique anthropological twist incorporating local custom and tradition thus creating an “ordinary Micronesian standard.” The Supreme Court of the Federated States of Micronesia described the standard in *Semens v. Continental Airlines* 382 as follows:

The court, when interpreting a contract, may not simply assume that reasonably intelligent Micronesians will perceive the same meaning as would reasonably intelligent Americans… Courts may not blind themselves to pertinent aspects of Micronesian society, such as less facility in the English language, less exposure to business concepts, and the paucity of legal resources, which might cause a reasonably intelligent Micronesian to perceive a meaning differently than would a person from some other nation. 383

**Definiteness and Certainty: Agreements to Agree**

Both formation and enforceability issues may arise as to whether contracts in which terms are to be agreed upon in the future or, what is commonly referred to as an “agreement to agree,” are sufficiently definite or certain. *Restatement (Second) of Contracts* §26 provides that preliminary negotiations like agreements to agree are non-binding unless the party has made a further manifestation of assent.
For example, in *Adelbai v. Masang*, the Supreme Court of Palau determined that an alleged agreement to “discuss” distribution of certain property in the future if a claim to that land was “successful” was too uncertain to be enforced. Prior to the Japanese mandate period, Salii Ngiraikelau owned property called Ngerias in Koror. During the mandate period, the Japanese government abolished private property rights and declared Ngerias to be public land. Title to the “public” land passed to the Trust Territory and then to the Koror State Public Lands Authority. Salii lived until 1967 well into the American era. Masang, whose mother was a niece of Salii’s, and two others timely filed for return of the land pursuant to statute. When Masang died in January 1991, his son, Sam was permitted to substitute into the litigation to take his father’s place. The trial was divided into three phases. The first phase determined that the land was public land eligible under the act to be returned to proper heirs to the land in question. After this initial success, Napoleon sought to intervene in 1996 claiming that Masang and his son agreed to represent her and other relatives in the land claim and that by pursuing this action in their individual capacity they breached the agreement and, alternatively, she was an heir and entitled to the land despite any agreement. The second phase of the trial resolved the dispute as to whether the property was Eteet clan property or belong to Salii and who was a proper heir to the property if it belonged to Salii. The court concluded the property belonged to Salii and his heirs and that Masang and one other were proper heirs

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384 9 ROP 35 (2001)
385 35 PNC 1304 (1986) Pursuant to §1304(b), a claimant must prove: (1) Palau citizenship; (2) that the claimed land is considered public land and that the land became public land as a result of “the acquisition by previous occupying powers or their nationals prior to January 1, 1981, through force coercion, fraud, or without just compensation or adequate consideration;” (3) the claimant is the original owner or proper heir; and (4) the claim for return was filed before January 1, 1989. See 9 ROP at 36-7.
386 Id at 37
who had timely filed. Before the third phase of the trial began, two adopted daughters sought to intervene claiming that they were proper heirs. After the trial, an adopted son tried to intervene. The third phase concluded when the trial court denied the attempts of the adopted son and daughters to intervene as well as Napoleon’s claim to the property because their claims were filed after the statutory cut off date. As to the alleged breach of contract, the trial court observed that the agreement to discuss ownership with the relatives if his individual claim was successful was “little more than an agreement to agree and is not a proper subject of judicial enforcement.”

On appeal, the Palau Supreme Court affirmed noting:

A court can only enforce a contract ‘only if the obligations of the parties are set forth with sufficient definiteness that it can be performed’…. Although a party may manifest an intention to offer performance, the offer cannot be said to form an enforceable contract ‘unless the terms of the contract are reasonably certain’…. Furthermore, if ‘one or more terms of a proposed bargain are left open or uncertain,’ that ‘may show that a manifestation of intention of intention is not intended to be understood as an offer or as an acceptance.’

Applying the facts of the case to the law, the Adelbai court concluded:

This agreement to ‘discuss’ is too uncertain to be judicially enforced because the promise leaves open the question whether the land is to be distributed among or shared between Masang, Napoleon, Urrimch, and Chomlei. ‘Courts refuse to enforce agreements that contain indefinite promises or terms they deem essential precisely because judicial clarification of the uncertainty entails great danger of creating intentions and expectations that the parties themselves never entertained…’ Thus, because Masang’s alleged obligation is effectively undefinable, the agreement does not meet the requirements of a valid contract.

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387 Id at 38.
388 Id at 40. (Citations omitted.) The court quoted Restatement (Second) of Contracts, § 33 in support of this holding.
389 Id at 40. (Citations omitted.)
Definiteness: Unilateral Contracts

Otherwise absent or vague terms may defeat contract formation unless part performance or acceptance make the terms clear. A bilateral contract generally consists of a mutual exchange of promises such as an offer to provide goods and a reciprocal offer to pay. A unilateral offer invites performance or part performance as acceptance as opposed to a reciprocal offer or promise. Since there is no reciprocal offer being made and the offer invites performance as acceptance, a potential for ambiguity exists. Where there is a unilateral offer, any ambiguity or concerns regarding certainty or definiteness may be dispelled, however, by performance or part performance.

Communication of Offer

To create a bilateral contract, an offer must be communicated in some manner to the offeree. Likewise, an offeree’s return promise must be communicated to the offeror. An offeror may dispense with the requirement that the offeree’s promise be communicated to the offeror. _CISG_ Article 15(2) indicates that an offer is not effective until it reaches the offeree. The offer cannot be communicated to a 3rd party and accepted by another unless the offeror intends the offer to be communicated by the third party to the offeree. A related concept provides that an offer may be communicated to a principal through an agent and accepted by the principal only if the offeror is aware of the agency relationship.
**TERMINATION OF OFFER**

An offer may be terminated prior to acceptance in a number of ways including lapse of time, death or lack of capacity, revocation, death or destruction, supervening illegality, by rejection, or by a counter offer under the common law. An offer may be terminated by the offeror, the offeree, or may be terminated by operation of law.

Specifically, *Restatement (Second) of Contracts*, §36 indicates that an offeree’s ability to accept may be terminated by rejection or counter-offer by offeree, lapse of time, revocation by offeror, death or incapacity, or the non-occurrence of any condition of acceptance. 390

Under *Article 2.15(2)* of the *UNIDROIT Principles*, however, there may be an obligation to negotiate in good faith prior to revoking or terminating any negotiation between the parties. 391

**Termination of offer by offeror**

An offer may be terminated by the offeror by direct revocation, indirect revocation, or by publication. Offers made by publication may be terminated by use of comparable means of communication.

Although most offers may be revoked, there may limitations upon the offeror’s ability to revoke if the offer is made as part of an option contract, 392 a firm offer under

390 Restatement (Second) of Contracts §36
391 In pertinent part, *UNIDROIT Article 2.15(2)* states: “A party who negotiates or breaks off negotiations in bad faith is liable for the losses causes to the other party.”
392 For contracts which do not involve the sale of goods, see *Restatement (Second) of Contracts* §37 which provides that the power of acceptance under an option contract is not terminated by rejection, counter offer, revocation, or by death or incapacity unless the requirements are met for the discharge of a contractual duty.
the UCC, if the offer is supported by promissory estoppel or detrimental reliance, or if the offer is unilateral and there is performance or part performance.

**Direct or Express Revocation by Offeror**

The offeror may directly terminate the offer by revoking the offer prior to acceptance by the offeree. Revocation must be communicated to and received by the offeree in order to be effective. *Restatement (Second) of Contracts* §42 indicates that an “offeree’s power of acceptance is terminated when the offeree receives from the offeror a manifestation of an intention not to enter into the proposed contract.”

*CISG* Article 15(2) provides that “an offer, even if it is irrevocable, may be withdrawn if the withdrawal reaches the offeree before or at the same time as the offer.”

One of the leading cases involving the issue of receipt of notification of revocation is *Byrne v Van Tienhoven.* In *Byrne*, the defendants offered to sell plaintiff tinplate on October 1 suggesting a reply by cable. When plaintiff had not replied by October 8, the defendants wrote the plaintiff revoking the offer. While the revocation letter was meandering through the postal system, plaintiff cabled acceptance which was received by defendants on October 11. The revocation letter from defendants was received by plaintiff nine days later on October 20. An enforceable contract was created on October 11 since revocation was not effective until received and communicated to the offeree.

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393 *Restatement (Second) of Contracts* §42
394 *CISG* Article 15(2)
395 5 CPD 344 (1880)
Indirect revocation by offeror

An offer may be revoked indirectly by conduct of the offeror. *Restatement (Second) of Contracts* §43 provides that an “offeree’s power of acceptance is terminated when the offeror takes definite action inconsistent with an intention to enter into the proposed contract and the offeree acquires reliable information to that effect.” For example, if the offeror acts inconsistently with offeror’s continued willingness to keep offer open and offeree indirectly receives correct information from a reliable source, the offer is considered to be revoked indirectly.

In *Dickinson v Dodds*, the defendant told plaintiff he would keep an offer open to purchase homes until Friday, June 12, 1874, at 9 AM. Despite this open offer, defendant sold the homes to a third party on Thursday. The plaintiff’s agent told him of the Thursday sale on Thursday evening and he attempted to accept the offer by handing defendant a formal acceptance before 9 AM Friday. The court held that the plaintiff could not accept an offer that he knew to be withdrawn. The *Dodds* case also illustrates that revocation can be communicated by conduct rather than words and that defendant’s conduct selling the homes to a third party was equivalent to stating “I withdraw the offer.” The *Dodds* decision has been more recently adopted in *Restatement (Second) of Contracts*. The *Dodds* case should, however, be distinguished from those offers that are kept open and supported by consideration that makes them irrevocable, i.e option contracts.

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396 *Restatement (Second) of Contracts* §43
397 2 Ch D 463 (1876)
398 *Restatement (Second) of Contracts* §43 states: “An offeree’s power of acceptance is terminated when the offeror takes definite action inconsistent with an intention to enter into the proposed contract and the offeree acquires reliable information to that effect.”
Termination of offer by publication

An offer may be extended and published in a newspaper, periodical, advertisement, or comparable publication. An offer made by publication may be terminated by offeror upon publication of notice of revocation. Restatement (Second) of Contracts § 46 provides that revocation is effective when notice of termination “is given publicity by advertisement or other general notification equal to that given to the offer” and no better means of communication are available. Termination is effective upon publication. Notice of revocation is adequate if published in a comparable medium as to that used initially to extend the offer.

LIMITATIONS: OFFEROR’S ABILITY TO REVOKE

As noted previously, there may be limitations upon the offeror’s ability to revoke. Generally, an offer can be revoked at anytime even if there is a promise not to revoke. There may limitations upon the offeror’s ability to revoke if the offer is made 1) as part of an option contract supported by consideration, 2) a firm offer under UCC 2-205, 3) if the offer is supported by promissory estoppel or detrimental reliance, or 4) if the offer is unilateral and there is performance or part performance.

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399 Restatement (Second) of Contracts §46  
400 Restatement (Second) of Contracts §37  
401 UCC 2-205  
402 Restatement (Second) of Contracts §90  
403 Restatement (Second) of Contracts §45
**Revocation: CISG**

*CISG Article* 15(2) states that an offer, even if irrevocable, can be withdrawn as long as revocation reaches the offeree before or at the same time as the offer.\textsuperscript{404}

*CISG Article* 16 limits an offeror’s ability to revoke and provides that an offeree can dispatch an acceptance and that the offeree’s dispatch of the acceptance terminates the offeror’s ability to revoke.\textsuperscript{405} *CISG Article* 16 provides three circumstances in which an offer cannot be revoked: 1) if the offer states it is irrevocable, that there is a fixed time for acceptance,\textsuperscript{406} 2) there is justifiable reliance by the offeree that the offer is irrevocable, or 3) the offeree has already acted in reliance upon the offer.\textsuperscript{407}

**Revocation: Merchant’s Firm Offer Under the UCC**

An offeror’s ability to revoke a merchant’s firm offer under *UCC* 2-205 or *Revised UCC* 2-205 is limited once the offer has been made.\textsuperscript{408} The firm offer must be in a record or writing signed by the merchant and can be held open for up to three months.

\textsuperscript{404} CISG Article 15(2)

\textsuperscript{405} CISG Article 16(1) state: “Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before he has dispatched an acceptance.”

\textsuperscript{406} CISG Article 16(2)(a)

\textsuperscript{407} CISG Article 16(2)(b). See also, *Drennan v Star Paving*, 333 P2d 757 (Cal 1958)

\textsuperscript{408} *UCC* 2-205. Firm Offers provides:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

*UCC* 2-205 (Revised) that was submitted for consideration to the American Law Institute in May 2003 is identical to the original version of *UCC* 2-205 except that it replaces the word “writing” with the word “record.” The intent of *Revised* 2-205 is to anticipate firm offers in wholly electronic form. See also, *UNCITRAL Model for E-Commerce, Article* 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”
months. The merchant’s firm offer is irrevocable for the time stated in the offer or up to three months if no time is stated. Unlike an option contract which requires consideration to remain open, a firm offer under either UCC 2-205 or Revised UCC 2-205 does not need additional consideration to be held open for up to three months. Consideration would, however, be required to keep a merchant’s firm offer open for longer than three month.

**Revocation: Promissory Estoppel or Detrimental Reliance**

Detrimental reliance is both a consideration substitute and may also limit the offeror’s power to revoke. Where an offeree detrimentally relies upon an offer and the offeror could reasonably expect the offeree to do so, the offeror will not be permitted to revoke the offer. *Restatement (Second) of Contracts* §90 provides that a promise may not be revoked if the promisor should reasonably expect to induce action or forbearance and that does induce such action or forbearance is binding to the extent injustice can be avoided.

In *Drennan v. Star Paving*, the general contractor, Drennan, relied upon Star Paving’s bid of $7131.60 for a subcontract involving paving a parking lot when submitting a bid on the Monte Vista School Construction project. Plaintiff Drennan submitted the overall low bid and was awarded the job. After the bid was awarded, Star Paving informed Drennan that the subcontract bid it submitted was an error and that it would do the work for no less than $15,000 and refused to perform the work. Drennan

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409 Id.
410 Id.
411 Restatement (Second) of Contracts §90
412 333 P2d 757,333 P2d 757 (Cal. 1958)
hired another paving contractor who did the work for $10,948.60 and Drennan sued Star Paving for the $3,187 difference. Relying upon a combination of original Restatement of Contracts §45 and §90, the court held that the plaintiff’s reliance on defendant’s bid created an option contract in which the offer was irrevocable and that plaintiff was entitled to recover its damages of $3187. The Restatement (Second) of Contracts §87 follows similar reasoning to that set forth in the Drennan decision.\textsuperscript{413}

Restatement (Second) of Contracts § 90 extends the rationale in Drennan and precludes withdrawal of a promise or offer which the offeror should reasonably expect to induce action or forbearance on the part of the promisee.\textsuperscript{414}

**Revocation: Performance or Part Performance of Unilateral Contracts**

In addition to constituting acceptance, part performance may also limit the offeror’s ability to terminate the offer by creating an option contract.\textsuperscript{415} Restatement (Second) of Contracts, §45, is consistent with this proposition.\textsuperscript{416}

\textsuperscript{413} Restatement (Second) of Contracts §87(2) provides:

An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character by the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

\textsuperscript{414} Restatement (Second) of Contracts, § 90(1) states:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

\textsuperscript{415} In Guaschino v Reimers and Reimers, 2 MILR 49 (March 8, 1995) the design professional tried to avoid contractual liability in the design and supervision of construction of a home by claiming that the contract was never accepted. However, the Supreme Court of the Marshall Islands noted that the defendant had acted on it and the house was substantially completed before his termination. Id at 54.

\textsuperscript{416} Restatement (Second) of Contracts, § 45 states:
Mere preparation to perform does not constitute part performance. Further, an offeror may expressly indicate that part performance will not constitute acceptance and refuse to accept part performance. If the offeror, however, accepts the benefits of part performance or allows offeree to partially perform without refusal, the offeror will be precluded from withdrawing the offer. Further, part performance may preclude withdrawal if the offer is indifferent as to the manner of performance. Part performance also precludes the withdrawal of an offer by the offeror in a true unilateral contract.

One of the earliest unilateral contract cases in Micronesia is *Kihara Real Estate v. Estate of Nanpei* (I)\(^{417}\) which involved an option lease agreement for the development of a golf course, condominiums, and resort in which the plaintiff paid defendant $12,500 as consideration for the option. Relying upon *Restatement (Second) of Contracts* §45, the *Kihara* court observed:

An option contract is a unilateral contract where an offer is made and the offeree is invited to accept by rendering a performance instead of promising something in return. Once the offeree either tenders or begins the invited performance, the option contract is created. The offer then becomes irrevocable. It is the very tender or ‘the beginning of performance...[which] furnishes the consideration for an option contract....The offeror may vary the common law rule by express provision in the contract; thus, he remains in control of his offer. Absent express provision to the contrary, an option contract is binding on the offeror who must keep the offer open for a specified period. The offeree is free to accept or reject within that period of time.\(^{418}\)

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\(^{417}\) 6 FSM Intrm 48 (Pon. 1993). If one wishes to review other Micronesian cases involving litigation between these particularly litigious parties one may also refer to *Kihara v. Nanpei* 5 FSM Intrm 342 (Pon. 1992); *Kihara Real Estate v Estate of Nanpei (III)* 6 FSM Intrm 502 (Pon. 1994); *Nanpei v. Kihara*, 7 FSM Intrm 319 (App. 1995)

\(^{418}\) 6 FSM Intrm at 53.
In granting partial summary judgment, the Kihara court concluded that the defendant breached the unilateral option contract when they failed to perform by providing a list to the plaintiff of lease property and when the defendant failed to allow the plaintiff the right of first refusal. 419

An option contract to keep an offer open for a specified time which is supported by consideration is also irrevocable until the agreed time expires. If an offeree pays consideration to offeror to keep a separate and distinct offer open for a particular period of time, an option contract is formed as it relates to the second offer.

As to part performance, a reasonable time to complete performance may be implied if no time is specified. If a series of acts is involved in an option contract situation, courts often employ a divisibility test so that the offeree’s consideration will bind the offeror to some specific severable duty. The offeree will be compensated to the extent of performance, in part or in whole.

**TERMINATION OF OFFER BY OFFEREER**

An offeree may also terminate the offer by express rejection or, under the common law, by communicating a counter-offer.

The offeree may indirectly reject by letting the offer lapse after a reasonable time or if the offeree does nothing within the specified time in which to accept.

Termination of an offer by the offeree is effective when a rejection is received by the offeror. *Restatement (Second) of Contracts* §40 provides that a rejection or counter

419 Id.
offer sent by mail or telegram does not terminate the power of acceptance until received by the offeror.\textsuperscript{420}

To extend the \textit{Dickinson v Dodds}\textsuperscript{421} scenario, it is possible for the offeree to send both a revocation and acceptance and if the revocation arrives first, the offer is terminated. Alternatively, if the acceptance arrives first, there is a binding contract despite the fact that revocation may have been sent first.

\textit{CISG Article} 17 is consistent with this hypothetical.\textsuperscript{422} Until notice of termination or rejection is received by the offeror, an offer may be accepted.

The offeree may expressly reject the offer. \textit{Restatement (Second) of Contracts} §38 provides that an offeree’s ability to except is terminated by rejection of the offer.\textsuperscript{423}

Under the \textit{Restatement (Second) of Contracts} §39 and the common law, the offeree may make a counter offer which is an implicit rejection terminating the offeree’s power of acceptance.\textsuperscript{424} When evaluating a purported counter-offer, it is important to distinguish mere inquiry from a counter offer. Mere inquiry as to the terms of the offer by the offeree will not constitute a counter offer or implicit rejection.\textsuperscript{425}

A rejection of the offer by the offeree is effective when received by the offeror. If rescission of the revocation arrives to the offeror prior to the revocation, the offeree may

\textsuperscript{420} \textit{Restatement (Second) of Contracts} §40. The rule also notes that the power of acceptance is limited so that “a letter or telegram of acceptance started after the sending of an otherwise effective rejection or counter offer is only a counter offer unless the acceptance is received by the offeror before he receives the rejection or counter offer.” In other words, if the acceptance is received first, a contract is formed even though the rejection or counter offer may have been mailed first in time.
\textsuperscript{421} 2 Ch D 463 (1876)
\textsuperscript{422} \textit{CISG Article} 17 provides that “an offer, even if irrevocable, is terminated when a rejection reaches the offeror.”
\textsuperscript{423} \textit{Restatement (Second) of Contracts} §38
\textsuperscript{424} \textit{Restatement (Second) of Contracts} §39(2)
\textsuperscript{425} Id.
still accept the original offer. Despite rejection by offer by offeree, an offer may be revived if the offeror renews a willingness to deal according to the terms of the rejected offer.

An offer may be implicitly rejected by the offeree due to lapse of time. Generally an offer must be accepted within a specified time set forth in the agreement or, in the absence of a specified term, a reasonable time in which to accept the offer will be inferred. When assessing reasonableness, it is important to look to when the offer was received by the offeree.

**TERMINATION OF OFFER: OPERATION OF LAW**

An offer may also be terminated by operation of law where there is: 1) death or incapacity of offeror or identified offeree, 2) destruction of the subject matter, 3) lapse of time, or 4) supervening illegality.

**Death and Incapacity**

Death, insanity, or incapacity of the offeror or identified offeree while the offer is pending may result in termination of the offer. *Restatement (Second) of Contracts* §48 provides that the offeree’s ability to accept is terminated when either the offeree or offeror dies or is deprived of legal capacity to formulate a contract.\(^{426}\) Death, incapacity or insanity need not be communicated to the other party in order to terminate the offer. An exception to this rule exists if the offer is an option contract supported by

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\(^{426}\) Restatement (Second) of Contracts §48
consideration. In that instance, death, incapacity or subsequent insanity may not automatically terminate an option offer by operation of law.

**Destruction of Subject Matter**

An offer also is terminated by operation of law if the proposed contract’s subject matter is destroyed while the offer is pending. Destruction of a thing essential to the contract prior to acceptance of the offer terminates the offer whether or not the offeree is aware of the destruction. This is particularly true for the sale of goods or identifiable property. For example, Section 8 of the Sale of Goods Act of 1986 in the Marshall Islands provides: “Where there is a contract for the sale of specified goods, and the goods without the knowledge of the seller have perished at the time when the contract is made, the contract is void.”

**Supervening Illegality**

An offer may be also terminated while the offer is pending and prior to acceptance by supervening illegality where a change of law or regulation would render the performance illegal. The pending offer is terminated by supervening illegality whether or not the offeree is aware of the change in law or regulation. If there is supervening statutory or regulatory prohibition enacted while the offer is pending rendering performance of the proposed contract subject matter illegal, the offer is declared void and terminated by operation of law. The termination of an offer due to supervening illegality is distinguishable from the situation where a contract has been

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formed which, after it is formed, is rendered void due to supervening illegality. Contract avoidance due to illegality will be discussed later in the text.

**Lapse of Time**

An offer may be terminated if the time specified in the offer expires and there has been no acceptance within the defined period of time. In those instances where no time is specified for acceptance, the courts will imply a reasonable time in which to accept the offer. If not accepted within the time specified within the contract or within a reasonable time implied by the court, the offer will be construed to be void and terminated. Considerations of good faith on the part of the offeree will also be considered by the court. A late acceptance after the initial offer lapses may be construed as an offer from the offeree. Alternatively, the offeror may waive the lapse due to the late acceptance and may accept. A third intermediate view provides that a late acceptance, but one that is still sent within a reasonable time, would still constitute an acceptance of the offer unless the offeror objects within a reasonable time. Failure to object or silence by the offeror could also constitute acceptance of the late acceptance.

**Acceptance**

Under the concept of acceptance, there are a number of related issues that we will address including general principles regarding acceptance, authority to accept, acceptance under the common law and other international standards, the implication of counter offers and acceptance, acceptance under the *UCC*, mode or manner of acceptance, and silence as acceptance.
Acceptance: Generally

An acceptance is a manifestation of assent by the offeree to the terms of an offer in a manner invited or required by the offer. 428 The Restatement (Second) of Contracts §53 provides that an offer can be accepted by performance only if the offer invites such an acceptance. 429 Acceptance may be by a return promise in a bilateral contract situation, or by conduct, i.e. performance or beginning to perform if the offer invites such in response to a valid unilateral written or oral offer in the absence of any mistake or ambiguity. 430 Either acceptance by a return promise, or performance or partial performance may, if supported by consideration or its alternative, constitute an objective manifestation of mutual assent sufficient to form an enforceable contractual relationship. 431

Authority to Accept

Restatement (Second) of Contracts §52 provides that acceptance is valid if accepted by an individual or entity that has power of acceptance. 432 A party to whom the offer is made has authority to accept. If the offer is made to a class, a member of the class or group may accept. This is particularly significant under traditional or customary law when one is dealing with the member of a clan. An agent has the authority to accept on

428 Restatement (Second) of Contracts §50
429 Restatement (Second) of Contracts §53
430 Restatement (Second) of Contracts §50
431 Restatement (Second) of Contracts, §17. For examples involving oral contracts in which performance constitutes acceptance and mutual assent, see Kamiishi v. Han Pa Const. Co., 4 ROP Intrm 37, 40-41 (1993); Guaschino v. Reimers and Reimers, 2 MILR 49 (March 8, 1995); O’Byrne v. George, 9 FSM Intrm 62 ( Kos. S. Ct. Tr. 1999)
432 Restatement (Second) of Contracts §52
behalf of the principal if the offeror is aware of the existence of the agency relationship. Otherwise, a third party may not accept unless it intended by the parties as part of the original agreement or the authority to accept has been assigned. An option contract supported by consideration, however, may also be assigned to a new offeree.

**Acceptance under the Common Law, the Mirror Image Rule, and Other International Standards**

*Common law*

Terms of acceptance of the offer must be unequivocal. Under the common law “mirror image” rule, the acceptance must mirror or comply exactly with the offeror’s original terms, neither omitting nor adding terms. Under the common law, any change to the offer would constitute a counter-offer and not an acceptance. Restatement (Second) of Contracts §58 requires that an acceptance must comply with the requirements of the offer as to the promise to be made or performance to be rendered.\(^{433}\) Restatement (Second) of Contracts §59 indicates that a reply that is a purported acceptance but is conditional on the offeror’s assent to additional terms is not an acceptance but a counter offer.\(^{434}\)

Some areas of concern under the common law involve statements or requests that make implicit terms explicit. Restatement (Second) of Contracts § 61 indicates that an offer which requests changes or additional terms but does not condition acceptance upon those changes or additional terms is still a valid acceptance.\(^{435}\) As long as the statements or requests do not change terms of offer, such requests or mere inquiries do not constitute an acceptance or counter-offer. A “grumbling acceptance” where offeree demonstrates

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\(^{433}\) Restatement (Second) of Contracts §58  
\(^{434}\) Restatement (Second) of Contracts §59  
\(^{435}\) Restatement (Second) of Contracts §61
some reluctance but does not change terms of the original offer still constitutes an acceptance under the common law.

The common law provides that additional terms do not become part of the contract and that additional terms would constitute a counter offer or rejection.

**CISG**

The common law approach was also adopted in Article 19(1) of CISG which provides: “A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.”

However, CISG Article 19(2) proceeds to take an intermediate position stating that a contact may be created if the acceptance “contains additional terms which do not materially alter the terms of the offer.” CISG Article 19(3) then lists those terms that would “materially” alter an offer if added to the original offer including such terms relating to price, payment, quality and quantity of goods, place and time of delivery, and the settlement of disputes or arbitration provisions.

**UNIDROIT**

The UNIDROIT Principles follow Article 19 of CISG to a certain extent but distinguish contracts utilizing standard forms or terms. UNIDROIT Article 2.22 specifically addresses what the drafters of the UCC affectionately refer to as the “battle of the forms.” Under the UNIDROIT Principles, a contract is formed on common terms

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436 CISG, Article 19(1)
437 CISG, Article 19(2)
438 CISG, Article 19(3)
439 UNIDROIT Article 2.19 through Article 2.22.
440 UNIDROIT Article 2.22 states:
and disputed terms eliminated and if the party does not wish to be bound by such disputed terms that party must clearly indicate without undue delay in advance that it does not intend to be bound by such particular terms or the contract.  

**Acceptance: Sale of Goods and the UCC**

The *Uniform Commercial Code* eliminates the distinction between bilateral and unilateral offers permitting multiple methods of acceptance of an offer.

An offer relative to the sale of goods can be expressly accepted by a return promise, i.e. a promise to buy or sell.

An offer can also be accepted by performance or part performance, i.e. selling or shipping the goods.

Implied acceptance occurs if there is retention after the goods have been inspected without objection. If a contract for the sale of goods contains a provision for cash on delivery (COD) payment, acceptance without inspection does not constitute acceptance and the buyer may still reject the offer and goods after they have been inspected if rejected within a reasonable time.

Under the *UCC*, if the offeree accepts the offer by performance, the offeree must provide notice to the offeror if the performance will take some time or if the offeror would be unaware of such performance. Alternatively, the offeree can accept an offer by

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Where both parties use standard terms to reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does not intend to be bound by such a contract.

*UNIDROIT Article* 2.19(2) defines standard terms as “provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party.”

*UNIDROIT Articles* 2.19 through 2.22
sending conforming or non-conforming goods. When sending non-conforming goods, the action of the offeree simultaneously constitutes both acceptance of the offer and breach of contract. The offeree has an opportunity to avoid breach if the offeree cures prior to the time of performance. If the seller ships buyer non-conforming goods expressly indicating that they are being sent as “an accommodation,” there is neither an acceptance of the offer nor a breach of contract.

**UCC Rejection of the Mirror Image Rule**

The *UCC* disfavors the common law concept of mirror image and counter-offer and goes a step further than most international contract standards. With contracts involving merchants and the sale of goods, *Revised UCC* 2-206(3) and *UCC* 2-207(1) provide a departure from the common “mirror image” rule of the common law and permit additional terms. Original *UCC* 2-207(1) provides:

A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.  

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442 *UCC* 2-207(1). *Revised UCC* 2-206(3). Original *UCC* 2-207 provides:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms. (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received. (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for the sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.
With the most recent amendments to the *UCC*, this particular provision was slightly modified to recognize modes of acceptance in e-commerce and moved to *Revised UCC* 2-206(3). *Revised UCC* 2-206(3) states: “A definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer.”\(^{443}\)

A “battle of forms” may occur when one party sends an offer in a standard form agreement and a standard form acceptance with different terms is sent as an acceptance. The original version and *Revised UCC* 2-207 address this particular situation. Under UCC 2-207, the “battle of the forms” is resolved and additional terms proposed by the offeree in response to the offer do not become a counter-offer or rejection and become part of the contract if they are minor, consistent and do not materially alter the contract and the offeror does not object within a reasonable time.\(^{444}\) If the additional terms are inconsistent or materially alter the contract, the terms offered by the offeree become part

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\(^{443}\) *Revised UCC* 2-206(3) submitted for consideration to the American Law Institutes May 2003.

\(^{444}\) *UCC* 2-207(2) provides:

> The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

*Revised 2-207. Terms of Contract; Effect of Confirmation provides:*

> Subject to Section 2-202, if (i) conduct by both parties recognizes the existence of a contract although their records do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance, or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract, are: (a) terms that appear in the records of both parties; (b) terms, whether in a record or not, to which both parties agree; and (c) terms supplied or incorporated under any provision of this Act.

*Revised 2-207 eliminates some important elements from the original version of *UCC* 2-207 resulting in an abbreviated text even if one takes into account the fact that *UCC* 2-207(1) was moved to *Revised UCC* 2-206(3).*
of contract only if the offeror expressly assents to their inclusion which is comparable to other international standards such as UNIDROIT Principle 2.22 and CISG Articles 19(2) and 19(3). Either party can avoid formation of a contract under original UCC 2-207(1) by expressly limiting acceptance to terms of original offer.

**UCC Limitations on Additional Terms**

Under the UCC 2-207, additional terms become part of the contract unless: 1) the offer is limited to its own terms, 2) the words of acceptance are expressly conditioned on a new or different term, or 3) if the new or different term materially alters the contract.

**Sale of Goods: Revocation of Acceptance**

Shipment of non-conforming goods expressly sent only as an accommodation and not as an acceptance would not constitute acceptance under UCC 2-206 and, if not cured, the offer may be revoked. The UCC also provides for revocation of acceptance where the manner of acceptance is receipt of the goods if: 1) there is a substantial non-conformity that substantially impairs the value of the goods, 2) there is a hidden or latent defect which could have not been reasonably discovered upon acceptance of the goods, and 3) the revocation must occur within a reasonable time after discovery of the non-conformity. The remedy in this situation would be rescission returning the parties to the status quo. The buyer is entitled to return of payment and must make the goods available to the seller who is entitled a return of the goods.

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445 Id.
446 This particular language, “unless the offer expressly limits acceptance to the terms of the offer” in original UCC 2-207(2) is some of the significant language deleted from Revised UCC 2-206(3) which is an abbreviated form of the original.
Confirmation of Contract for Sale of Goods Containing Additional Terms

A contract which contains differing terms may be confirmed under Revised UCC 2-207 by a record containing terms additional or different if they are in records of both parties, the parties agree, or if the terms are supplied, implied or incorporated by other provisions of the Act.\(^{447}\)

Manner or Mode of Acceptance: The “Mailbox” Rule

Generally, acceptance must be communicated in the traditional bilateral contract setting. Communication of acceptance assists in determining whether there is an objective manifestation of assent. Under the common law, acceptance is effective if accepted within the authorized mode of acceptance. The method used by the offeror to communicate the offer is the implied authorized manner of acceptance. Under common law, the offeree could only accept using the same medium used by the offeror to extend the offer.

This common law rule is referred to as the “postal” or “mailbox” rule. Under the mailbox rule, acceptance is effective on dispatch in a properly addressed, prepaid envelope. The mailbox rule is readily adaptable and applies to all medium of communication including telecommunications, facsimile, electronic, etc…and is not

\(^{447}\) Revised UCC 2-207. Terms of Contract; Effect of Confirmation provides:

Subject to Section 2-202, if (i) conduct by both parties recognizes the existence of a contract although their records do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance, or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract, are: (a) terms that appear in the records of both parties; (b) terms, whether in a record or not, to which both parties agree; and (c) terms supplied or incorporated under any provision of this Act.

Revised 2-207 eliminates some important elements from the original version of UCC 2-207 resulting in an abbreviated text even if one takes into account the fact that UCC 2-207(1) was moved to Revised UCC 2-206(3).
limited to just mail. However, the “mailbox” rule applicability of the mailbox rule is questionable or at a minimum must adapt to those regions, like the Pacific islands, where individual “mailboxes” or comparable mediums of communication may not be prevalent or exist as contemplated when the rule was formulated.

There are four exceptions to the common law “mailbox” rule: 1) where the offer specifically indicates that the mailbox rule does not apply, 2) to acceptance under an option contract where the offer has lapsed and expired, 3) where there has been detrimental reliance by offeror where offeror acts on rejection received first and acts on it even if the acceptance was mailed first, or 4) where offeree rejects by letter but before offeror receives the letter indicating rejection, the offeree dispatches a second letter indicating an acceptance of the offer and the second letter is received first. In this fourth instance, the first correspondence received by offeror prevails despite mailbox rule.

*Restatement (Second) of Contracts* §40 departs from the common law and provides:

Rejection or counter-offer by mail or telegram does not terminate the power of acceptance until received by the offeror, but limits the power so that a letter or telegram of acceptance started after the sending of an otherwise effective rejection or counter-offer is only a counter-offer unless the acceptance is received by the offeror before he receives the rejection or counter offers.\(^{448}\)

\(^{448}\) *Restatement (Second) of Contracts* §40
One of the leading mailbox or postal rule cases is *Adams v. Lindsell*. In *Adams*, the defendants who were wool dealers offered on September 2, 1817 to sell wool to the plaintiff manufacturers requiring a response “in the course of post.” The letter from defendants was misdirected and took three days to arrive to plaintiffs. The plaintiffs immediately responded that night of September 5 and their response was received by defendants four days later on September 9. Had the letter been properly addressed, a reply from plaintiffs to defendant’s offer should have arrived two days earlier on September 7. Because a reply had not been received two days earlier, the defendant dealers sold the wool to third parties on September 8 the day before receipt of the plaintiffs’ response. The court found that the plaintiffs used the designated manner of acceptance, acceptance was complete upon mailing the letter in the post, a contract was formed, and defendants breached the contract by selling the wool the previous day.

The “mailbox rule” provides that if the authorized means of acceptance is used that acceptance occurs when dispatched rather than upon receipt. Pursuant to the mailbox rule if an unauthorized means of acceptance is utilized, then acceptance is effective only upon receipt.

**Relationship of Mailbox Rule to International Contract Standards**

The civil law tradition in Europe, particularly in Germany (which controlled the Marshall and Caroline Islands in the late 19th and early 20th centuries) and Austria, provides that an offer is considered irrevocable and that a contract is not formed until

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449 106 ER 250 (1818)
acceptance is received by the offeror since there is “no necessity for fixing an earlier
moment in order to protect the offeree against possible speculations of the offeror.”

*CISG* Articles 16(2) and 18(2) are consistent with this European civil law
tradition. *Article* 16(2) states that an offer cannot be revoked after the offeree has
dispatched an acceptance. *CISG Article* 18(2) also provides that acceptance is not
effective until it reaches the offeror. There are limits on the mailbox rule. For example,
the offer may stipulate that acceptance is not effective until receipt. This exception is the
rule, however, in *CISG Article* 18(2).

**Restatement and UCC Rejection of Mailbox Rule**

The modern rule set forth in the *Restatement (Second) of Contracts* and the
*Uniform Commercial Code* departs from the common law. Under *UCC* 2-206, acceptance
can be by any reasonable manner. Acceptance can be made by any reasonable means
unless the offer unambiguously limits acceptance to a particular means. Unless sent in
the specified manner, acceptance under the *Uniform Commercial Code* and *Restatement*
is effective upon receipt.

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450 See 1 Rudolf Schlesinger, Formation of Contracts: A Study of the Common Core of Legal Systems,
109-11, 159, 747-91 (1968)
451 *CISG* Article 16(2)
452 *CISG* Article 18(2)
453 *Restatement (Second) of Contracts* §40
454 *UCC* 2-206(1) (a) and *Revised UCC* 2-206(1) (a) state: “an offer to make a contract shall be construed
as inviting acceptance in any manner and by any medium reasonable in the circumstances.”
455 *Restatement (Second) of Contracts*, §63(a) provides: “Unless the offer provides otherwise, (a) an
acceptance made in a manner and by a medium invited by the offer is operative and completes the
manifestation of mutual assent as soon as put out of the offeree’s possession, without regard to whether it
ever reaches the offeror.”
Option Contracts and the Mailbox Rule

The other exception to the mailbox rule is an option contract supported by consideration. The reason the mailbox rule does not particularly apply to option contracts is that the optionee must notify the offeror before a certain date of the exercise of the option and the underlying policy reason for the mailbox rule is absent in this particular situation.\footnote{Restatement (Second) of Contract §63.}

*CISG Article* 16 provides for a situation like an option contract without consideration where an offeree sends an acceptance and the sending of the acceptance precludes revocation of an offer by the offeror\footnote{CISG Article 16(1)} but where the actual acceptance is not effective until received by the offeror under *CISG Article* 18(2).\footnote{CISG Article 18(2)}

Likewise, *UNIDROIT Article* 2.4(2) which prohibits revocation of an offer if it indicates that the offer is irrevocable, there is a fixed time for acceptance, or there is justifiable reliance by the offeree\footnote{UNIDROIT Article 2.4(2)(a) and Article 2.4(2)(b).} and *Article* 2.6(2) that indicates an acceptance of an offer becomes effective when the indication of assent reaches the offeror\footnote{UNIDROIT Article 2.6(2)} are in accord with European civil law standards.

Reverse Mailbox Rule: Revocation and Acceptance

If a rejection and an acceptance of an offer are sent and the rejection is received first, there is no contract even if the acceptance was dispatched before the rejection. For example, see *CISG Article* 17 that provides than an offer is terminated when a rejection
reaches the offeror.\textsuperscript{461} \textit{CISG} Article 17 is consistent with other modern standards like \textit{Restatement (Second) of Contracts} §40 which focus upon receipt by the offeror rather than whether an acceptance or revocation is dispatched first. Acceptance by unauthorized means is effective if it is actually received by the offeror while the offer is still in existence.

\textit{Crossing Offers}

There is also the problem of crossing offers in the mail. If there are two offers, neither accepting, then no contract is created.

\textit{Acceptance by Performance and the Perfect Tender Rule}

Particularly in unilateral offer situations, performance or part performance can constitute acceptance of an offer. The \textit{Restatement (Second) of Contracts} §53 provides that an offer can only be accepted by performance if the offer invites such a performance.\textsuperscript{462}

Acceptance of an offer in a service contract can be by performance. For example, in \textit{Guaschino v Reimers and Reimers},\textsuperscript{463} the design professional tried to avoid contractual liability in the design and supervision of construction of a home by claiming that the contract was never accepted. However, the Supreme Court of the Marshall Islands noted that the defendant provided professional services by acting on it and the house was substantially completed before his termination.\textsuperscript{464}

\textsuperscript{461} CISG Article 17  
\textsuperscript{462} Restatement (Second) of Contracts §53  
\textsuperscript{463} 2 MILR 49 (March 8, 1995)  
\textsuperscript{464} Id at 54
The *UCC 2-206* eliminates any distinction between unilateral and bilateral contracts and allows acceptance of an offer for a contract involving the sale of goods by return promise or performance, i.e. shipment or promise to ship.\(^{465}\) In a contract for sale of goods, acceptance can also be by performance by shipping either conforming goods or non-conforming goods under the *UCC 2-206*.\(^{466}\)

Although the general requirements of Article 2 of the *UCC* are consistent with the common law perfect tender rule which requires that the goods shipped will correspond exactly to those described in the contract, this particular provision of the *UCC* permitting the intentional but well intentioned shipment of non-conforming goods to constitute acceptance initially appears contrary to the “perfect tender” rule implied at common law. However, this rule must be taken in context with the seller’s right to cure prior to the expiration of the time for performance in order to avoid a breach. If both rules are taken in proper context, the *UCC* still mandates perfect tender. The perfect tender rule has been adopted legislatively in some jurisdictions. These statutory schemes may seem to

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\(^{465}\) *Revised UCC 2-206*(1) (b) states:

> an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but the shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

Original *UCC 2-206*(1) (b) is identical.

\(^{466}\) *Revised UCC 2-206*(1)(b) provides:

> an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but the shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

Original *UCC 2-206*(1)(b) is identical.
conflict somewhat with provisions in the *UCC* which provide that shipment of non-conforming goods can equal acceptance.

For example, Sale of Goods Act 1986 in the Marshall Islands provides that goods will correspond identically with the description contained in the contract. 467 Section 15 of the Sale of Goods Act of 1986 provides:

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description. 468

**Silence as Acceptance**

There are exceptions to the requirement that acceptance must be communicated. *Restatement (Second) of Contracts* §69 provides that under certain circumstances, offers may be accepted by silence or by exercising of dominion or control without any communication. 469 In certain circumstances, the offer may expressly waive the need to communicate acceptance. Further, an act or conduct may constitute acceptance. Under *UCC* 2-206, for example, one can send goods as an act constituting acceptance. 470

Silence can constitute acceptance where the offeree silently takes the offered benefits. In the Marshall Islands, Section 36 of the Sale of Goods Act provides:

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller; or when after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them. 471

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469 Restatement (Second) of Contracts §69.
470 *UCC* 2-206(1) (b); *Revised UCC* 2-206(1)(b).
CRITICAL DISTINCTIONS BETWEEN UNILATERAL AND BILATERAL CONTRACTS AT THE FORMATION STAGE

**Performance v. Return Promise**

A bilateral contract may be accepted by return promise, silence, or performance. For unilateral contracts, performance or part performance equals acceptance. In *Carlill v. Carbolic Smoke Ball Co*, the purchaser’s use of the smoke ball constituted acceptance of the advertised unilateral offer that the defendant would pay £100 to anyone who used the smoke ball and got the flu. The court held that there was waiver of the normal requirement that plaintiff provide notice of acceptance when performance is invited and is an acceptable method of acceptance.

Part performance under *Restatement (Second) of Contracts*, § 45 makes the offer irrevocable enabling offeree to complete performance. Risk of non-performance is assessed to the offeree.

For a bilateral contract, acceptance may be a 1) a return promise, 2) performance or part performance, or 3) promissory estoppel under *Restatement (Second) of Contracts*, § 90. A related minority rule states that by performing in response to a unilateral offer

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472 1 QB 256 (1893)
473 Restatement (Second) of Contracts, § 45, states:

(1) Where an offer invites an offeree to accept by rendering a performance and does not invite a promissory acceptance, an option contract is created when the offeree tenders or begins the invited performance or tenders a beginning of it. (2) The offeror’s duty of performance under any option contract so created is conditional on completion or tender of the invited performance in accordance with the terms of the offer.

474 Restatement (Second) of Contracts, § 90, provides:
an offeree creates an implied bilateral promise to complete it. Acceptance for a contract for the sale of goods is allowed by either act or return promise. For example, shipment of nonconforming goods under the UCC can both constitute acceptance and breach with a right to cure.

**Rule of Construction: Ambiguous Offer**

As far as interpretation is concerned, ambiguous unilateral offers are to be construed as bilateral as a matter of construction.

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(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires. (2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

475 UCC 2-206 (1) (b); Revised UCC 2-206 (1) (b).
476 UCC 2-508 Right to Cure of Improper Tender or Delivery; Replacement provides:

(1) where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery. (2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

Revised UCC 2-508 which was submitted to the American Law Institutes for consideration in May 2003 expands and refines the seller’s right to cure but imposes some limitations in regard to consumer contracts. Revised UCC 2-508 provides:

(1) Where the buyer rejects goods or a tender of delivery under Section 2-601 or 2-612 or, except in a consumer contract, justifiably revokes acceptance under Section 2-608 (1) (b) and the agreed time for performance has not expired, a seller that has performed in good faith, upon reasonable notice to the buyer and at the seller’s own expense, may cure the breach of contract by making a conforming tender of delivery within the agreed time. The seller shall compensate the buyer for all of the buyer’s reasonable expenses caused by the seller’s breach of contract and subsequent cure. (2) Where the buyer rejects goods or a tender of delivery under Section 2-601 or 2-612 or, except in a consumer contract, justifiably revokes acceptance under 2-608(1)(b) and the agreed time for performance has expired, a seller that has performed in good faith, upon reasonable notice to the buyer and at the seller’s own expense, may cure the breach of contract, if the cure is appropriate and timely under the circumstances, by making tender of conforming goods. The seller shall compensate the buyer for all of the buyer’s reasonable expenses caused by the seller’s breach of contract and subsequent cure.
Formation

There are formation problems peculiar to unilateral contracts. The offeree must act with knowledge of the offer and be motivated by it. Although the offeree may have knowledge of the offer and act, the offeror may be unaware of acceptance. Generally, notice of performance is required under *Restatement (Second) of Contracts* §54 unless 1) the offeree exercises reasonable diligence to notify the offeror of acceptance and is unable to do so, 2) the offeror learns of acceptance, or 3) if the offer indicates that no notification is required.

There is also the situation where the offeree learns of the offer during performance. *Restatement (Second) of Contracts* §51 provides that unless the offeror manifests a contrary intention, an offeree who learns of an offer after he has rendered part of the performance requested by the offer may accept by completing performance. However, there is a duty to give notice of performance where offeror requests notice as part of the offer or the act of performance would not normally be brought to the offeror’s attention.

Two additional issues arise in relation to contract formation as to unilateral offers: 1) how many people may accept a unilateral offer, and 2) what is the actual performance that must be performed to constitute acceptance. These issues are to be resolved by looking at the objective intent of the offeror.

There are also formation problems with bilateral contracts. Acceptance may be by return promise if intended, conduct in full or in part if offeror should reasonable

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477 Restatement (Second) of Contracts §54
478 Restatement (Second) of Contracts §56
479 Restatement (Second) of Contracts §51
understand that conduct constitutes acceptance, or by silence under certain circumstances. Acceptance is an objective standard and subjective intent is irrelevant.

Bilateral contracts share the same formation problems with unilateral contracts when performance is the method utilized to demonstrate acceptance. For bilateral contracts, performance may constitute acceptance if performance is completed before time due. Under the *UCC*, notice of performance is required within a reasonable time.480 Under *Restatement (Second) of Contracts*, § 54, notice is required if the offeror is or would be unaware of performance.481

**Time of Tender**

Occasionally, the time for tender of performance constituting acceptance may become an issue in bilateral contracts if time for delivery is not stated in the contract. In the Northern Pacific region, it is implied that the time of tender would be “made at a reasonable hour.”482 A “reasonable hour” is a question of fact to be determined by the trier of fact.483

**Knowledge of Terms of Bilateral Contracts**

Formation problems also occur in relation to bilateral contracts in regard to knowledge of contract terms. Ignorance of terms may be a defense to formation of a

480 *UCC* 2-206(2) states: “Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.” *Revised UCC* 2-206(2) contains identical language.

481 *Restatement (Second) of Contracts*, § 54(2) provides:

If an offeree who accepts by rendering a performance has reason to know that the offeror has no adequate means of learning of the performance with reasonable promptness and certainty, the contractual duty of the offeror is discharged unless (a) the offeree exercises reasonable diligence to notify the offeror of acceptance, or (b) the offeror learns of the performance within a reasonable time, or (c) the offer indicates that notification of acceptance is not required.


483 *Sale of Goods Act, Cap. 1, §30(4).*
bilateral contract.\textsuperscript{484} Knowledge of the terms is judged by an objective standard. Oppressive terms may be contrary to public policy.\textsuperscript{485} Blanket form recitals may not constitute a contract because reasonable persons would not understand provisions. Contracts may also contain provisions like forum selection clauses which may be enforceable but other contracts may include buried provisions which are contrary to public policy that may constitute unconscionable terms.\textsuperscript{486}

**Modern Approach**

The current trend is to eliminate any dichotomy between bilateral and unilateral contracts. Karl Llewellyn, one of the principle drafters of the \textit{UCC},\textsuperscript{487} and \textit{Revised UCC} 2-206(1) (a) explicitly reject disparate treatment when it comes to acceptance and invite “acceptance in any manner and by any medium reasonable in the circumstances” unless the contract unambiguously indicates to the contrary.\textsuperscript{488}

Similarly, \textit{Revised UCC} 2-206(1) (b) gives an offeree an option among reasonable methods to accept by either prompt promise or current shipment where the buyer offers to

\textsuperscript{484} See for example, Restatement (Second) of Contracts §20
\textsuperscript{485} \textit{Restatement (Second) of Contracts} §178 address when a contractual term is unenforceable on grounds of public policy.
\textsuperscript{486} For example, the scope and effect of forum selection clauses in which the contract designates the forum where any disputes are to be resolved are determined under contract law and given full effect if unaffected by fraud, undue influence, or overweening or disparate bargaining power. \textit{National Fisheries Corp. v. New Quick} 9 FSM Intrm 120, 126-7 (Pon 1999); \textit{FSM Dev Bank v. Gouland}, 9 FSM Intrm 605, 607-8 (Chk 2000); \textit{FSM Dev. Bank v. Ifraim} 10 FSM Intrm 1, 5 (Chk 2001); \textit{FSM Dev Bank v. Ifraim}, 10 FSM Intrm 107, 109 (Chk 2001). For another forum selection clause case see, \textit{Mobil Oil Micronesia v. Helgenberger}, 9 FSM Intrm 295, 296 (Pon 1999) which involved the enforcement of a compulsory arbitration clause.
\textsuperscript{488} \textit{Revised UCC} 2-206(1) (a) states: “an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.”
purchase goods for “prompt or current shipment” and the contract language does not indicate that acceptance by shipment is required.\footnote{489}

Although the original Restatement of Contracts included references to both unilateral and bilateral contracts, the Restatement (Second) of Contracts has followed the modern trend abolishing any references to “unilateral” and “bilateral” contracts.\footnote{Restatement (Second) of Contracts, § 50(2) requires an offeree to perform or at least tender part of the performance invited in order to constitute acceptance.\footnote{490} However, this performance or tender of part performance acts as both an acceptance and “a promise to render complete performance.”\footnote{491}}

Under the first Restatement of Contracts, this performance or tender of part performance would have been referred to as either an option contract as was the case in Drennan or an implied bilateral contract because performance or partial tender constitutes acceptance and also creates a reciprocal commitment to complete.\footnote{Under the first Restatement of Contracts, this performance or tender of part performance would have been referred to as either an option contract as was the case in Drennan or an implied bilateral contract because performance or partial tender constitutes acceptance and also creates a reciprocal commitment to complete.}

This bilateral relationship is not to be confused with an option contract which is now clearly defined in Restatement (Second) of Contracts, § 45. The Restatement indicates that no notice of performance is required unless required in the offer\footnote{Restatement (Second) of Contracts, § 54(1)} or unless the offeree has reason to know that offeror has no adequate means of learning of

\footnote{\textit{Revised UCC} 2-206(1)(b) states:}\footnote{Original UCC 2-206(1)(b) is identical.}

\begin{quote}
 an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but the shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.
\end{quote}
performance without reasonable promptness. Under those circumstances, contractual
duties may be discharged if the offeree fails to exercise “reasonable diligence to notify
the offeror of acceptance.”

493 Restatement (Second) of Contracts, § 54(2)(a)
494 Restatement (Second) of Contracts, § 54(2)(a)
PART II: CONSIDERATION AND ITS ALTERNATIVES

In addition to an exchange of promises or performance, in order for a contract to be binding there is a requirement of consideration. A promise not supported by consideration or its equivalent is not enforceable. Three things must occur in order for a bargained for exchange and enforceable contract to be created: 1) the promisee or third party must incur legal detriment, i.e. do something not legally obligated or refrain from doing something that they are legally entitled to do, 2) the detriment must induce the promise, i.e. the promisor must make the promise in exchange for the detriment incurred by the promisee or third party, and 3) the promise must induce the detriment. i.e. the promisee must be aware of then offer and intend to accept it. Restatement (Second) of Contracts § 71 sets forth these requirements and indicates that to constitute consideration a performance or a return promise must be bargained for in exchange.\(^{495}\) The performance may consist of an act other than a performance, forbearance, or the creation, modification, or destruction of a legal detriment.\(^{496}\) If mutually exchanged promises lack either the elements of bargain or legal detriment, there is no contract formation. Consideration may be either an element of bargain or an element of legal value.

There may also be substitutes for consideration such as promises under seal, promises in writing, promissory estoppel or detrimental reliance, or a merchant’s firm offer under the UCC. Custom and tradition are intertwined with concepts of value and bargain and vary depending from culture to culture.

\(^{495}\) Restatement (Second) of Contracts §71
\(^{496}\) Id.
ELEMENTS OF CONSIDERATION

In a bargained for exchange, something of value must be given in exchange for promise when made. Restatement (Second) of Contracts §71 indicates that a performance or return promise is bargained for if it is sought by promisor in exchange for a promise and is given by promisee in exchange for the promise. The “benefit-detriment” test requires that an act or forbearance by promisee must be of benefit to promisor or detriment to promisee. Consideration may not be a gift although an actual economic benefit to promisor is not required.

Consideration, Gifts, and Traditional Law

A gift is not adequate consideration because there is nothing bargained for in exchange for the offer. Regional customary or traditional law may influence whether a payment is interpreted to be construed as valid consideration or a gratuity, i.e. an expression of gratitude to a senior clan leader for granting a use right.

In Arbedul v. Isimang, Defendant Arbedul’s father had been evicted and needed a small portion of land to build his house. Defendant’s father approached the Plaintiff, Isimang, a 93 year old senior clan member of the Omrekongel Clan, and requested that she sell him a small portion of land. She refused to sell but agreed to let him use the land but that if he stopped using it, the land would remain hers. He paid her

497 Id.
498 7 ROP Intrm 200 (1999)
$2500 telling her it was for “cigarettes and sardines.” The defendant son presented a deed to plaintiff misrepresenting that it reflected the agreement she had with his father when, in fact, it was a deed transferring 2/3 of Plaintiff’s property. In examining one of the elements that led to the court setting aside the deed due to fraud, the Arbedul court observed: “The Trial Division credited Isimang’s testimony that she reached an agreement with Arbedul giving him a use right to Tberbor, and discredited [the son’s] testimony that the $2500 was the purchase price of the land, not an expression of gratitude to a traditional leader for granting a use right.”

Adequacy of Consideration

When analyzing the element of legal value, one needs to focus on the adequacy of consideration and its interrelationship with the requirements of the legal benefit and legal detriment theories. When looking to adequacy of consideration, generally the courts do not inquire into adequacy. There is an old saying that even a peppercorn may be sufficient consideration if genuinely given in exchange for a return promise. Restatement (Second) of Contracts §79 is consistent with the general rule in that if the requirement of consideration is met there will be no additional evaluation of sufficiency. However, if the consideration is a sham, token or illusory, it will be construed as inadequate to support an offer.

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499 Id at 200-1
500 Id at 202
501 Restatement (Second) of Contracts §79
502 Restatement (Second) of Contracts §77
A leading English case addressing adequacy of consideration indicted that a worthy motive is insufficient consideration but that nominal consideration would suffice. In *Thomas v. Thomas*, plaintiff’s husband indicated that if his wife survived him that she should use and occupy his house. When the husband died, the executor agreed to let the wife occupy the house because of the deceased’s wishes or worthy motive but required her to pay £1 a year. The court held that the husband’s worthy motive or wishes did not constitute adequate consideration but that the nominal consideration of £1 per year would suffice.

Similarly, in *Goyo Corp. v. Christian*, which was a promissory note and security interest case, the FSM trial court observed that courts do not generally inquire into the sufficiency of consideration offered pursuant to a promissory note and that the parties to an agreement are free to attach value to whatever is exchanged.

Courts will inquire into adequacy, however, if the consideration is considered token or sham consideration devoid of any value.

As long as there is some possibility of value, there is no requirement that each of the promises given as consideration necessarily be sufficient as consideration. For example, one promise may be defective but another may be sufficient. As long as there is one promise and it has the possibility of value, it will be construed as sufficient consideration.

As far as legal detriment and legal benefit theories are concerned, a majority of the courts consider detriment to promisee as the exclusive test of consideration. If the

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503 114 ER 482 (1842)
504 12 FSM Intrm 140 (Pon 2003)
505 Id at 148
promisee does something the promisee is under no legal obligation to do or refrains from doing something that promisee has a legal right to do that conduct or restraint will be considered adequate consideration.

**Interrelationship Between Value of Consideration and Custom**

The value of consideration may also be determined by anthropological or cultural considerations. For example, some cultures value precious stones and metals like gold, silver and diamonds which may be utilized in bargained for exchanges as consideration.

In the Northern Pacific region, the Yapese of Micronesia are famous for and value stone money ("rai") made of shiny quartz like aggregate, coral limestone, or volcanic material obtained from the Rock Islands of the Republic of Palau. The wheel shaped stone money is not uniform and varies in size from tiny 1 foot wide pieces of rock to larger wheel shaped pieces 12 feet in diameter weighing several tons. The wheel shaped "rai" has a hole in the center so that it can be moved. The value of "rai" comes from its age, size, shape, mineral content, and the degree of difficulty in transporting the stone money to Yap by canoe from the Republic of Palau over 300 hundred miles of open Pacific Ocean.

If given by the Yapese as consideration in a bargained for exchange in Western or Asian culture, “rai” may not have any cultural value at all to the recipient. This lack of cultural appreciation of the value of rai is evidenced during the Japanese occupation of Yapese Culture, Yapese Culture, Yapese Culture, Yapese Culture.

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these islands where the stone money had no monetary value and was culturally insignificant to the Japanese who seized and crushed the stone money using it for road beds.\(^{510}\) Similarly, Western culture does not generally equate the value of currency to volcanic minerals such as quartz or coral limestone and it would have de minimus, if any, value.

Although the official currency in Micronesia and in the State of Yap is the United States dollar, “banks” of stone money still line footpaths of Yapese villages.\(^{511}\) Although US dollars are used in commercial businesses, the Yapese use both United States dollars and stone money today as currency. Stone money is used for a number of social transactions such as marriage gifts as well as traded in exchange for agricultural production, fish, pigs, goats and land.\(^{512}\) If a purchase is made with rai and the rai is too large to move, ownership, or what Western societies would consider “title” to the stone, transfers to the new owner.\(^{513}\)

Yap and its stone money are are not regionally unique. Other island nations in the region like Vanuata have parallel economies. The Tari Bunia Bank has 14 branches and has savings and checking accounts, reserves, issues check books and has security protecting its “currency” of pig tusks, hand woven mats, shells and rai. Approximately 80% of the people use the “traditional” economy and have rejected Western capitalism

\(^{510}\) Yapese Culture, [http://www.mnsu.edu/emuseum/oldworld/asia/yapese_culture.html](http://www.mnsu.edu/emuseum/oldworld/asia/yapese_culture.html)

\(^{511}\) Yapese Culture, [http://www.mnsu.edu/emuseum/oldworld/asia/yapese_culture.html](http://www.mnsu.edu/emuseum/oldworld/asia/yapese_culture.html)


and the use of Western currency. The year 2007 was declared the “year of the traditional economy” by the Vanuatu government in recognition of Vanuatu traditional economy.\textsuperscript{514}

The dual use of Yapese stone money and US currency is a regional example of the balanced reciprocity between the disciplines of anthropology as defined by tradition and culture and the substantive law of contract and sales law which is intended to accomplish social order. As it relates to the concept of consideration, it is also an example where local culture and tradition give anthropological value to an item where other cultures do not.

\textbf{Consideration and Legal Value: Forbearance to Sue and Pre-Existing Duty}

Aside from the exchange of an item of value, value may arise under other circumstances. When assessing alternative elements of legal value, there are two specific situations that arise: forbearance to sue and pre-existing legal duty.

\textbf{Forbearance to Sue}

Forbearance to sue is a promise to refrain from suing or pursuing a validly legal claim and may be considered adequate consideration as long as there is a good faith belief or basis for the claim. Dismissal of a valid lawsuit can constitute valid consideration.\textsuperscript{515} \textit{Restatement (Second) of Contracts} §74 provides that forbearance to


\textsuperscript{515} For example, in \textit{Marshall Islands Development Bank v. Alik and Alik}, 1 MILR 193 (December 12, 1989), the Marshall Islands Supreme Court reversed the underlying High Court decision in part because the High Court failed to address whether an agreement settling a prior claim between the parties was a valid
assert or surrender a claim or defense is adequate if the claim or defense is valid or in dispute. Restatement of a pending claim or acceptance of an offer of judgment may also give rise to an enforceable contractual agreement. Surrender of, or forbearance to assert, an invalid claim may also constitute valid consideration if the claimant asserted it in good faith and a reasonable person could believe the claim to be a valid claim.

*Restatement (Second) of Contracts* §74 provides that either good faith or objective uncertainty as to a claims validity is sufficient.

**Pre-Existing Duty**

If a party does what they are already legally obligated to do or refrains from doing something they are not legally privileged to do, no detriment has been incurred. No legal contract before enforcing that agreement in subsequent litigation. The Marshall Islands Supreme Court stated:

> Aside from the fact that the March 11, 1998 agreement was subsequent to and not mentioned in the complaint and answer, unless the parties have stipulated that the agreement is valid, the High Court must before rendering judgment on the agreement find that the agreement is valid under contract law and that it has not been superseded by any subsequent agreement. There does not appear to have been any stipulation nor was any evidence taken as to whether there was a valid contract. For example, was dismissal of the lawsuit, allegedly relied upon by Alik, a condition precedent to or consideration for the contract?

In *Sumang v. Pierantozzi*, 7 ROP Intrm 36 (1998) Pierantozzi gave Sumang a $3000 loan which was secured by a parcel of land in Koror. When she was not paid, Pierantozzi filed suit to foreclose on the land securing the debt. Sumang offered to convey the disputed property in exchange for the dismissal of a lawsuit plus a six month period to negotiate a re-conveyance. Pierantozzi accepted and acted accordingly. The Palau Supreme Court observed that dismissal of the suit and subsequent negotiations are sufficient consideration. The agreement became a valid contract when the suit was dismissed and subsequent negotiations began despite the absence of a redemption price. Id at 37 See also, an old Trust Territory case, *Yamamoto v. Ulechong*, 1 ROP Intrm 12 (High Court 1982) which involved a dispute over the contractual relationship between the parties who wanted to start a tour guide business in Koror, Palau and ownership of a boat, the “Y. Yamamoto.” The *Yamamoto* court found that a valid compromise and settlement of their claims against each other is a valid, final, conclusive and binding agreement upon the parties and upon those who knowingly accept the benefits of the settlement. Id at 14

See *Barrett v. Chuuk*, 12 FSM Intrm 558 (Chk 2004) which indicated that a post judgment action was governed by contract law and did not give rise to any deprivation cognizable under the Constitution permitting garnishment of payments from the FSM to the State of Chuuk.

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516 See Barrett v. Chuuk, 12 FSM Intrm 558 (Chk 2004) which indicated that a post judgment action was governed by contract law and did not give rise to any deprivation cognizable under the Constitution permitting garnishment of payments from the FSM to the State of Chuuk.
rights are surrendered and performing an existing legal obligation is not detriment. Consequently, pre-existing legal duty is generally not viewed as being adequate consideration.\textsuperscript{518} A promise to perform or performance of an already existing legal duty or pre-existing duty is generally inadequate because nothing new is being given to the other in the bargained for exchange. \textit{Restatement (Second) of Contracts} §73 indicates that a pre-existing duty is inadequate consideration unless it differs from the original duty in a way that reflects more than a pretense of bargain.\textsuperscript{519} The pre-existing duty rule has a few exceptions. For example, some courts assert that where the parties modify the agreement, a party incurs legal detriment by giving up the right to claim breach of the original contract. Alternatively, some jurisdictions fictiously import the original consideration into the new agreement. Other jurisdictions have expanded and extended a concept adopted by the \textit{UCC} applicable to contracts for the sale of goods which provides that no new consideration is required to modify an already existing agreement. Under the

\textsuperscript{518} Pre-existing duty was raised as a defense in \textit{FSM v Ting Hong Oceanic Enterprises}, 8 FSM Intrm 166 (Pon 1997) which was a case where the FSM was seeking criminal penalties under the Foreign Fishing Agreement signed by Ting Hong for a number of its ships for their failure to maintain catch logs in English, failure to maintain VHF radios, exceeding authorized crew size, and knowingly transporting fish taken or retained in violation of law. Ting Hong argued that paragraph 23 of the Agreement was unenforceable because it had a pre-existing duty to comply with applicable law before it signed the agreement with the Micronesia Maritime Authority and consequently the agreement failed due to lack of consideration. The trial court rejected this defense noting:

\begin{quote}
The reason traditionally set forth for the pre-existing duty rule, as the rule of contract law defendant refers to is commonly known, is that a promise to perform an act which is already required supplies no consideration for the return promise or performance. On that basis, a contract may fail for lack of consideration. In this case, however, the Court finds that there is sufficient consideration flowing between the parties to support the Agreement and all of its provisions. Paragraph 23 of the Agreement cannot be examined in isolation to determine sufficiency of consideration for the contract as a whole. Defendant’s other undertakings under the Agreement provide ample consideration to support the contract between Ting Hong and MMA. Id at 175
\end{quote}

\textsuperscript{519} Restatement (Second) of Contracts §73
common law, if any new or different consideration is promised for a pre-existing duty, the new or different consideration would be adequate.\(^{520}\)

In *Foakes v Beer*,\(^ {521}\) the defendant owed plaintiff a judgment of £2090. The parties agreed that if the defendant paid plaintiff £500 cash and the balance of £1590 in installments plaintiff would take no further action on the judgment. After defendant had paid in full, the plaintiff claimed an additional £360 on the judgment which defendant refused to pay citing the earlier agreement. The plaintiff sued and it was held by the House of Lords that the defendant was bound to pay the interest to plaintiff because the defendant had a pre-existing duty to pay and paid no more than he was already obliged to pay. Consequently, there was no consideration for the promise not to take further proceeding on the judgment.

Another exception involves a pre-existing duty owed to a third party rather than to the promisor. If there is an honest dispute as to the original duty, a subsequent promise to perform may then be adequate. A minority view holds that unforeseen circumstances or hardship may also relieve a party from the pre-existing duty rule.

The settlement of existing debts by different kinds of consideration needs no additional consideration, i.e. stocks for cash, personal guarantee etc….\(^ {522}\)

\(^{520}\) Id.
\(^{521}\) 9 App Cas 605 (1884)
\(^{522}\) For example, see *Goyo Corp v. Christian*, 12 FSM Intrm 140 (Pon 2003) in which defendants argued lack of consideration because Indand Imports already owed Goyo the money due in the promissory note. The FSM trial court rejected this argument because Goyo had a legal right to initiate suit for unpaid debt at the time of the note but, instead of initiating suit, requested Christians personally guarantee that payment be made. Each side gained something from the transaction and consideration was exchanged and plaintiff was entitled to summary judgment on defense of lack of consideration. Pre-existing debt established sufficient consideration to support formation of the contract. Id at 146.
runs counter to the pre-existing duty rule but consistent with the forbearance to sue exception. UCC 1-107, which addresses a waiver or renunciation of a claim or right after breach, provides that no consideration is required. UCC 2-209 indicates that any agreement modifying a contract subject to the UCC needs no additional consideration to be binding. The writing may prohibit oral modification but such a provision even though valid and binding may also be waived. There may also be waiver of the contract provision requiring that modifications must be in writing.

**Mutuality and Illusory Promises**

Mutuality of obligation or consideration on both sides of the contract must exist in order for a contract to be considered enforceable. The exception is a true unilateral contract where there is no mutuality of obligation because the offeree is not obligated to perform at any point.

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523 UCC 1-107 states: “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.” UCC 1-107 was modified and renumber Revised UCC1-306 in the version submitted to the American Law Institutes in May 2003. Revised UCC 1-306 provides: “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.”

524 UCC 2-209 and Revised UCC 2-209 involving modification, rescission and waiver provide:

1. An agreement modifying a contract within this Article needs no consideration to be binding.
2. A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party. (3) The requirements of the statute of frauds section of the Article (Section 2-201) must be satisfied if the contract as modified is within its provisions. (4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver. (5) A party who has made a waiver affecting an executory portion of a contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change in position in reliance on the waiver.
A promise is illusory if the promisor has made no commitment even though the expression may be shrouded in promissory terms. If a promisor or promisee has unfettered and subjective discretion to perform or where the contract contains a provision permitting one or both parties to terminate without consequence, the promise is considered illusory and is inadequate consideration.

Conditional promises or aleatory promises which are conditional upon the occurrence of a fortuitous event are not illusory because the happening of the condition is outside the promisor’s control or discretion. *Restatement (Second) of Contracts* §77 provides that an apparent promise or promise is inadequate consideration if the promisor reserves a choice of alternative performances.  

**Mutuality and Output Contracts**

Requirement and output contracts for the sale of goods are not considered to be illusory. In the past, such contracts were considered illusory because a party could refrain from output or having any requirements. Good faith and fair dealing will be implied in requirement and output contracts for the sale of goods under *UCC* 2-306. Problems with mutuality arise in output contracts if there is a demand for unreasonable

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525 *Restatement (Second) of Contracts* §77
526 *UCC* 2-306 and *Revised UCC* 2-306 submitted to the American Law Institute in May 2003 are identical. *UCC* 2-306. Output, Requirements and Exclusive Dealings states as follows:

1. A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded. (2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.
disproportionate quantities. Issues of mutuality also arise in requirements or output contracts if there is no previously established business or if a business is going out of business.

**Conditional Promises and Mutuality**

A conditional promise does not necessarily fail due to lack of mutuality. However, under certain circumstances, a conditional promise may also fail to satisfy the requirement of mutuality and constitute an illusory promise. A conditional promise may satisfy the requirement for mutuality unless the “condition” is entirely within the promisor’s control. If so, then the contract will fail because it is illusory and lacks mutuality. Likewise, the right to cancel a contract or withdraw from a contract will satisfy the requirement of mutuality if the right is restricted. If it is unrestricted, the contract will fail due to lack of mutuality because one can withdraw or cancel without penalty.\(^{527}\) An example would be the right to cancel or withdraw on 60 days notice.

**Mutuality and Exclusive Dealing Contracts**

In some instances courts will imply a “best efforts” requirement in exclusive dealing contracts in order to achieve mutuality and avoid illusory promises. An example of where courts would imply best efforts in order to achieve mutuality would be in an exclusive dealing contract.

\(^{527}\) Restatement (Second) of Contracts §77
Voidable Promises and Mutuality

Superficially, voidable or unenforceable promises and unilateral or option contracts may also raise some concern regarding illusory promises and mutuality. However, voidable promises and unilateral or option contracts are generally not objectionable on mutuality grounds due the nature of the relationship between the parties. A voidable or unenforceable promise may be adequate consideration permitting a party who has the right of avoidance to ratify it.

Mutuality and Alternative Courses

The right to choose among alternative courses is generally illusory and unenforceable. Where a choice among each alternative promise is detrimental to the promisor, the choice among alternatives may not be illusory and would satisfy mutuality requirements. In addition to the where every alternative involves legal detriment to the promisor, alternative courses may be adequate if the power to choose rests with a third party, or a valuable alternative among those which have no value is actually selected. If there is a substantial probability that events will eliminate the alternative that is not detrimental before the promisor makes a choice among alternative courses, the rule does not apply, the promise is illusory, and the contract is unenforceable.

528 Restatement (Second) of Contracts §87
529 Restatement (Second) of Contracts §77
SUBSTITUTES FOR CONSIDERATION

There are a number of substitutes for consideration such as: 1) promises under seal, 2) promises in writing, 3) firm offers under the UCC, and 4) promissory estoppel and detrimental reliance. The Restatement (Second) of Contracts also recognizes similarly related concepts as consideration substitutes such as promises to pay indebtedness discharged in bankruptcy, promises to perform a duty despite non-occurrence of a condition, and modification of executory contracts as potentially binding contracts.

Promises under Seal

Promises under seal were considered a valid substitute for consideration under the common law. The distinction between a promise under seal or not under seal has been abolished in most jurisdictions. The UCC does not recognize such a distinction although some scholars argue that a modest resurgence of this concept is contained in UCC 2-205 which involves firm offers between merchants. The Marshall Islands

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530 Restatement (Second) of Contracts §83
531 Restatement (Second) of Contracts §84
532 Restatement (Second) of Contracts §89
533 UCC 2-203 which declares seals inoperative provides: “The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing of a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.” Revised UCC 2-203 is slightly modified to take into account the development of e-commerce and substitutes the word “record” for “writing.” Revised UCC 2-203 provides: “The affixing of a seal to a record evidencing a contract for sale or an offer to buy or sell goods does not constitute the record of a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.” See also, UNCITRAL Model for E-Commerce, Article 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”
534 UCC 2-205. Firm Offers provides:
recognizes promises under seal and still maintains the distinction providing that if the contract is under seal, a ten (10) year statute of limitations applies. 535

Promises in Writing

There is a minority rule which holds that any promises in writing are valid in the absence of consideration. This is also position also taken by the UCC governing certain transactions between merchants. The UCC provides three (3) specific instances where promises in writing will suffice in the absence of consideration: UCC 2-209, UCC 2-205, and UCC 1-107. When modifying or amending an existing agreement for the sale of goods, UCC 2-209 indicates that there is no need for additional consideration. 536 A firm offer by a merchant under UCC 2-205 also needs no consideration. 537

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

UCC 2-205 (Revised) that was submitted for consideration to the American Law Institute in May 2003 is identical to the original version of UCC 2-205 except that it replaces the word “writing” with the word “record.” The intent of Revised 2-205 is to anticipate firm offers in wholly electronic form. See also, UNCITRAL Model for E-Commerce, Article 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”

535 Civil Procedure Act, 29 MIRC 1, § 20
536 UCC 2-209(1)
537 UCC 2-205. Firm Offers provides:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

UCC 2-205 (Revised) that was submitted for consideration to the American Law Institute in May 2003 is identical to the original version of UCC 2-205 except that it replaces the word “writing” with the word “record.” The intent of Revised 2-205 is to anticipate firm offers in wholly electronic form. See also, UNCITRAL Model for E-Commerce, Article 6, § 1 which provides: “Where the law requires information to
acknowledgement of a claim arising out of an alleged breach of sales contract also does not need consideration pursuant to UCC 1-107 which provides for written waiver in the absence of consideration.\textsuperscript{538}

**Promise Plus Antecedent Benefit: Moral Obligation**

As indicated previously, an offer must induce a current or future performance as part of the bargained for exchange. As part of the bargained for exchange, there must also be some current of future legal detriment associated with the exchange.

Consequently, gratuitous promises, promise supported by past or moral consideration, and promises based on a past act or past consideration are generally not considered sufficient consideration. There is no bargained for exchange associated with gratuitous promises. Moral consideration based upon a sense of honor or purpose is also generally construed to be inadequate because nothing of value is given in exchange. As for past acts or past consideration conferring an antecedent benefit, these items are generally considerate inadequate consideration because they were not intended to induce the current performance.

However, a prior legal or moral obligation in support of a promise is adequate consideration under *Restatement (Second) of Contracts*, § 86.\textsuperscript{539} Under the

\textsuperscript{538} UCC 1-107 states “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.” UCC 1-107 was modified and renumbered Revised UCC 1-306 in the version submitted to the American Law Institutes in May 2003. Revised UCC 1-306 provides: “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.”

\textsuperscript{539} Restatement (Second) of Contracts, § 86 provides:
Restatement’s concept of moral obligation, promises to perform a voidable duty or promises to pay a liquidated debt, fixed amounts for services previously requested, fixed amount for services not requested, debts discharged or rendered unenforceable by operation of law or those barred by the statute of limitations may also be enforceable. This position is not novel or new and more than 240 years ago Lord Mansfield considered past or moral consideration to be adequate in certain circumstances to prevent injustice from occurring.\textsuperscript{540}

**Exceptions**

There are two primary exceptions to the general rule and where past or moral consideration may be considered adequate. The first exception is founded upon a basis of detrimental reliance and the second is based on public policy.

A new promise would be enforceable and moral or past consideration may be adequate the past requested act was performed by the promisee at promisor’s request and they were performed in reliance and with an expectation of compensation.

As a matter of public policy, moral or past consideration may be adequate in support of a promise to pay a debt barred by statute of limitations or discharged in bankruptcy. The public policy basis is intended to promote and encourage payment of debts. The promise to pay debts barred by statute or discharged in bankruptcy would only be enforceable to the extent that debt has been admitted. Promises plus an antecedent benefit or to pay for legal obligations barred by law have particularly been held to be

\textsuperscript{540} See for example, Moses v. MacFerlan, 97 ER 676 (1760)
enforceable in the absence of consideration if those promises are in writing. When oral, enforceability is a bit more problematic if not impossible. Some refer to this second exception as the “moral obligation” alternative.

*Restatement (Second) of Contracts*, § 86, permits enforcement of such a contract if the enforcement of a promise plus moral obligation would prevent injustice. These promises would only be enforceable according to its terms and not the terms of the original agreement. Similarly, reaffirmation of a voidable promise may also be enforceable in the absence of consideration.

Also, moral or past consideration may be adequate if the terms of the new promise are in writing or partially performed. In that situation, the terms of the new promise supported by moral obligation would be enforceable and binding.

**Promissory Estoppel: Promise Plus Unbargained for Reliance**

Promissory estoppel or detrimental reliance is also a substitute for consideration. A promise that foreseeably induces reliance and substantial or definite acts by the promisee or a third party is enforceable. Promissory estoppel is recognized as a consideration substitute by *Restatement (Second) of Contracts*, § 90 and provides that a promise is enforceable in the absence of consideration if it is one that the promisor should reasonably expect to induce action or forbearance of a detrimental or substantial character and such action or forbearance is in fact induced.\(^{542}\)

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\(^{541}\) In pertinent part, *Restatement (Second) of Contracts*, § 86 states: “(1) A promise made in recognition of a benefit previously received by the promisor from the promisee is binding to the extent necessary to prevent injustice.”

\(^{542}\) *Restatement (Second) of Contracts*, § 90 provides:
One of the earlier promissory estoppel cases in the United States is *Rickets v. Scothorn*. In *Ricketts*, the plaintiff, Katie Scothorn, received a written promise from her grandfather, Andrew Ricketts, indicating that he would pay her on demand $2000 at 6 percent per annum so that she would not have to go to work anymore. The plaintiff, acting in reliance on her grandfather’s promise, quit her job as a bookkeeper. A year later with the consent of her grandfather, she got a new job as a bookkeeper with another company. Her grandfather died two years later. At the time he died, he had paid Katie one year’s interest and had expressed regret that he had not been able to sell his farm in Ohio and pay the balance. Plaintiff sued her grandfather’s estate seeking the balance due. The issue was whether the grandfather’s promise was enforceable despite the lack of formal consideration. The court drew an analogy to “equitable” estoppel and indicated that the plaintiff intentionally influenced his granddaughter to change her position for the worse on the reliance of the note being paid when due. The court concluded that it would be grossly inequitable to permit the executor to deny payment upon the basis of lack of formal consideration and the executor was estopped from asserting this defense and required to pay the balance due on the note.

One of the criticisms of the concept of promissory estoppel is that it is inconsistent with the concept of the requirements of consideration or pre-existing duty as

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A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

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543 77 NW 365 (Neb 1898)
expressed in *Foakes v. Beer*[^544] and similar cases where there has been a promise made, the defendant’s have relied on the promise, but the court has found no enforceable contract due to the absence of consideration.

Some have argued that the courts have employed the doctrine of promissory estoppel to equitably mitigate the harshness of rule enunciated in cases such as *Foakes v. Beer*.[^545] In order to be consistent with the rule in *Foakes v. Beer*,[^546] promissory estoppel is better suited in those cases where the creditor agrees to something different from the original contractual obligation, i.e. and earlier date or different amount, and relies upon that promise to their detriment.

[^544]: 9 App Cas 605 (1884) (Defendant had pre-existing duty to pay £2090 under a settlement agreement. After defendant paid £500 in a lump sum payment and £1590 in installment payments, plaintiff sued for an additional £300 in interest. Court held that defendant had to pay the £300 interest, that plaintiff had a pre-existing duty to pay the underlying debt, and a subsequent agreement not to pursue any other action on the debt was unenforceable due to lack of consideration.)

[^545]: 9 App Cas 605 (1884)

[^546]: Id
PART III: AVOIDANCE OF CONTRACTS

LEGAL CAPACITY TO CONTRACT

A contract may be voided if there is legal incapacity. Legal incapacity generally arises with infants and those who are not mentally competent to enter into contractual relationships.

CAPACITY TO CONTRACT: INFANCY

The general rule is that one deals with a minor at their own peril. Under the common law, a person was considered an infant until the age of 21. The infancy age limit has dropped to the age of 18 in most jurisdictions. An infant, usually under the age of 18, can void a contract due to their infancy. An infant may also disaffirm a contract at any time prior to ratification. An effective ratification, however, can not take place before age of majority. As indicated in Restatement (Second) of Contracts §14, all contracts are voidable until the beginning of the day before the person’s 18th birthday.547

In the Marshall Islands, § 4 of the Sale of Goods Act 1986 regulates contracts for the sale of goods to minors.548 In all other contracts which do not involve the sale of goods, infancy is governed by the Restatement (Second) of Contracts and the common law of the United States due to the rule of decision statute previously in effect and the

547 Restatement (Second) of Contracts §14.
548 Sale of Goods Act 1986, 23 MIRC, Cap 1, § 4
Constitution of the Marshall Islands. In Palau and Micronesia, the Restatement (Second) of Contracts would control under the rule of decision statutes.

If an adult enters into a contract with an infant, the infant can either perform or request that the court void the contract due to their infancy. The contract is binding on the adult and the infant could demand performance by the adult but the adult cannot demand performance by an infant who requests the contract be voided. Voiding the contract is at the option of the infant.

A contract entered into with an infant may be affirmed or ratified upon the infant reaching the age of majority. However, there can be no effective affirmation or ratification if the former infant is ignorant of the facts or law upon which liability is contingent. Upon reaching the age of majority, most courts hold that if there is no express act of disaffirmation by the infant, this lack of overt conduct is considered an act of affirmation. There may be statutory exceptions to this rule as well as an exception for necessities.

If the infant disaffirms and sues for return of consideration, recovery will generally be permitted less the value of use or deprivation of any property obtained from the defendant.

Even though an infant will still be required to pay restitution for the reasonable value of necessities provided under a contract voided or disaffirmed due to infancy under a theory of quasi-contract, it is important to note that the reasonable value of necessities does not necessarily equate to the contract price.

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Constitution of the Marshall Islands 1979, Art. XIII

\[550\]

The necessities rule as it relates to minors is statutorily adopted in the Marshall Islands and also requires that those found mentally incompetent or intoxicated also pay for necessaries.\textsuperscript{551} Section 4 of the Sale of Goods Act of 1986 provides:

Capacity to buy and sell is regulated by the general law concerning capacity to contract, and to transfer and acquire property; provided, that where necessaries are sold and delivered to a minor, or to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price therefore. The term ‘necessaries’ as used in this Section means goods suitable to the condition in life of such minor or other person, and to his actual requirements at the time of the sale and delivery.\textsuperscript{552}

Occasionally an issue arises as to what are “necessities.” Necessities generally include such items as food, clothing, rent, and similar items. Necessities do not include luxuries such as an automobile. In those instances in which a contract for a luxury such as an automobile is voided due to minority, the automobile would simply be returned if the contract is voided. If the automobile was sold by the minor, then the proceeds would be returned. If the automobile was destroyed, the remnants, if any, would be returned to the dealer.

Occasionally, a set off rule applies when calculating damages and where the item is returned after disaffirmance and cash was originally paid by the minor for the item. Damages attributable to the disaffirmance may be set off or deducted from the amount to be returned to the minor after the contracted has been voided.

Misrepresentation of age does not affect the minor’s ability to disaffirm the contract and is not a defense. The minor may have tort liability attributable to the misrepresentation but is not liable under substantive contract law.

**CAPACITY TO CONTRACT: MENTAL INCAPACITY**

Similar rules to those involving infancy apply to mental incapacity. The Sale of Goods Act in the Marshall Islands, for example, combines the two concepts in one statutory section.553 *Restatement (Second) of Contracts* §15 provides that a contract is voidable by reason of mental illness or defect in the party to the contract if the party is unable to understand the nature and consequences of the transaction or is unable to act in a reasonable manner in relation to the transaction and the other party has reason to know of the condition.554

Mental incapacity is a basis to void a contract. If it can be shown that an individual generally lacks mental capacity then they cannot formulate an enforceable agreement and may disaffirm the contract. However, one who is mentally incompetent can contract during a lucid interval.

The Marshall Islands Sale of Goods Act provides that a person intoxicated by alcohol or drugs may also lack capacity to contract.555 An extremely intoxicated person who does not understand the nature or implications of the transaction may disaffirm and void the contract when sober.

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554 Restatement (Second) of Contracts §15
Like infancy, necessities may be recovered in quasi-contract for a contract voided due to lack of mental capacity. Quasi-contract provides a remedy for a voided contract permitting recovery of the reasonable value of necessities expended. Article 4 of the Marshall Islands Sale of Goods Act of 1986 requires payment of a reasonable price for necessities.  

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PART IV: DEFECTS IN BARGAINING PROCESS

Defects in the bargaining process include such concepts, among others, as 1) mutual and unilateral mistake, 2) mistake by an intermediary, 3) mistake in value, 4) latent ambiguity, 5) fraud, 6) duress and undue influence, or 7) unconscionability.

**Mistake: Unilateral and Mutual**

A mistake is a belief that is not in accord with the facts. A mistake of fact may prevent contract formation. A mistake of judgement, however, will not relieve a party from contractual obligations. A mistake may be unilateral or mutual. Generally, a party is not entitled to recission or relieved of contractual liability for unilateral mistake unless the mistake is obvious to the other party.

Where one sees this sort of unilateral mistake made quite frequently is in the construction context where a subcontractor will submit a bid to a general contractor in which there is an error. The subcontractor’s bid may be withdrawn if the error is blatant or before the contractor submits the bid relying on the subcontractor’s bid and is bound contractually. Where the error is blatant in light of the overall contract amount and the general contractor is, or should be, aware of the subcontractor’s unilateral mistake, the subcontractor would be entitled to contract avoidance.

*Restatement (Second) of Contracts* §153 specifically provides two instances in which a unilateral mistake may make a contract voidable: 1) if the effect of the mistake is

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557 Restatement (Second) of Contracts §151
558 See Drennan v. Star Paving, 333 P2d 757 (Cal 1958)
such that enforcement would be unconscionable or, 2) if one party knew of the mistake or caused the mistake.

A mutual mistake as to any of the essential terms of the contract would prevent a contract from being formed due to lack of mutuality. The contract can be avoided only if a substantially different exchange of values occurs attributable to the mistake and the risk of the mistake has not been expressly allocated in the agreement between the parties or by the court because such an allocation would be reasonable. Restatement (Second) of Contracts § 152 provides that when a mutual mistake occurs a contract is voidable and relief may be obtained through reformation, restitution or otherwise.

Mistake as to value or opinion is generally sufficient to constitute a mutual mistake entitling one to rescission. If the court finds there is mutual mistake, the court will generally rescind the contract and mutually release the parties from any further obligations. Alternatively, the court try to salvage that agreement, if possible, by reforming it to reflect the true agreement between the parties than as it was written.

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559 See for example Restatement (Second) of Contracts §208 and UCC 2-302
560 Restatement (Second) of Contracts §153
561 Restatement (Second) of Contracts §§152 and 158
562 See Restatement (Second) of Contracts §§152 and 158 and Phillip v. Marianas Ins. Co, 12 FSM Intrm 464 ( Pon 2004) where the court observed:

Under one reading of the pleadings, it appears that Phillip may be seeking, without articulating it clearly, reformation of the contract under a theory of mutual mistake, see 43 Am. Jur. 2d Insurance §374 (rev. ed. 2003), or mistake or fraud of the insurance agent, id. § 372, in his breach of contract claim. Reformation is an equitable doctrine that allows a court to conform a contract to the true agreement between the parties rather than the agreement as written. See generally Irwin J. Schifres, Annotation, Reformation of Insurance Policy to Correctly Identify Risks and Causes of Loss, 32 A.L. R. 3d 661 (1970). If so, full payment of the premium would be part of any recovery on this claim. 12 FSM Intrm at 470.
Two leading cases frequently cited in contract textbooks and case law involving mutual mistake are *Sherwood v. Walker*\(^{563}\) and *Lenawee County v. Messerly*\(^{564}\).

In *Sherwood*,\(^{565}\) Walkers sold Sherwood a specific cow, Rose the Second of Aberlone, discounting the price because both parties believed that the cow was barren. The Walkers found out that the cow was pregnant and refused to deliver the cow to Sherwood. Sherwood sued seeking replevin. The Michigan Supreme Court rescinded the contract because the mutual mistake and because the error was not as to the “mere quality of the animal, but went to the very nature of the thing.” The Court continued observing that “the thing sold and bought had in fact no existence.”

In *Lenawee County*, Bloom owned a piece of land which had a three unit apartment building. Bloom illegally installed a septic tank on the property without a permit and in violation of the local health code. Bloom then sold the land and building to defendant Messerlys who in turn sold it to James Barnes. Barnes defaulted and executed a quit claim deed conveying the land back to defendant Messerlys. The Pickles were interested in the rental property. After inspecting the property, the Pickles purchased the property for $25,500 from the Messerlys and the contract for sale between the parties included an “as is” clause. Five or six days later, the Pickles discovered raw sewage seeping out of the ground when they went to introduce themselves to the tenants. The Lenawee County Board of Health condemned the property as uninhabitable. The County obtained an injunction against human habitation and then the court was asked to address the Pickles’ claim against Messerly and Barnes. Relying on *Sherwood*, the Pickles argued

\(^{563}\) 33 NW 919 (Mich. 1887)
\(^{564}\) 331 NW 2d 203 (Mich. 1982)
\(^{565}\) 33 NW 919 (Mich. 1887)
failure of consideration and sought to rescind the contract due to willful concealment, misrepresentation, or due to mutual mistake in that the thing that they had purchased did not in fact exist. The trial court concluded the Pickles’ had no cause of action against either party because there was no fraud or misrepresentation. None of the parties knew of Bloom’s earlier transgression until it was discovered by the Pickles. The property was purchased “as is” after an inspection by Pickles and its negative value cannot be blamed upon an innocent seller. Foreclosure against the Pickles was ordered and a judgment in the amount of $25, 943.09 including interest was entered against them. The Michigan Supreme Court affirmed indicating that rescission is granted in the sound discretion of the trial judge noting that it is usually granted when the mutual mistake goes to the very nature of the consideration, not merely its quality or value. The Lenawee court concluded that the mistake in this case went to the very essence of the consideration, however, the plaintiff assumed the risk of such a mistake by inspecting the property and by signing a contract which contained an explicit “as is” clause.

The two approaches to mutual mistake, reformation or restitution, differ from those instance of unilateral mistake by one party which would only preclude contract formation if one party knew or should have known the other was under a mistaken belief. Otherwise, a unilateral mistake does not preclude contract formation. Arguments against contract formation due to unilateral mistake of identity, subject matter, or computation are generally unsuccessful. A contract is formed unless there is knowledge of the one party’s mistake by the other party. The unilateral error may be addressed in equity through reformation but there is no generally no remedy or relief for unilateral mistake in contract.
The issue of mistake and the remedy of reformation was most recently addressed by the FSM trial court in *FSM Dev. Bank v Arthur*.\textsuperscript{566} The defendants contended that there was a mutual mistake in the loan agreement and that they were entitled to rescission. Citing *Restatement (Second) of Contracts*, § 152, the *Arthur* court rejected the defendants argument indicating that the mistake made in identification of the parties in the loan agreement did not go to a basic assumption upon which the contract (loan) was made and there was no mutual erroneous belief about the facts that were the basis for the loan and its terms. Consequently, the defendants were not entitled to rescission. The parties were entitled, however, to reformation of the loan agreement and promissory note to reflect the true intent of the parties which, due to the scrivener’s error identifying the individuals as the borrowers, should have identified the individuals in their capacity as member of the board of directors of the corporation, AHPW, Inc., as the borrowers. The court observed that “where, because of mistake, a writing fails to accurately reflect the agreement of the parties reformation of the writing is the exclusive remedy.”

In *Melander v. Kosrae*,\textsuperscript{567} the Kosrae trial court noted that reformation or cancellation may be appropriate where fraud or mistake are involved but that relief will be denied if the aggrieved party failed to read the necessary documents which in this case had been written in both English and Kosraean.\textsuperscript{568}

Mistake, reformation and rescission were also addressed in *ROP v. Tmetuchl*,\textsuperscript{569} where the Palau trial court observed:

\textsuperscript{566} 13 FSM Intrm 1 (Pon. 2004) which is currently on appeal.
\textsuperscript{567} 3 FSM Intrm 324 (Kos. S. Ct. Tr. 1988)
\textsuperscript{568} Id at 328.
\textsuperscript{569} 1 ROP Intrm 214 (Tr. Div. 1985)
The court finds no basis for declaring a recission since the demand for same is unilateral as to Intervenors, and the mistake (intentional or otherwise) likewise unilateral as to Defendants. To effect recission of a complete contract the mistake sought to be corrected by such recission must be mutual. It involves ‘in effect a mutual release of further obligations’....An effort which Defendant resists of accomplishment. Further, rescission involves the placing of the parties in status quo,... It occurs to the court that more properly is Intervenors’ plea one for ‘Reformation,’ a situation where a written contract fails to properly express the true intent of the parties by reason of legal mistake on one side (Intervenor) and purported fraud on the other (Defendants). 570

A mistake by an intermediary in transmission is held against the party who chose the intermediary unless the other party should have known of the mistake. If other party knows of mistake, then a valid contract is formed.

Mistakes in value generally go without remedy. Parties generally assume all risks of value or mistakes in value. Mistakes in value are generally construed to be part of the bargaining process. The only exception is if one party knew or should have known of the other’s mistake in value. Likewise, where the parties are uncertain or deliberately ignorant of a vital fact, there is no right to contract avoidance.

**Ambiguity**

Ambiguity occurs when a material term is capable of having more than one meaning and may preclude contract formation. For example, if there are two ships named “Peerless” with one shipping in September and the other in December, no contract for the sale of goods to be sent on the ship Peerless may be formed due to ambiguity.

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570 Id at 224. (Citations omitted)
A general rule of interpretation is that the plain meaning of any terms is to be utilized and that any ambiguity in the contract is to be held against the drafter. It is also a well established principle of contract construction and interpretation that when a clause is knowingly incorporated into a contract that the clause should not be interpreted or treated as meaningless.

Latent ambiguity generally arises in the first instance where neither party is aware of the latent ambiguity. In that case, no contract is formed unless both parties by happenstance intended the same thing. The second instance occurs where only one party is aware of the latent ambiguity or mistake and the other is not. In that situation, there is a binding contract based on the terms that the ignorant party reasonably attributed to be the meaning of the ambiguous words and the contract is enforceable against the party with knowledge of the ambiguity.

When latent ambiguity or mistakes are involved, objective intent of the parties is considered and controls whether a contract was formed. As noted in Ponape Transfer & Storage Inc. v. Wade, the intention of the parties is the predominant consideration in deciding whether a vague or missing term is to be implied at common law.

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571 See, for example, Dai Wang Sheng v. Japan Far Seas Purse Seine Fishing Ass’n, 10 FSM Intrm 112, 115 (Kos 2001) which was a maritime wrongful death action in which the plaintiff tried to impose liability upon the Association for the action of its members who owned an operated a ship which plaintiff claimed was negligently operated causing the death of her husband. Plaintiff claimed the Association was also liable because it agreed to facilitate liability claims of its members. In granting the Association’s motion for summary judgment, the court looked to the language of the agreement of the Association with the Micronesia Fishing Authority and determined that the plain meaning of the word “facilitate” did not impose any tort duty or liability upon the Association. Id at 114-5

572 See, for example, FSM Dev. Bank v Ifraim, 10 FSM Intrm 107, 111 (Chk 2001)

573 FSM Dev. Bank v. Ifraim, 10 FSM Intrm 107, 110 (Chk 2001) (interpretation of forum selection clause in mortgage)

574 5 FSM 354 (Pon. 1992) (Court implied a term that compensation was to be paid for unused holiday time minus taxes.)
Extrinsic evidence is often admitted in order to clarify ambiguous terms but, consistent with the Parol Evidence Rule, it is not admissible to add to, detract from, or vary the terms of a written contract.575

Ambiguous terms are construed objectively and not subjectively based upon the secret intent of one of the parties.

In Nanpei v. Kihara,576 the FSM Supreme Court, in examining the terms of a debt bond for $50,000, indicated that when a contract is ambiguous the court may look beyond the words of the contract to the surrounding circumstances in which it was formed to determine the parties’ intent without changing the writing.577 The court also indicated that the court should focus on the words employed rather than the subjective intent of one of the signatories.578 The court observed:

Interpretations of terms in contracts are matters of law to be determined by the court…. The parties agree on this. Issues of law are reviewed de novo on appeal…. When the language of a contract is ambiguous or uncertain may a court look beyond the words

575 Pacific Gas & Electric v. Thomas Drayage & Rigging, 442 P2d 641 (Cal. 1968). Compare to Article 4.3 of the UNIDROIT Principles which states in pertinent part that in interpreting contract language “regard shall be had to all the circumstances, including…preliminary negotiations between the parties.” Article 4.3 is slightly different than the plain meaning rule in that it does not set forth an initial stage in which extrinsic evidence is to be considered. In Goyo Corp v. Christian, 12 FSM Intrm 140, (Pon 2003) which was a promissory note and security interest case, the court observed:

Only when there is ambiguity within a contract and there are various reasonable and practical alternative constructions available is it necessary to employ rules of interpretation. Semens v. Continental Airlines, 2 FSM Intrm 131, 147 (Pon. 1985). Otherwise, a party may not seek to introduce evidence that shows that the clear and unambiguous terms of a written agreement are other than as shown on the face of the agreement. Such a prohibition preserves the security and credibility of those who contract in good faith belief that what they sign is what they agree to. Kihara Real Estate v. Estate of Nanpei (I), 6 FSM Intrm 48 (Pon. 1993).

576 7 FSM Intrm 319, 323 (App.1995)
577 Id at 324.
578 Id at 324
of the contract to the surrounding circumstances to determine the parties’ intent without changing the writing.\textsuperscript{579}

In \textit{Marshall Islands National Development Bank v. Alik}\textsuperscript{580} and in \textit{Les Northup Boat Repair v. O/S Holly},\textsuperscript{581} the Marshall Islands Supreme Court also employed the intention of the parties test to determine whether a novation occurred as it related to a settlement agreement and a mortgage.

In \textit{Winterthur Swiss Ins. Co. v Socio Micronesia, Inc}\textsuperscript{582}, Socio Micronesia moved and was granted summary judgment on Winterthur’s claim of indemnity because Winterthur had not discharged Socio’s potential liability. On appeal, one of the arguments advance by Winterthur was that the settlement language was ambiguous as to whether the settlement agreement was all inclusive or limited to the signatories. The court observed that mental impressions of a party do not control\textsuperscript{583} and it is the actual language of the agreement that is used to discern the parties’ intent. The court found that where the parties used clear language in the settlement agreement to release “defendants who are parties to the Agreement” from further liability, the settlement agreement did not indemnify others who were not party to the agreement from their potential liability and

\begin{flushleft}
\textsuperscript{579} Id at 323-4. See also, \textit{Wolphagen v. Ramp}, 8 FSM Intrm 241 (Pon 1998); affirmed 9 FSM Intrm 191, 194-5 (App. 1999) (lease)
\textsuperscript{580} 1 MILR (Rev.) 193 (December 12, 1989) (novation as to all claims subject to a settlement agreement)
\textsuperscript{581} 1 MILR (Rev.) 176 (October 2, 1989) (whether additional financing constituted a novation effecting the superiority of a first mortgage to subordinate claims)
\textsuperscript{582} 8 ROP Intrm 169 (2000)
\textsuperscript{583} For this proposition the court relied on \textit{Tomomi v. Nelson}, 4 ROP Intrm 169, 170 (1994) and \textit{Ngerketit Lineage v. Seid}, 8 ROP Intrm 46, 50 (1999) (“a private understanding of what a contract means is…immaterial.”)
\end{flushleft}
those parties that were a party to the settlement agreement could not recover indemnity from a party who was not.\textsuperscript{584}

\textit{Ambiguity and Anthropology}

\textit{Semens v. Continental Airlines}\textsuperscript{585} is of the more significant regional cases interpreting ambiguity of an indemnification clause. The \textit{Semens} case also raises significant socio-cultural anthropological issues particularly as it relates to these contractual concepts.

In \textit{Semens}, plaintiff Semens was injured while unloading a Continental Airlines/Air Micronesia airplane. Semens was employed by Martin Enterprises and was part of a ground handling crew assigned to the Pohnpei Airport pursuant to an agreement with United Micronesia Development Association (UMDA). He sued Martin, Continental, Air Micronesia, and UMDA. In pertinent part, Continental and Air Micronesia claimed protection as third party beneficiaries of the indemnification clause in the agreement between UMDA and Martin. Air Micronesia claimed express contractual indemnification under its agreement with UMDA. Continental claimed it was a third party beneficiary of that indemnification agreement as well.

Because this case was one of first impression, the \textit{Semens} court citing Article XI, §11, initially noted:

\begin{quote}
The Constitution does not mandate a particular source of law, only prescribing that, ‘Court decisions shall be consistent with this Constitution, Micronesian customs and traditions, and the social and geographical configuration of Micronesia.’\textsuperscript{586}
\end{quote}

\textsuperscript{584} 8 ROP at 172-3  
\textsuperscript{585} 2 FSM Intrm 131(Pon 1985)  
\textsuperscript{586} Id at 137
When discussing the intent of the Judicial Guidance Clause, the *Semens* court disclosed its significant socio-cultural anthropological import. Although such concepts as “inherent sovereignty” and “pertinent aspects of Micronesian society and culture” are somewhat ambiguous and difficult to apply, the *Semens* court observed:

The Judicial Guidance clause was intended to have pervasive effect on the decision making of the Court. This Clause was the effort by the drafters to assure that judges would recognize that the Constitution represents the aspirations of the People of Micronesia to exercise ‘our inherent sovereignty,’ to ‘affirm our common wish to live together in peace and harmony, to preserve the heritage of the past’ and ‘to protect the promise of the future,’ by becoming ‘the proud guardian of our own islands; now and forever.

The framers of the Constitution had learned from experience that judges trained in other places might often assume that what is good for their home states in the United States is also the right approach for Micronesians. The convention anticipated that judges in the new constitutional court system would find it necessary to draw on the experience and decisions of courts in other nations to develop a common law of the Federated States of Micronesia. They recognized the desirability of such a search and amended the earlier draft of the provision to be sure to leave it open to the constitutional courts to draw principles from other nations. Nonetheless, the Judicial Guidance Clause manifests a strong and deeply felt sense that judges functioning under the constitution are not to consider the relationship between the common law of the United States and the legal system here in the same way that relationship was viewed by the Trust Territory High Court.

The clause places affirmative obligations upon an FSM Supreme Court justice in every case that comes before this court. Our decision making must be grounded upon a ‘new basis which will allow the consideration of the pertinent aspects of Micronesian society and culture.’

\[587\] Id at 139 (Citations omitted)
The Semens court then set forth the hierarchy of legal and anthropological analysis to be employed which some authors would consider a “balanced reciprocal” approach: 588

First, in the unlikely event that a constitutional provision bears upon the case, that provision would prevail over any other source of law. Second, any applicable Micronesian custom or tradition would be considered and the Court’s decision must be consistent therewith. If there is no directly applicable constitutional provision, custom or tradition, or if those sources are insufficient to resolve all the issues in the case, then the court may look to the laws of other nations. Any approach drawn from those other sources, however, must be consistent with the letter and spirit of the Constitution as well as principles and values inherent in, Micronesian custom and tradition. Even then, the approach selected for the common law of the Federated States of Micronesia should reflect sensitive consideration of the ‘pertinent aspects of Micronesian society and culture,’ including Micronesian values and the realities of life here in general and the nation building aspirations set forth in the Preamble of the Constitution in particular. 589

Applying these criteria, the court found no constitutional provisions or applicable Micronesian custom or tradition. Consequently, it was appropriate to utilize common law decisions of courts from the United States as authority. 590 The court listed a number of reasons why this was appropriate including a significant anthropological reason that Llewellyn & Hoebel would classify as the concept of cultural integration or in this particular instance, a desire for cultural assimilation. 591 The Semens court observed:

Common law’ is a label identifying a widespread historical legal process tracing its origins back to medieval England. This is a trial and error process in that common law judges base current decisions upon earlier precedents but, where those precedents are at odds with current accepted notions of social justice, the judges are free to modify or overrule earlier precedent. This system is now employed by numerous independent sovereignties throughout the world including

588 Donovan and Anderson, Anthropology & Law, supra at 2.
589 Id at 139-40.
590 Id at 141.
591 Llewellyn & Hoebel, The Cheyenne Way, supra at 239.
Great Britain, the United States, India, and nations in Africa and throughout the Pacific. Alaphonso v. FSM, 1 FSM Intrm 209,220 (App. 1982). By linking ours to that long-established and widely used system of justice, we draw on the experience insights and improvements gained through hundreds of years of application in numerous cultural contexts. Moreover, our system of justice thereby becomes more recognizable and predictable. Hence, it is more familiar to other nations in this part of the world and; less threatening to potential investors. This in turn creates a better climate for economic development, an important goal of this new nation.\(^{592}\)

For this reason and others, the *Semens* court stated:

I conclude then that common law decisions of the United States are an appropriate source of guidance for this Court for contract and tort issues unresolved by statutes, decisions of constitutional courts here, or custom and tradition within the Federated States of Micronesia. Review of decisions of courts of the United States, and any other jurisdictions, must proceed however against the background of pertinent aspects of Micronesian society and culture.\(^{593}\)

Having addressed the constitutional, cultural, traditional and anthropological issues, the *Semens* court then turned to the tort and contract issues presented.

As it relates to the issues of ambiguity, express contractual indemnification and third party beneficiary of express contractual indemnification issues, the *Semens* court listed such factors as choice of language, bargaining power, control over the work activities and proportionality between potential profits and risks assumed. Where it is shown that the party seeking express contractual indemnification or indemnification as a third party drafted the contract language, had greater bargaining power than the other party, had greater control over the work activity, and had a larger stake and expectation of profits, the courts have become increasingly insistent upon precise language in the indemnity clause as a condition to finding that a non-negligent indemnitor is required by

\(^{592}\) Id.

\(^{593}\) Id. See also, *FSM v. Ocean Pearl*, 3 FSM Intrm 87, 90-91 (Pon. 1987)
the clause to bear the burden of the indemnitee’s negligence.\textsuperscript{594} The \textit{Semens} court concluded both anthropologically and legally “that all the common law grounds referred to above for strictly construing an ambiguous indemnification clause against the indemnitee are consistent with Micronesian values and therefore should be adopted as part of the common law of the Federated States of Micronesia.”\textsuperscript{595}

The \textit{Semens} court noted that where there is ambiguity within a contractual clause and there are various interpretations and practical alternative constructions available, it is necessary to employ rules of interpretation.\textsuperscript{596}

Further, the \textit{Semens} courts stated that the purpose of the common law rules of interpretation are: 1) to assist in reaching an objective interpretation, and 2) to determine the meaning which reasonably intelligent people, knowing the circumstances would place upon the words.\textsuperscript{597} However, anthropological considerations are implicated in defining a reasonably intelligent person in Micronesia. The \textit{Semens} court observed:

\textsuperscript{594}2 FSM Intrm at 146.
\textsuperscript{595} Id at 147. See also Bank of FSM v. Bartolome, 4 FSM Intrm 182, 185 (Pon. 1990) which addressed an indemnification clause in bank loan where the court observed:

This court has previously held that where ‘there are various reasonable and practical alternative constructions [of a contractual provision] available,’ rules of interpretation dictate that any ambiguities in a contract ‘should be construed more strictly against the party who wrote it. \textit{Semens} v. Continental Air Lines, 2 FSM Intrm 131,146-7 (Pon. 1985). In indemnification provisions, in particular, the Court requires ‘pristine clarity in the language of the…clause.’ In part, this insistence flows from recognition of ‘pertinent aspects of Micronesian society, such as less facility in the English language, less exposure to business concepts, and the paucity of legal resources, which might cause a reasonably intelligent Micronesian to perceive meaning differently than would a person form some other nation. Id at 149.

The \textit{Bartolome} court legally extended the \textit{Semens} decision due to anthropological concerns to the bank loans involved in this case concluding: “Those aspects of Micronesian society referred to in \textit{Semens}, and the rules of interpretation employed in that case, are no less applicable to the bank’s loans agreement forms at issue here.” 4 FSM Intrm at 185

\textsuperscript{596}2 FSM at 147
\textsuperscript{597} Id at 148
But that is not enough. A message of the Judicial Guidance Clause is that this Court may not simply assume that reasonably intelligent Micronesians will perceive the same meaning as would reasonably intelligent Americans. We may not blind ourselves to the pertinent aspects of Micronesian society, such as less facility in the English language, less exposure to business concepts, and paucity of legal resources, which might cause a reasonably intelligent Micronesian to perceive meaning differently than would a person from some other nation.\(^{598}\)

The *Semens* court observed that where there was no clear indication in the contractual indemnification clause that the indemnitee was to be protected against its own negligence, a reasonably intelligent FSM citizen aware of the general circumstances of the parties would not have perceived the English words utilized would require that the non-negligent party who lacked control over, and had minimal economic stake in the work, must hold harmless and indemnify the major contractor against the negligence of the major contractor.\(^{599}\)

This subjective Micronesian standard would seem to conflict with the more objective manifestation of mutual assent standard employed by the traditional common law.

Nonetheless, this amalgam of constitutional law, common law, local custom and traditional law, and anthropological considerations, led the *Semens* court to conclude that the ambiguous indemnification language did not support the express or third party contractual relief sought by Continental and Air Micronesia. The *Semens* courts concluded: “This combination of standard common law principles of construction and pertinent aspect’s of the ‘social configuration’ of Micronesia, leads to the conclusion that

\(^{598}\) Id at 148-9  
\(^{599}\) Id at 149
the indemnification clause cannot be given the construction sought by Continental and
Air Micronesia.600

**Mistake in Transmission**

The general rule is that if there is a mistake in transmission, the person who chose
the manner of transmission is bound by the method chosen in transmitting. Although
there may not be any contractual relief for mistake in transmission, there may be a cause
of action against the transmitter.

**Fraud and Misrepresentation**

Misrepresentation and fraud will result in the contract being rescinded or declared
null and void. In the case of misrepresentation, avoidance will be permitted if a
misrepresentation constitutes an actionable tort. In contract, however, a cause of action in
contract for misrepresentation does not require proof scienter. In contract, avoidance can
be obtained for intentional, negligent, or even innocent misrepresentations.

In the event of misrepresentation, the parties may be entitled to rescission of the
contract and restitution to make them whole. If the misrepresentation, reliance and injury
constitute a tort, the party must elect between either pursuing a tort action or a contract
action seeking avoidance and restitution. The Uniform Commercial Code permits both
remedies but provides that recovery cannot be duplicated.

Misrepresentation is defined in *Restatement (Second) of Contracts* §159 as an
assertion that is not in accord with the facts. *Restatement (Second) of Contracts* §160
and §161 recognize that concealment and non-disclosure may both be equivalent to a

600 Id at 149.
fraudulent assertion. Restatement (Second) of Contracts §162 defines when a misrepresentation is fraudulent and when it is a material misrepresentation.

Misrepresentation can either prevent contract formation or, alternatively, can make a contract voidable. In order to be entitled to relief, one must rely on the assertion. If reliance is not justifiable, the party is not entitled to relief.

The misrepresentation must be of fact and generally does not include opinion or law. There may be exceptions to this general rule where the opinion implies facts or the misrepresentation of law is made by a person who claims to be an expert or who has superior access to information upon which the opinion is based. Additional exceptions include instances where a trust or confidential relationship exists between the parties, where the opinion intentionally varies from reality, or where the misrepresentation involves the law of another jurisdiction.

**Fraud**

A contract may also be avoided where there is fraud. The making of a promise with no intention to perform is fraud or a misrepresentation of fact. Fraud may also include “fraud in factum” where a party signs a document which is very different from that which the party was led to believe was being signed. Fraud in factum or in the execution is different than misrepresentation or fraud in the inducement in that the bona fide purchaser for value in a fraud in factum case does not acquire good title from the

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601 Restatement (Second) of Contracts §163
602 Restatement (Second) of Contracts §164
603 Restatement (Second) of Contracts §168
604 Restatement (Second) of Contracts §169
fraud-feasor. In the ordinary fraud in inducement case, a bona fide purchaser for value would obtain good title from the fraud-feasor.

The Palau Supreme Court sets forth the generally recognized elements of fraud in *Arbedul v. Isimang*. In this case, Isimang, who was 93 years old, filed suit alleging fraud seeking to void a warranty deed that she signed conveying 2/3rds of her property to Arbedul. The trial court agreed that the deed was procured by fraud and voided the conveyance. Defendant appealed claiming that the plaintiff failed to prove the necessary elements of fraud. To prove fraud, the *Arbedul* court indicated that the plaintiff must prove defendant: “(i) made a fraudulent misrepresentation of fact, opinion, or law, (ii) with the purpose of inducing the plaintiff to act upon the representation, (iii) that the plaintiff justifiably relied on the representation, and (iv) was damaged as a result of that reliance.” The court reviewed the evidence supporting the trial court’s finding as to each element relying particularly on a statement that defendant made to Plaintiff that the deed reflected an agreement that she had made with Defendant’s father that he knew was not true. After reviewing each element and the evidence, the Palau Supreme Court affirmed the lower court decision voiding the sale.

*Fraud and Customary Law*

One unique feature of the *Arbedul* case is that it highlights a difference in Palauan law from Anglo-American common law in that Palauan common law excuses a party from reading a document or having it read to him if a party misrepresents the contents of

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605 7 ROP Intrm 200 (1999)
606 Id at 200
607 Id at 201-2
608 Id at 205
the document. Under Anglo–American common law, a person is presumed to know the contents of the document they sign and an illiterate person is held to the terms of a contract if they have been given an opportunity to have the contract read to them before signing. The Palau Supreme Court explicitly rejected this Anglo-American substantive contract law approach because: “This rule would tend to suggest that a party who is given the opportunity to read (or have it read to them) a contract before signing it cannot instead rely on someone else’s characterization of it.”

A second interesting aspect of the Arbedul case is that it imposes a higher duty of good faith and due regard for the interests of each other where the parties share a sufficiently close relationship. Under customary law, defendant was considered to be a “nephew” of the Plaintiff in the Omrekongel Clan and the court found that she was more likely to rely on his characterization of a legal document than she would believe a stranger.

**Competent Evidence of Fraud and Reliance**

An allegation of fraud cannot be based on suspicion, innuendo, or conjecture and must be more than speculation and surmise. Further, one has to show reliance upon the fraudulent misrepresentation as a necessary element in order to prevail.

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609 7 ROP Intrm at 203
610 See, 7 ROP Intrm at 203 which cites 17A Am Jur 2d Contracts §§ 224,225
611 7 ROP at 203
612 Id at 203-4
613 See, Bilamang v. Oit, 4 ROP 23 (1993) which involved a complaint by Oit to remove Bilamang from certain property and a counterclaim by Bilamang against Oit in which Bilamang asked the trial court to remove Oit as trustee of the clan property and to declare Bilamang and his relatives as owners of the property at issue. In support of his counterclaim, Bilamang claimed that Oit fraudulently tried to convert the clan property to his own property. Other than two innocuous hearsay statements, the trial court concluded that Bilamang introduced no competent evidence to support this allegation. The court concluded: “Fraud cannot be found on ‘suspicion, innuendo, or conjecture.’” 37 Am. Jur. 2d Fraud and Deceit 468
Duty to Disclose

The general rule is that there is no duty to disclose facts that would discourage the other party from entering into the bargain relationship. The general rule, however, is being eroded by exceptions such as where partial disclosure may be construed as being misleading, where concealment or intentionally hiding information would be the equivalent of misrepresentation, or where there are statutory disclosure rules such as required by Truth in Lending, the U.S. Security Exchange Commission, or by Consumer Protection Statutes. In order to avoid fraud, there may be a duty to disclose under certain circumstances. Restatement (Second) of Contracts § 160 addresses when non-disclosure is equivalent to an assertion for purposes of misrepresentation.

Various Forms of Fraud

Misrepresentation may take many forms including the misrepresentation of the intent to perform, or misrepresenting the quality of goods or services. Promissory fraud or fraud in the inducement occurs when an individual is fraudulently enticed into a contractual relationship and will result in the contract being declared null and void.615

(1968). Since the testimony regarding Oit’s alleged fraud rose no higher than suspicion or surmise, the trial court’s finding that Bilamang failed to introduce any evidence of fraud is not clearly erroneous.” Id at 25. 614 See, Aguon v Aguon, 5 ROP Intrm 122,127 (1995) which was an appeal from a prior judgment concerning ownership of Ngerchur Island in Ngerchelong State. The prior decisions involving the Ngerchelong State Public Land Authority had awarded ownership of the island to Francisco Aguon who was the true and proper successor in interest to Ngerchur Island. Relatives filed suit to set aside the first decision awarding the property to Francisco, to revoke a lease that Francisco had entered that included their property, and for damages. As to plaintiffs’ fraud claim against defendant and the reliance requirement, the Aguon court observed: “The trial court found no evidence had been presented establishing that the defendants had made any statements relied upon by Plaintiffs to their damage. A necessary element of a claim for fraud is reliance on the fraudulent misrepresentation.” Id at 127. 615 See, Restatement (Second) of Contracts §§ 163, 164 which provide grounds which prevent formation or for when a contract will be declared voidable.
An example of fraud in the inducement can be found in *Miner v. Delngeli*\(^6\) in which the Palau Supreme Court was asked to address a dispute over ownership of a parcel of land located in Melekeok State. Five siblings owned a particular piece of land as tenants in common as of August 1977. In August 1977, one of the five siblings needed $2000 to purchase a boat so he went to an adjacent land owner, Miner, and his brothers and offered to sell the property at issue for $2000. The adjacent property owner’s brothers approached the five siblings and tried to obtain their signatures on a document entitled “Oterullel a Chutem” or “Land Sale”. One of the five siblings read it and refused to sign indicating that the property should remain in the family. Another who was illiterate signed with an “X”. A third who was also illiterate signed with Japanese symbols. A fourth signed the document but indicated that he and the other two others who signed the document couldn’t read Palauan and indicated that it was not read to them. These three were never told that the document was a document of sale. They were only told that one of their siblings wanted to borrow money to buy a boat and that their signatures were needed in order for their brother to secure the loan. When a son of the five siblings went to build a house on the property several years later, the adjacent landowners sued the son seeking ejectment. Four of the tenant in common siblings intervened in the ejectment suit claiming that the deed and land sale was procured by fraud. The trial court agreed, declared the land sale document a nullity, and dismissed the ejectment suit. The appellate court affirmed. The *Miner* court observed: “if a party to a transaction misrepresents the contents of a document then the deceived party is excused

\(^6\) 4 ROP Intrm 163 (1994)
from his normal obligation of reading the document or asking that it be read to him.”

Applying the law to the facts of the case, the court concluded:

The fact that the intervenors failed to read the ‘Land Sale’ document or ask that it be read to them is, in this instance, irrelevant. Because they were deceived as to the document’s contents, it is considered void and not binding on them. The ‘Land Sale’ document did not transfer the intervenors’ interest in Mimai to Miner and his brothers.

Having lost the case, Miner asked that the court equitably order the intervenors’ to reimburse him if they wished to keep the land. The appellate court also rejected this argument indicating that Miner had a cause of action in law and that he should sue the one brother who had borrowed the money, i.e. the $2000, before resorting to equity.

**Duress and Undue Influence**

Duress, coercion, or undue influence undermine the voluntary nature of the contractual relationship and provide a basis to void a contract. *Restatement (Second) of Contracts* §175 indicates that duress by threat makes a contract voidable. *Restatement (Second) of Contracts* § 176 defines when a threat is improper and delineates conduct which would void a contract such as threats that would be a crime or a tort, the threat of criminal prosecution, the bad faith threat of civil process, or a bad faith threat breaching the duty of good faith and fair dealing. Wrongful conduct that would constitute duress or coercion also includes violence or threats of violence, imprisonment or threats of imprisonment, wrongfully seizing or retaining property, the abuse of legal rights, or

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617 Id at 166. In reaching this conclusion, the court relied on 37 Am Jur 2d Fraud and Deceit 268 (1968) (Where the execution of an instrument is obtained by fraud, “the instrument is not binding on the party executing it even though he did not read it or request that it be read to him.”) 4 ROP Intrm at 166-7.

618 Id at 167-8.

619 Id. at 168
breach or threat of breach of contract. *Restatement (Second) of Contracts* §177 provides that in those instances where undue influence occurs, a contract is voidable.

Duress or intimidating conduct can occur during the negotiation phase. In *Bank of Hawaii v. Helgenberger*, the State of Pohnpei claimed that it reached a verbal settlement agreement with co-defendant Helgenberger over the $289,833.45 held by the plaintiff, Bank of Hawaii. Defendant Helgenberger claimed that counsel for co-defendant State of Pohnpei used foul language and intimidated the defendant to accept the settlement agreement. The *Helgenberger* court observed:

> Under the circumstances, the Court will not enforce the written settlement agreement submitted by Pohnpei State. An enforceable contract requires an offer, an acceptance, definite terms, and consideration…. Based upon the conflicting affidavits submitted by the defendants, the Court finds that the terms of the settlement were not sufficiently definite to constitute an enforceable contract. Additionally, the Court will not approve any settlement when there are questions as to whether the settlement was freely and fairly negotiated by the parties thereto. Thus, the Court rejects Pohnpei State’s written settlement agreement, which has not been signed by defendant Helgenberger.621

The FSM Supreme Court tangentially addressed coercion, duress and undue influence in *Nahnken of Nett v United States* in which a traditional Pohnpeian leader sued to recover monetary damages for land that he claimed as traditional tribal land.623 The Supreme Court noted that in regard to the land claimed that title never passed to the Japanese Government and this land never became public land under the Trust Territory

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620 9 FSM Intrm 260 (Pon 1999)
621 Id at 262.
622 7 FSM Intrm 581 (App. 1996)
623 *Nahnken of Nett v. United States* is anthropologically significant in that a claim was brought by a traditional Pohnpeian leader, Salvadore Iriarte, seeking monetary damages against defendants regarding the alleged loss of possession of land it he claimed was traditional tribal land that was wrongfully returned by the Trust Territory to defendants. Under customary law, traditional tribal leaders are permitted to seek relief on behalf of the group.
because the parcels were obtained by the Japanese as a result of a forced sale under duress. Because the land was obtained by forced sale by the Japanese Government it retained its original character and did not covert into government owned public lands. The property was merely held in trust by the Trust Territory and was to be returned to the rightful owner. The court concluded that “since freedom of will is essential to the validity of a contract an agreement obtained by duress, coercion, or intimidation is void.”

Undue influence involves situations of unfair persuasion rather than the aspect of coercion which is present in duress. Undue influence occurs where a person uses a position of trust or confidence to enter into a contractual relationship that is not in the other’s best interest. A second form of undue influence exists where an individual utilizes a position of superiority to influence a transaction which is against the best interests of the inferior party. This second form of undue influence is similar to the related concept of unconscionability.

**Unconscionability**

The concept of unconscionability is recognized both at common law and under the *UCC*. Historically, equity has refused to grant specific performance of unconscionable contracts. *Restatement (Second) of Contracts* §208 generally addresses when a contractual term is unenforceable on grounds of public policy. *UCC 2-302* particularly addresses unconscionability in sales contracts.

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624 Id at 588
625 Id
Unconscionability may occur in two different situations: 1) when there is either unfair surprise which is categorized as procedural unconscionability, or 2) where there is oppression which is classified as substantive unconscionability.

Unconscionability in consumer contracts occurs most often when an agreement contains an inconspicuous risk shifting provision buried in the fine print of an adhesion contract or where there is disparate bargaining power between the parties. Where one party has substantially superior bargaining power and can dictate the terms of the contract to the other party with inferior bargaining power, the potential for unconscionability arises.

There may be unconscionability in either consumer or commercial transactions. Whether a commercial or consumer transaction is involved, the courts look for and evaluate disparate bargaining power when assessing whether a term is unconscionable. Scrutiny of the courts in regard to unconscionability is heightened in consumer transactions and is of less of a concern in commercial transaction with business entities of equal bargaining power.

_**UCC 2-302**_ address unconscionability involving the sale of goods between merchants.\(^{626}\) An adhesion contract is a “take it or leave it” type of a contract is another type of contract which raises issues of unconscionability.

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\(^{626}\) _**UCC 2-302**_ which addresses an unconscionable contract or clause states:

1. If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of the unconscionable clause as to avoid any unconscionable result. (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.
Courts are suspicious of price unconscionability and warranty waivers in these sorts of contractual relationships. Courts are particularly wary and concerned with these sorts of provisions in consumer contracts and may excuse the party from performance and refuse to enforce a contract which contains such a provision. Alternatively, the court may preserve the contract but limit the unconscionable result.

**Illegality**

A contract is generally void as a matter of public policy if it involves a subject matter or requires a performance which is illegal or unlawful in nature. Illegality may both prevent contract formation and serve as a defense to enforcement. *Restatement (Second) of Contracts* § 178 particularly discusses when a contractual term is unenforceable on grounds of public policy which would include unlawful or illegal behavior. 627 *Restatement (Second) of Contracts* § 181 addresses a related topic of the effect of failure to comply with licensing or similar requirements which will generally result in the contract being declared unenforceable unless the interest in enforcement clearly outweighs the public policy underlying the licensing or registration requirement.628 A contract which requires the performance of an act which is illegal or unlawful at the time of contract or subsequently becomes illegal or unlawful after contract formation will be declared void as a matter of public policy.

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627 *Restatement (Second) of Contracts* § 178
628 *Restatement (Second) of Contracts* § 181
There may be some circumstances or exceptions to voiding a contract due to illegality and where the contract may be enforceable. If the contract is divisible and the illegal portion extracted, the legal portion may be enforced. Where the parties are not in pari delicto or ignorant of the facts creating the illegality, the contract will not be declared void due to illegality. Where certain statutes protect a certain class from illegal contracts, the innocent or protected party will be permitted to enforce the contract. Lastly, where there is a change of facts or in law making what was once illegal now legal, the contract will be enforced. Also, if an agreement is ambiguous and can be interpreted as legal or illegal, a rule of construction prefers that the contract be construed as being legal. Alternatively, the contract can be reformed to make it legal where there is ambiguity.

If the contract is illegal, not only is the contract void but it may also subject one to prosecution. For example in Partridge v Crittenden charges were brought for the violating §6(1) of the Protection of Birds Act 1954 (UK) by offering for sale a wild bird. However, the advertisement in the periodical for “Bramblefinch cocks, Bramblefinch hens 25s each” was treated as an invitation to treat rather than an “offer” relieving any criminal liability because the offense was not established.

The issue of contract avoidance due to illegality is of particular concern to foreign entities seeking to do business in the Northern Pacific region particularly when it comes to employment issues and the acquisition or lease of real property. The concept of illegality may also impact foreign investment in numerous other ways.

629 2 All ER 421 (1968)
Illegality and Employment Issues

Illegality in the context of employment contracts was addressed in the Republic of Palau in *Kerradel v. Micronesian Dev. Corp.*, where it was liberally found that Plaintiff employee was a third party beneficiary of the defendant foreign corporation’s contract with the Palau Economic Development board and was entitled to indemnification for loss of wages when the defendant employer violated Palau’s overtime wage law. As a result of a strike, the defendant entered into an agreement in July 1978 that provided that overtime would be paid if employees worked in excess of 96 hours bi-weekly when Palau statute required overtime pay for in excess of 80 hours bi-weekly. The defendant argued that a payment of $87.20 it made to the plaintiff was an accord and satisfaction. The trial court rejected this argument noting that defendant was operating illegally in violation of Public Laws 6-65 and 7-7-3 and the payment was an effort to avoid statutory overtime requirements. Because it was an illegal effort to avoid the law, defendant’s efforts were contrary to public policy and could not be considered an accord and satisfaction of a disputed matter. The court permitted the payment of $87.20 as an offset to damages due to the plaintiff.

In *Kingon v. ROP*, the Palau court addressed the requirement that all government contracts, including employment contracts, with the Republic of Palau committing public funds need to be pre-certified according to statute. In the absence of such certification, the employment contract is void ab initio due to illegality and the

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630 1 ROP Intrm.118 (Tr. Div 1984),
631 Id at 121
632 Id
633 Id
634 Id
635 2 ROP Intrm 72 (1990)
plaintiff’s employment status shifts from for cause status to at will status. In *Kingon*, the plaintiff was hired as a member of the Vice-President’s staff. The personnel action form (PAF) he signed indicated that he was to be hired for a term not to exceed one year and could be terminated at will. He signed a subsequent employment contract indicating a specific term of employment for one year from May 9, 1986 to May 8, 1987.\(^{636}\) The plaintiff’s employment contract was declared to be void because it was unlawful and contrary to Palau statute\(^{637}\) which requires that any contract obligating public funds requires certification that public funds are available to fund the contract. Since it was unlawful and not certified according to statute, the contract was declared void ab initio.\(^{638}\) Contrary to the earlier decision of the Palau Supreme Court decision in *Towai v. ROP*\(^{639}\) which held that a PAF cannot be used to modify the terms of an employment contract, the *Kingon* trial court had utilized the PAF to declare the plaintiff “exempt” from the statutory requirements, to cure or clarify deficiencies in the employment contract, and to award damages.\(^{640}\) The Palau Supreme Court held in *Kingon* that it was incorrect for the trial court to do so.\(^{641}\) Since the employment contract was void ab initio and the PAF, which was the only enforceable agreement the employee signed, indicated

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\(^{636}\) Id at 72-3

\(^{637}\) 40 PNC § 401

\(^{638}\) This statutory requirement of contract certification applies to all contracts with the Republic of Palau not just employment contracts. See, *Gibbons and Andrew v. ROP*, 1 ROP Intrm 634, 640-45(1989) (a taxpayer challenge to a contract between the Republic of Palau and Gorones International Construction Company to build and manage the Aimeliik Power plant); *Orion Telecommunications Ltd. v PNCC*, 1 ROP Intrm 633A, B-C (Civ. Tr. 1989) (involving a joint venture with Palau National Communications Corp. (PNCC) to operate and manage a local and international communications system for the Republic of Palau.)

\(^{639}\) 1 ROP Intrm 658, 662-3 (1989)

\(^{640}\) 2 ROP Intrm at 74

\(^{641}\) Id. at 75
that he could be terminated at will, plaintiff was appropriately discharged at will and no damages were owed.\textsuperscript{642}

Illegality and government employment and other contracts has also been addressed by the Micronesian courts. The requirements in Micronesia are similar to those in Palau requiring certification or advance funding for government contracts or the contracts will be declared illegal and contrary to statute.

In \textit{Hauk v. Terravecchia},\textsuperscript{643} the court indicated that an appropriation funding a government position of Legal Aid for the Legislature was required by the Truk Financial Management Act.\textsuperscript{644} In the absence of such an appropriation, any agreement was void due to illegality. Additionally, the \textit{Hauk} court observed that there was failure to comply with civil service requirements in that no list of eligible individuals was prepared. Further, the person who signed the proposal did not have authority to bind the Legislature. For these reasons, the \textit{Hauk} court declared that even where there was an offer, acceptance, and consideration there was no contract because it was void due to its illegality.\textsuperscript{645} As an aside, the \textit{Hauk} court also noted that an employment case seeking entitlement to permanent employment with the State Government is subject to the Truk State Public Service System Act and is not governed by general principles of contract law.\textsuperscript{646}

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{642} Id at 75-77.
  \item \textsuperscript{643} 8 FSM Intrm 394 (Chk 1999)
  \item \textsuperscript{644} Truk S.L. No 5-44.
  \item \textsuperscript{645} 8 FSM Intrm at 396
  \item \textsuperscript{646} Id.
\end{itemize}
\end{footnotesize}
Illegality, Foreign Investment and Corporate Formation

The concept of illegality and the requirements for foreign investors and corporations are also interrelated and investors and corporations which do not comply with local foreign investment requirements will have their contractual relations declared void due to illegality.

There are several cases in Micronesia which address illegality, foreign corporations, and investment. In Richmond Wholesale Meat v. Kolonia Consumer Cooperative, the defendant attempted to raise a defense of illegality to a collection action by plaintiff Richmond who had supplied $30,874.38 in product on an open account to defendant cooperative. The defendant tried to nullify the contract due to the fact that plaintiff Richmond did not have a valid foreign investment permit in violation of 32 FSMC §202. The Richmond court noted that “a claim of illegality cannot be raised by a party to nullify a contract until it restores to the other party all that it has received under the contract.” This Micronesian rule precludes unjust enrichment by the party attempting to void the contract and requires the status quo be restored. Because the defendant had not returned all it received under the contract it could not assert an illegality defense.

647 7 FSM Intrm 387 (Pon 1996)
648 Id at 389
649 Id.
650 Id. The Court relied upon an earlier case, Nanpei v. Kihara, 7 FSM Intrm 319, 325 (Pon. 1985). In Nanpei, the defendant tried to void a bond debt in the amount of $50,000. The court noted that the defense of illegality was unavailable because defendant had failed to return the $50,000. Id. at 325. See also, Goyo Corp. v. Christian, 12 FSM Intrm 140 (Pon. 2003) in which the defendant tried to raise an illegality defense to enforcement of a promissory note and security agreement on the basis that the foreign entity did not obtain a foreign investment permit. The Goyo court noted a claim of illegality cannot be raised by a party to nullify a contract while it continues to enjoy the benefits of the agreement and has failed to restore to the other party all that it has received under the contract. Id at 148
651 7 FSM at 389
In *Kihara v. Nanpei*, the defendant claimed that a $50,000 loan was contrary to the Pohnpei State Foreign Investment Law and was illegal and unenforceable. The court indicated that a one time loan by plaintiff to defendant was not engaging in business within the meaning of the act and granted plaintiff summary judgment. The trial court decision was affirmed in *Nanpei v. Kihara*.

On appeal, the FSM Supreme Court observed that the defense of illegality was unavailable to the defendant because defendant is not entitled to utilize that defense as long as he retains the benefit conferred upon him. Until the defendant returned the $50,000, he could not assert illegality and summary judgment for plaintiff was affirmed.

The Republic of Palau has also addressed the issue of illegality and foreign investment. The relationship between illegality and foreign investment is of significant concern for those investing in Palau and in this region due to its close proximity to Japan, China, Korea, Singapore and other major Asian markets.

An example of the significant interrelationship between illegality, foreign investment and corporate formation can be found in *Jiangsu State Farms & Agribusiness Corp. v. Ho*, where the Palau trial court was asked to resolve a complex dispute over shares in a corporation to be formed in Palau to manufacture garments. The dispute was

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652 5 FSM Intrm 342 (Pon. 1992)
653 Pon. S.L. 1L-85-86
654 5 FSM Intrm at 343-4
655 Id at 346.
656 7 FSM Intrm 319,325 (App. 1995)
657 Id at 325.
658 Id.
659 7 ROP Intrm 267 (Tr. Div. 1998)
between Pukou, a wholly owned subsidiary of plaintiff, Jiangsu, a corporation organized under the laws of the People’s Republic of China, and the defendants. Pukou owned 49 percent of Nanjing Orientex, a corporation in the business of manufacturing garments in China. The defendants were Waisei, a Palauan corporation, a number of individual Palauan citizens, and Frank Ho, a U.S. citizen who was the owner of a Hong Kong corporation, World Fame Trading. World Fame Trading owned the remaining 51% of Nanjing Orientex. The dispute was over whether money advanced by Pukou was a loan or a capital contribution in exchange for shares in the new Palauan garment manufacturing corporation.

At the time that the new Palauan Corporation was formed, Pukou did not have its permit from the Chinese government to invest in Palau so it funneled its capital contribution through Nanjing Orientex. Frank Ho was to hold the shares of the new corporation as Pukou’s nominee. When the shares were not transferred upon request by Pukou after Pukou received its permit to invest in Palau from China, Plaintiff sued for specific performance.

One of the defenses asserted was illegality and that any agreement was void since Pukou did not have its license from China at the time of corporate formation. The Jiangsu decision addresses the concept of contractual choice or conflict of law where a contract does not specifically indicate which country’s law is applicable in governing disputes over legality.\(^{660}\) Citing Restatement of Conflict of Laws (Second), § 188, the Jiangsu court indicated that the law of the country which has the most significant relationship to

\(^{660}\) Id at 272
the transaction and the parties will apply. Factors which are to be utilized in making this
determination include place of contracting, where the contract was negotiated, the place
of performance, the location of the subject matter of the contract, and the domicile,
residence, nationality, place of incorporation and place of business of the participants. The \textit{Jiangsu} court rejected the illegality defense asserted concluding:

\begin{quote}
Defendants do not claim that Pukou violated any Palauan law by entering into the
contract to invest in Orientex nor in performing its obligation under the contract
by contributing capital to Orientex without first obtaining the permission of the
Chinese government. Therefore, the fact that China did not give its approval to
Pukou’s investment until after the investment had already been made did not
excuse Ho from performing his obligation to assign to Pukou the Orientex shares
he held as Pukou’s nominee.
\end{quote}

\begin{center}
\textit{Illegality and Government Contracts}
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In addition to prior appropriation of government funding required by statute in
Micronesia and Palau which may trigger an illegality defense if there is no prior
appropriation and result in a contract with the government being declared void, there are
numerous other statutes which requiring compliance the failure which will result in the
contract with the government being declared null and void.

One of the more litigious cases involving illegality and government contracts
issues in Micronesia is \textit{FSM v. Falcam}.\footnote{3 FSM Intrm 112 (Pon. 1987). The \textit{Falcam v FSM} litigation reappears in two other locations in the
official reports: \textit{Falcam v. FSM}, 3 FSM Intrm 194 (Pon. 1987) and \textit{FSM v Falcam}, 9 FSM Intrm 1 (App. 1999).} This case is significant due to its discussion of

\footnote{\textit{Id.} In regard to the issue of specific performance, the \textit{Jiangsu} court observed that specific performance is generally not available if an award of damages would adequately compensate an injured party. \textit{Id} at 272. See also, \textit{Restatement (Second) of Contracts}, §359. Because specific performance is an equable remedy, the \textit{Jiangsu} court also observed that there is no absolute right to specific performance and will be granted or denied within the discretion of the court based upon consideration of the facts and circumstances of the case. \textit{Id} at 273. See also, \textit{Restatement (Second) of Contracts}, §357. Applying these general principles to the facts of the case, the court concluded that specific performance was not warranted. \textit{Id} at 273-4.}

\footnote{\textit{Id.} See also, \textit{Restatement (Second) of Contracts}, §359. Because specific performance is an equable remedy, the \textit{Jiangsu} court also observed that there is no absolute right to specific performance and will be granted or denied within the discretion of the court based upon consideration of the facts and circumstances of the case. \textit{Id} at 273. See also, \textit{Restatement (Second) of Contracts}, §357. Applying these general principles to the facts of the case, the court concluded that specific performance was not warranted. \textit{Id} at 273-4.}
the requirement that both parties need to be in pari delicto and, if not, the court is permitted to balance the competing public policy interests permitting enforcement on behalf of the party who is not in pari delicto versus those against enforcement due to illegality.

The *Falcam* case arose out of a government contract of employment in which Albert Falcam was hired as postmaster for Pohnpei State by his uncle, Leo Falcam, who was FSM postmaster at the time.

The trial court found that the uncle violated a statute preventing nepotism, 11 FSMC §1305, by hiring his nephew but that because it was the uncle, not the nephew, who was in pari delicto. Because the nephew did not violate the law, the trial court applied the balancing test set forth in *Restatement (Second) of Contracts*, §178 and the plaintiff nephew was awarded back pay.

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664 *Restatement (Second) of Contracts*, §178 provides:

When a Term is Unenforceable on Grounds of Public Policy.

(1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

(2) in weighing the interest in the enforcement of a term, account is taken of

(a) the parties' justified expectations
(b) any forfeiture that would result if enforcement were denied, and
(c) any special public interest in the enforcement of the particular term.

(3) in weighing a public policy against enforcement of a term, account is taken of

(a) the strength of that policy as manifested by legislation or judicial decision,
(b) the likelihood that a refusal to enforce the term will further that policy,
(c) the seriousness of any misconduct involved and the extent to which it was deliberate,

and (d) the directness of the connection between that misconduct and the term.

665 3 FSM Intrm at 119-122. See also, *Falcam v. FSM*, 3 FSM Intrm 194,197-8 and 203 (Pon. 1987). Of particular personal interest, the trial court also cited E. Murphy and R. Speidel, *Studies in Contract Law* 674 (3rd ed. 1984) which I assisted Professor Edward J. Murphy edit and update while serving as his research assistant while attending the University of Notre Dame Law School from 1984 to 1987. 3 FSM Intrm at 121.
Falcam is significant from an anthropological assimilation perspective in that the trial court found “All of the tests set forth in section 178(2) of the Restatement (Second) of Contracts, which this Court adopts as suitable for application in Micronesia, weigh in favor of Mr. Falcam’s compensation claim.”

The FSM government appealed only that portion of the Falcam case awarding back pay. The Micronesia Supreme Court rejected the appeal and affirmed the trial court. At the outset, the Micronesia Supreme Court observed that the general rule that all contracts which are in violation of applicable law are illegal and void is not without exception and that equitable considerations may permit restitution to be awarded under certain circumstances.

The Supreme Court then observed that if there is no local custom or tradition governing the substantive law matter, and if there is no national precedent from constitutional courts of the FSM on the issue of the enforcement of an employment contract that was in violation of statute and contrary to public policy, the court may then turn to the common law of the United States for guidance on the issue.

666 3 FSM Intrm at 203.
667 3 FSM Intrm 112, 121; 9 FSM Intrm at 4. See also, Ponape Transfer & Storage v. Federated Shipping, 3 FSM Intrm 174, 178 (Pon. 1987) (a contract regarding the Taketik Island Dock facility ostensibly entered by government officials on behalf of the government but in violation of applicable law is illegal. Courts will seldom enforce such a contract where both parties failed to comply with the applicable requirements. Id.)
668 9 FSM Intrm at 4
669 Id at 4. The trial court had previously noted:

This is the first case presenting to this court an allegedly illegal national employment contract. No direct case precedent is available. No party has suggested any customary principles of law or traditional values which should guide our decisionmaking. We therefore look to the common law as established in other jurisdictions to assist in developing principles suitable for Micronesia. See Semens v. Continental Airlines Inc. 2 FSM Intrm 131, 141-42 (Pon. 1985). 3 FSM Intrm at 120, fn
Because the FSM Congress had not explicitly made employment contracts in violation of 11 FSMC §1305 unenforceable, the FSM Supreme Court noted that it had the authority to properly determine whether a violation of statute by the uncle in contravention of public policy was grave enough to warrant unenforceability for his nephew who committed no criminal act. In determining whether to enforce an employment contract, the trial court had balanced the public interest in denying enforcement because the hiring by the government official, his uncle, violated public policy against a number of other factors to determine enforceability. Those factors the trial court weighed against the competing policy interests prohibiting illegal conduct by government officials were: 1) a due process violation as a result of the government’s failure to provide any hearing or opportunity to be heard concerning its failure to pay the employee or take any steps to terminate the contract; 2) the employee’s justified expectation to be paid; and 3) the substantial forfeiture that would result if enforcement was denied. The standard of review of the trial court decision is abuse of discretion and the Micronesia Supreme Court concluded in light of those considerations set forth in Restatement (Second) of Contract, § 178, that the trial court did not abuse its discretion in weighing these competing factors to determine enforceability and order payment of back pay by FSM to the plaintiff. When assessing whether the trial court properly balanced these factors against the competing policy of illegality violating public policy, the standard of review of the trial court’s decision on a matter of law is a de novo review.

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670 9 FSM Intrm at 4
671 Id at 4
672 Id at 5
673 Id at 4
In Billimon v Chuuk State, the State of Chuuk signed a fifty year lease in the amount of $150,000 for a piece of property with the plaintiff which was void and illegal because the State of Chuuk had incurred public indebtedness and had not requested a prior appropriation by the Chuuk Legislature as required by both the State Constitution and the Truk Financial Management Act. Plaintiff had sued for enforcement when the $150,000 was not paid within 30 days of execution of the contract. Justice Wanis Simina reluctantly declared the lease void because it was contrary to statute but employed a unique remedy finding that there was a forcible and unlawful detainer of plaintiff’s property by the State of Chuuk. He ordered that the property had to be returned to the plaintiff, its rightful owner. He also indicated that the State of Chuuk had to remove all utilities and any and all public improvements to the land including a road right of way but stayed enforcement of the judgment for a short period of time allowing the Chuuk legislature an opportunity to make an appropriation and renegotiate the original contract.

In Truk Shipping v. Chuuk, the plaintiff filed a declaratory judgment action seeking clarification on an existing Vessel Agency Agreement that plaintiff had with the State of Chuuk to service Micro vessels and their cargoes. The plaintiff claimed that

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674 5 FSM Intrm 130 (Chk. St. Ct. Tr. 1991). The author of this opinion, Justice Wanis Simina, represented the Chuuk Supreme Court and was one of the initial twenty-two (22) participants in the Pacific Islands Legal Institute in August 2003. He tragically suffered a heart attack one evening after leading us in prayer and Chuuk traditional song while attending dinner at this continuing judicial education program in Pohnpei.
675 Chuuk State Constitution, Article VIII, §1
676 T.S.L. 5-44
677 5 FSM Intrm at 133.
678 Id at 136-7
679 Id at 137-8
680 7 FSM Intrm 337 (Ck. S. Ct. Tr. 1995)
when the legislature passed a statute\textsuperscript{681} terminating the contract it impaired an existing contractual relationship contrary to the Chuuk State Constitution.\textsuperscript{682} The court observed that a state as a party to a contract has the same rights as any party to a contract and may exercise all the rights that the parties have agreed upon in the contract including a 30 day notice provision terminating the contract.\textsuperscript{683} Where the current contract was signed by the Governor who was the brother of the shipping company president for an excessive interest rate and without complying with the bidding procedures for public contracts, the agreement may be void due to illegality and public policy so there was no valid contract to impair under the Chuuk Constitution.\textsuperscript{684} Further, no obligation may arise from an agreement that lacks the essential element of consideration. If a contract does not have valid consideration, there is no enforceable contract which would be impaired under the Chuuk Constitution.\textsuperscript{685} The \textit{Truk Shipping} court noted that the Constitutional prohibition against impairment of contract is not absolute and that a contract must be valid and enforceable when made. If the contract is illegal when made, such as an this agreement containing interest rates that exceed allowable interest rates permitted by law or negotiated contrary to bidding requirements for public contracts, it does not result in an impairment of contract because the agreement is void and unenforceable ab initio.\textsuperscript{686}

\textsuperscript{681} Chk. S.L. 3-95-4
\textsuperscript{682} Chuuk State Constitution, Article III, §10
\textsuperscript{683} FSM Intrm. at 340-2
\textsuperscript{684} Id at 341-2
\textsuperscript{685} Id at 341
\textsuperscript{686} Id at 340-1.
Palau addressed illegality and government contracts in *ROP v. Toribiong*.\(^{687}\) In *Toribiong*, the Palau trial court had ordered specific performance requiring the Republic of Palau to transfer airport property to the State of Airai and the Airai State Public Land Authority. The Palau Supreme Court reversed indicating that there was no express promise to transfer the land and to order specific performance would require ROP officials to disobey or ignore the law which would be illegal and unenforceable.\(^{688}\)

**Illegality and Customary Law**

Customary law and traditional rights also affect the concept of illegality in the Northern Pacific region.

An example of anthropological assimilation of a foreign concept of substantive contract law can be found in *Falcam v. FSM*,\(^{689}\) where the trial court found that *Restatement (Second) of Contracts* §178(2) addressing illegality based on public policy was consistent with Micronesian culture and suitable for application in Micronesia. The *Falcam* court observed “All of the tests set forth in section 178(2) of the *Restatement (Second) of Contracts*, which this Court adopts as suitable for application in Micronesia, weigh in favor of Mr. Falcam’s compensation claim.”\(^{690}\)

Traditional and customary law prevalent in the Northern Pacific region indicates that it is unlawful to enter into a contract to sell, lease, license, mortgage or dispose of land contrary to customary law and tradition and any such contract will be declared illegal and void.\(^{691}\)

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687 2 ROP Intrm 43 (1990)
688 Id at 50.
689 3 FSM Intrm 194 (Pon. 1987) affirmed 9 FSM Intrm 1 (App. 1999)
690 3 FSM Intrm at 203.
691 The Constitution of the Marshall Islands, Article X, § 1, subsection 2, provides:
For example, under the Constitution of the Marshall Islands, matters of custom and tradition such as contracts for the sale, lease, or mortgage of land, are referred by the High Court to the Traditional Court. The High Court may also appoint traditional court assessors to sit with the High Court in an advisory capacity and give an advisory opinion on matters of custom or tradition but not to participate in the determination of the case.

There are a number of cases in the Marshall Islands in which the courts have found transfers or contracts for the sale, lease, mortgage, or disposal of land to be either valid or, alternatively, contrary to “customary” law and declared null and void.

Without prejudice to the continued application of the customary law pursuant to Section(1) of Article XIII, and subject to the customary law or to any traditional practice in any part of the Marshall Islands, it shall not be lawful or competent for any person having any right in any land in the Marshall Islands under the customary law or any traditional practice to make any alienation or disposition of that land, whether by way of sale, mortgage, lease, license or otherwise, without the approval of the Iroijlaplap, Iroijedrik where necessary, Alap and the Senior Dri Jerbal of such land, who shall be deemed to represent all persons having an interest in that land.

For example, in Tobeller v. David 1 MILR (Rev) 81 (April 6, 1987), the Marshall Islands High Court adopted Marshallese customary law and traditional rights to determine whether appellant rightfully possessed certain property that had unilaterally been transferred to Appellant without notice. In declaring the “execution of the kalimur” or transfer void and affirming the High Court, the Supreme Court noted that both the Traditional Court and High Court concluded that the deceased had no authority prior to her death under customary law to unilaterally transfer the property to appellant and try to change the hereditary character of the property without notice and that this “holding is so clearly correct as to require no citation of authority to sustain it.” Anthropologically, this case also discusses a unique aspect of Marshallese customary law that provides that certain rights in land, i.e. property originally given as a gift as a reward for bravery in battle, are inherited maternally. In Hermios v. Minister of Internal Affairs, 2 MILR 127 (September 7, 1998) the Marshall Islands Supreme Court in affirming the High Court relied upon a finding of the Traditional Rights Court under customary law and traditional rights determining the validity of a lease, who was the proper party to a lease with the Republic, and who was entitled to lease payments for a school to be built on Wotje Atoll. In Gushi Bros. v. Kios, 2 MILR 120 (August 26, 1998) parties to a lease sued to obtain injunctive relief to stop construction of a dwelling by a third party on property they had leased. Defendants claimed the lease and subsequent addendum were invalid and should be declared void. The Marshall Islands Supreme Court and High Court utilized customary law to determine the validity of the initial lease. Subsequent to the original lease, one of the lessors sold his interest in the property to the lessee. The Marshall Islands Supreme and High Court utilized customary law to determine the validity of the subsequent bill of sale and addendum. Applying customary law, the High Court found that the terms of the lease, sale and subsequent addendum were valid and that construction by Defendant Kios violated the terms of the lease. The Marshall Islands Supreme Court affirmed the issuance of a prohibitory injunction.
Customary and traditional law has also been utilized to void otherwise valid contracts in the other Northern Pacific Island nations as well. Customary and traditional law has been asserted to void contracts for the sale, lease or transfer of land in the Republic of Palau. For example, in *Ngiraloi v. Faustino*, the Ngermeriil lineage asserted traditional or customary law in an attempt to void the oral transfer or purchase of land from their father, Mikel Ngermeriil, to the defendants in the 1950’s, 1960’s and in 1974. They claimed that the transfers or sales were contrary to Palauan custom and traditional law. The children claimed that they were ochell or strong members of the Ngermeriil lineage and that under Palauan custom and tradition the sale or transfer of lineage land was void in the absence of their consent. Both the trial court and the appellate court examined Palauan custom and tradition and concluded that the plaintiff

In *Jack v. Hisaiah and Hisaiah*, 2001 MHHC 1 (March 12, 2001) the High Court referred an issue of who the proper party was for a lease for certain uses of land on Arrak Island, Majuro Atoll to the Traditional Court for determination under customary law and tradition. The *Jack* court observed:

> The Judges of the TRC are selected for, among other things, their knowledge of the customary law and traditional practices of the Marshallese community. They are, themselves, experts on the legal subject under their jurisdiction. Although they are obligated to consider evidence, they also bring this personal expertise to bear on the controversies before them. The High Court is not bound by findings of fact of the TRC. However, as noted above, the High Court is directed by the Constitution to give substantial weight to their findings. Therefore, this court will not disregard the findings of the TRC unless they are clearly erroneous.

After referral to the Traditional Court, the matter returned to the High Court and the High Court’s decision in favor of the defendants was then appealed to the Supreme Court in *Jack v. Hisaiah and Hisaiah*, 2 MILR 206 (November 20,2002). The Supreme Court determined that the purchase of certain property and subsequent distribution was not subject to distribution under traditional rights and that a lease entered into by defendants with their sister was valid.

The statute of frauds requiring the transfer of land be in writing became effective in 1977. *Andreas v. Masami*, 5 ROP Intrm 205,206 (1996). See also, 6 ROP Intrm at 260, fn.1.

appellants were not ochell members\textsuperscript{698} and that the transfers and sales were valid.\textsuperscript{699}

There are a number of other cases in the Republic of Palau in which the courts have found contracts for the sale, lease, mortgage, or disposal of land to be either consistent with “customary” law and valid or, alternatively, contrary to “customary” law and declared null and void.\textsuperscript{700}

\textsuperscript{698} From an anthropological perspective, the Ngiraloi case raises several interesting issues in that clans or lineages can assert claims based upon customary law, that Palauan hereditary rights are passed maternally, that adoption into the lineage of the mother has significant impact on the determination who is a blood relative of the clan and entitled to lineage rights, and that contracts can be voided under customary law despite the fact that they meet all other requirements of a valid contract.

\textsuperscript{699} 6 ROP Intrm at 260-1

\textsuperscript{700} For example in Ngirumerang Trolii v. the Eluil Clan by its Chief Rengiil Ra Eluil Francisco Gibbons, - ROP Intrm - (October 17, 2003) the trial court was asked to determine the validity of a deed negotiated by Daniel Ngirchokebai, purportedly acting on behalf of the Eluil clan, in which Ngirchokebai sold several lots to the Western Caroline Trading Company. Gibbons sought to void the transfer because he was a strong member of the clan and had not consent to the sale as required under Palauan custom. Ngirumerang Trolii and Irachel Adelbai intervened claiming they were strong members of the clan and that they too had not consented to the sale or transfer but they disputed Gibbons claim to be a senior member under customary law. The trial court declared the transfer and sale to Western Caroline Trading Company void under customary law and invalidated the deed. The Appellate court agreed that the sale was void under customary law and was only asked to resolve the dispute between Gibbons and the intervenors as to whether Gibbons was a strong member of the clan. In Obak v. Ikelau Bandarii, et al 7 ROP Intrm 254 (Tr. Div. 1998) Plaintiff sued his joint tenant defendant claiming that a transfer of her joint tenancy interest in land to her children, the other defendants in the case was contrary to customary law and should be void. The trial court observed that under Anglo-American law a joint owner could not sell or transfer land in the absence of an agreement by all joint owners but the joint owner had the ability to sell or transfer their undivided interest in the property to another person or persons without consent. The court then contrasted Anglo-American law to Palauan custom and tradition which differs significantly. The court observed that under Palauan custom it is indisputable that an individual even if they have a clan interest in the land cannot sell or transfer an interest in land, whether in whole or in part, if that land is owned by a clan or lineage except upon approval by the ochell or senior strong members. The Plaintiff filed a motion for summary judgment citing Children of Ngeskesuk v. Espangel, 1 ROP Intrm 682 (1989), in which the trial court treated land owned by multiple owners the same as clan or lineage land holding that under Palauan custom or traditional law one co-owner of five joint tenants could not sell or transfer an interest in land, whether in whole or in one fifth part and declared the sale void. The issue to be resolved in the Obak case was how to treat joint ownership under Palauan custom where the land was not clan, lineage or family land. The Obak court distinguished the Ngeskesuk decision by citing several cases in which the interests of joint owners passed separately upon death and the fact that an expert in Palauan culture filed an affidavit indicating that contrary to Ngeskesuk under Palauan custom a co-owner of land which is not clan or lineage property is entitled to sell or transfer an interest in that land. In reaching this conclusion, the Obak court addressed a significant anthropological issue and the tension which exists between cultures based on traditional law or status and those based substantive law, such as contract and sales law, which is intended to provide social order. Omitting citations and footnotes, the Obak court stated:
Similar cases, such as *Nahnken of Nett v. United States*, among numerous others can also be found in the Federated States of Micronesia where tribal leaders assert traditional or customary law in an effort to void otherwise valid contracts relating to the sale, lease or transfer of land.

These cases are significant from an anthropological perspective in that otherwise bargained for facially valid contractual relationships can be voided by customary or traditional law. Additionally, these cases reflect another aspect of customary law which is more group focused and permits groups, clans and lineages standing to file law suits in the absence of privity based upon social status under traditional law while seeking to enforce, void or regulate individual or business relationships based on contract law.

One of the peculiarities of our early determination to treat custom and customary law as facts to be proven...is the possibility that two different courts may determine the content of custom differently on the basis of the different records before them....To that extent, although there are probably some customary matters that have attained the status of law, issues of custom-if not agreed to-must generally be proven anew in each case in which they arise. Here, the Court does not believe that the principle stated in *Ngveskesuk* is so firmly established that the Court must accept it even in the face of a proffer of expert testimony to the contrary. Id.

From an anthropological perspective, the court was indicating that some customary matters may be considered law (like requiring senior strong members to approve the sale or transfer of clan or lineage land) but that other customs (like the transfer or sale of land by joint tenants that was not clan or lineage) are not and have to be proven in each case. This customary law approach in *Obak* reflects the inconsistencies inherent within societies which adopt a status based approach to defining relationships which perpetuates uncertainty and instability when different courts can determine the content of custom differently based on the different records before them, rather than one which interprets relationships based upon principles of contract or sales law which are intended to promote stability.

7 FSM Intrm 581 (App 1996) in which a tribal leader tried to reclaim land which he claimed on behalf of the clan which the Japanese had seized during a forced sale. The court declined indicating that the land had been seized from a private owner under duress coercion and was not public land subject to tribal claims. Another FSM case in which clan leaders or members attempted to invalidate a lease is *Marcus v. Truk Trading Corp.*, 11 FSM Intrm 152 (Chk 2002). In *Marcus*, the lease agreement was upheld because the litigants had accepted benefits. While on appeal, the clan sold the property to the defendants and settled. Some clan representatives later sued in *Edgar v. Truk Trading*, 13 FSM Intrm 112 (Chk 2005) claiming that they had not been properly paid pursuant to the terms of the agreement.
Illegality and Restraint of Trade

Restraint of trade clauses are illegal in the Northern Pacific region and may result in a contract being declared void. Under the common law non-ancillary restraints on competition are construed to be a restraint of trade.\textsuperscript{702} Ancillary restraints on competition may also be an unreasonable restraint of trade if the restraint is greater than needed to protect a legitimate interest, or the promisee’s need is outweighed by hardship to the promisor and will result in injury to the public.\textsuperscript{703} Statutorily, the Marshall Islands and Palau have adopted an Unfair Business Practices Act.\textsuperscript{704} These acts make it illegal for individuals or entities to use capital, skills or acts “to create or carry out restrictions in trade or commerce.”\textsuperscript{705} Similarly, Micronesia has adopted an Anti-Competitive Practices Act making such restriction illegal.\textsuperscript{706} Consequently, contracts found to be in restraint of trade will be declared illegal and void.

Further, contracts creating monopolies or eliminating or reducing competition are expressly prohibited.\textsuperscript{707} Not only will such contracts be declared void but a penalty of $50 to $5000 may be imposed upon criminal conviction.\textsuperscript{708} Like many consumer protection acts,\textsuperscript{709} the Marshall Islands Restraint of Trade Act and Palau Unfair Business Practices Act also permit a civil suit allowing any person injured by an act covered by the statute to sue for treble damages and costs.\textsuperscript{710}

\textsuperscript{702} Restatement (Second) of Contracts §187
\textsuperscript{703} Restatement (Second) of Contracts §188
\textsuperscript{704} Restraint of Trade Act, 20 MIRC, Cap 3; Unfair Business Practices Act, 11 PNCA § 101 et seq.
\textsuperscript{705} Restraint of Trade Act, 20 MIRC, Cap 3, § 4; Unfair Business Practices Act, 11 PNCA § 102(a)
\textsuperscript{706} 32 FSMC §301 et. seq. See also, AHPW Inc. v. FSM, 12 FSM Intrm 544, 551 (Pon. 2004)
\textsuperscript{707} Restraint of Trade Act, 20 MIRC, Cap 3, § 4; Unfair Business Practices Act, 11 PNCA, § 103
\textsuperscript{708} Restraint of Trade Act, 20 MIRC, Cap 3, § 7(1); Unfair Business Practices Act, 11 PNCA § 106(a).
\textsuperscript{709} See for example the Marshall Islands Consumer Protection Act, 20 MIRC, Cap 4, § 406
\textsuperscript{710} Restraint of Trade Act, 20 MIRC, Cap 3, § 7(2); Unfair Business Practices Act 11 PNCA § 106(b)
**Illegality and Usury**

A contract may be declared illegal and void if it incorporates a usurious interest rate. The rate is generally set by statute and varies from jurisdiction to jurisdiction.

For example, it is illegal in Micronesia and Republic of Palau for any creditor to include a usurious interest rate in any transaction conducting business within the Republic entitling the aggrieved party to equitable relief and double damages. The Marshall Islands Usury Act prohibits interest in excess of 24% per annum to be assessed.

**Supervening Illegality**

Under some circumstances, a contract may be enforceable at the time it was entered into by the parties and the subject matter was legal but during performance there is supervening illegality. In this instance, the outcome is governed by the doctrine of impracticability of performance. As noted previously, supervening illegality may also terminate the power of acceptance if after a lawful offer is made, but before it has been accepted, the performance of the proposed contract is declared illegal.

There is a requirement that both parties be aware of the illegality or be “in pari delicto.” If one party is aware of illegality and the other is not, in pari delicto does not exist.

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711 Micronesia Usury Act, 34 FSMC §201 et seq. See also, examples of state usury statutes such as the Kosrae Usury Act, Kos. State Code, § 13.518
712 Usurious Interest Act, 11 PNCA § 301, et seq.
713 Usurious Interest Act,11 PNCA§ 306
714 20 MIRC §701 et. seq.
715 20 MIRC § 704
An example of a case involving the issue of “supervening” illegality in the Federated States of Micronesia is *Ponape Construction v. Pohnpei.* In *Ponape Construction*, the State Government hired and issued permits to two companies to dredge and perform emergency repairs to severe erosion of power poles on the Dekehtik causeway. As part of the consideration and the bargain, coral was to be dredged and used to repair the causeway and the two companies were also permitted to keep some coral for commercial purposes.

During the project, the local government of Nett objected to the dredging and damage being done to the reef along the causeway. Consequently, the Governor issued a moratorium on dredging in the area to appease local political concerns. Further, during construction, the State of Pohnpei promulgated S.L No. 2L-197-91 which prohibited dredging in the area. The State Government claimed that the objections of a local government constituted a valid basis to terminate a contract and, alternatively, the State legislature made the essential purpose of the contract illegal and the contract unenforceable. The trial court initially noted that, as a general rule, illegal contracts are void and unenforceable and that even when performance occurs and a benefit is conferred there is no recovery of either expectation damages or quantum meruit as a matter of public policy. As to the objection of the local Nett municipality, however, the *Ponape Construction* trial court observed:

> However legitimate the desire to accommodate a municipality, such a decision is a matter of policy and does not constitute a legally valid reason for unilateral termination of an unenforceable contract. The State must make whatever political

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716 6 FSM Intrm 114 (Pon 1993), aff’d 7 FSM Intrm 613, 621 (App. 1996)
717 Id at 125
decisions it sees fit. However, that such decisions may result in a breach of contract is a consequence that the State, not the plaintiffs, must bear.\textsuperscript{718}

As to the issue of supervening illegality, the \textit{Ponape} trial court rejected the State’s argument that the agreement with the plaintiffs was rendered illegal by the enactment of Pohnpei S.L. 2L-197-91. The \textit{Ponape} trial court relied on the Pohnpei State Constitution which prohibits enacting laws impairing existing contractual obligations except for the protection of an essential public interest.\textsuperscript{719} In interpreting the language of the statute in light of the Constitutional limitation, the \textit{Ponape} court concluded that the legislation did not apply retroactively and applied only to contracts entered into after its enactment.\textsuperscript{720}

The trial court observed:

Nothing in the language of Pohnpei S.L. 2L-197-91 suggests a retroactive application which would impair already existing contracts. Thus, in view of the constitutional limitation and the language of the state law, it must be presumed that the law would only apply to contracts entered after its enactment. Because the law does not impair existing contracts, the issue of ‘an essential public interest’ does not arise, nor was such an issue ever raised by the State at trial. Contracts entered into before S.L. 2L-197-91’s enactment are exempt from its prohibition.\textsuperscript{721}

The \textit{Ponape} trial court also found that any illegality rendering the contract unenforceable arose long after the agreement was entered into and already terminated and breached by the State.\textsuperscript{722} Consequently, one Plaintiff was entitled to compensatory damages since it had nearly completed the work and the other was entitled to specific performance due to the State’s breach of contract.\textsuperscript{723}

\textsuperscript{718} Id at 124
\textsuperscript{719} Pon. State Const. Art IV, §5
\textsuperscript{720} 6 Intrm at 125
\textsuperscript{721} Id.
\textsuperscript{722} Id
\textsuperscript{723} Id at 125-126
On appeal to the FSM Supreme Court, the State argued that indefinite contracts for the use of land violated *FSM Constitution Article XIII, Section 5*. Like the trial court had done previously, the FSM Supreme Court determined that the contract for emergency repairs to the causeway and dredging of coral was coterminous with the Army Corps of Engineers Dredging Permit which expired on December 31, 1994.\textsuperscript{724} Consequently, the contract was neither void for violation of the constitutional provision prohibiting indefinite contracts for the use of land, nor was it void for vagueness and wholly indefinite as to time.\textsuperscript{725}

\textsuperscript{724} 7 FSM Intrm at 621
\textsuperscript{725} Id.
PART V: CONTRACT PERFORMANCE ISSUES: PROPER FORM AND GENERAL RULES OF CONTRACT INTERPRETATION

There are a number of basic rules regarding proper form and contract interpretation which will be reviewed in this section including the parol evidence rule and statute of frauds. Interpretation issues during performance may arise in situations in which there is ambiguity, conflicting provisions, where typed provisions have been replaced by written provisions, and where custom and usage exist which may define the relationship between the parties. The *Restatement (Second) of Contracts* provides several rules to assist the court in assessing the meaning of ambiguous contractual agreements. For instance, the *Restatement (Second) of Contracts* contains provisions addressing such topics as which meaning prevails, \(^{726}\) rules in aid of interpretation, \(^{727}\) standards of preference in interpretation, \(^{728}\) and supplying an omitted essential term. \(^{729}\)

**Basic Rules of Contract Construction**

**Ambiguity: The Rule and Standards**

The general rule is that any ambiguity in the contract is to be construed against the drafter. \(^{730}\) If the terms of a contract are clear, unambiguous and certain, the construction and legal effect to be given to a contract is a question of law. \(^{731}\) The plain

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\(^{726}\) *Restatement (Second) of Contracts* §201

\(^{727}\) *Restatement (Second) of Contracts* §202

\(^{728}\) *Restatement (Second) of Contracts* §203

\(^{729}\) *Restatement (Second) of Contracts* §204

\(^{730}\) See *Semens v. Continental Air Lines*, 2 FSM Intrm 131, 146-7 (Pon. 1985); *Bank of FSM v. Bartolome*, 4 FSM Intrm 182, 185 (Pon. 1990); *FSM Dev. Bank v Ifraim*, 10 FSM Intrm 107,111 (Chk 2001) (ambiguity regarding a forum selection clause may be construed against the drafter)

\(^{731}\) *Nanpei v. Kihara*, 7 FSM Intrm 319, 323 (App 1995)
meaning doctrine states that if the writing or term at issue has a plain meaning then the plain meaning of the writing or term must be given effect without resort to extrinsic evidence to aid in interpretation.

*Restatement (Second) of Contracts* §201 provides that if the parties have attached the same meaning to the agreement or to a contractual term it is to be interpreted consistent with that understanding. If the parties have difference of interpretation as to the meaning of the agreement or a contractual term, it is interpreted consistent with the meaning attached by one of the parties if at the time of the agreement: 1) that party did not know the different meaning attached by the other but the other knew the meaning attached by the first party, or 2) that party had no reason to know the different meaning attached by the other and the other had reason to know the meaning attached by the first party. If this reconciliation cannot be accomplished, the contract fails due to lack of mutual assent.

Other rules of interpretation can be found in *Restatement (Second) of Contracts* §202 which provides that contract language is to be interpreted in accord with its generally prevailing meaning and that technical terms and words are to be given their technical meaning when used in a transaction within a technical field.

In assessing this question of law courts will employ standards of preference in interpretation. *Restatement (Second) of Contracts* §203 establishes a hierarchy of interpretation and provides: 1) reasonable, lawful, and effective meaning will be given to

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732 Restatement (Second) of Contracts §201(1)
733 Restatement (Second) of Contracts §201(2)
734 Restatement (Second) of Contracts §202(3)
735 Restatement (Second) of Contracts §202 (3)
all contractual terms, 2) express terms are to be given greater weight than course of performance, course of dealing and usage of trade, 3) course of performance is given more weight than course of dealing or usage of trade, 4) course of dealing is given more emphasis than usage of trade, 5) specific terms prevail over general, and 6) separately negotiated or added terms have more weight than standardized form language.

In *Gibbons and Andrew v. ROP* the Palau Supreme Court addressed the issue of ambiguity and also recognized that interpretation is a question of law observing:

That construction and legal effect to be given an unambiguous contract is a question of law to be decided by the court…; this is so even though the ultimate inquiry under the interpretative process is the intent of the parties—an issue ordinarily considered inherently factual….Because the unambiguous term of the contract are presumed to embody the intent of the parties, submission of questions of interpretation to the trier of fact is unnecessary.

In *Ngerketit Lineage v. Seid,* the Palau Supreme Court similarly held that the interpretation of a clear, certain and unambiguous contract is for the court, and a party’s private understanding or secret intent of what a contract means is immaterial when assessing mutual assent. A review of a lower court’s interpretation of a contract is a de novo review.

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736 1 ROP Intrm 634 (1989)
737 Id at 44. (Citations omitted.)
738 8 ROP Intrm 44 (2000)
739 Id at 48. A Kosrae state trial court reached a similar decision in *Melander v. Kosrae*, 3 FSM Intrm 324,328 (Kos. S. Ct. Tr. 1988) (A court interpreting a deed should attempt to determine the meaning of the words used rather than what the signatory later says he subjectively intended. Id)
A similar result was reached in *Kihara v. Nanpei*,\(^{741}\) where the Micronesian court observed:

Contracts are not interpreted on the basis of subjective uncommunicated views, or secret hopes of one of the parties, but on an objective basis, according to the reasonable expectations or understanding of parties based upon circumstances known to the parties and their words and actions, at the time the agreement was entered into.\(^{742}\)

**Contract Construed as a Whole**

Another rule of contract construction would require that the contract be construed as a whole. *Restatement (Second) of Contracts* §202 requires that words and other conduct be interpreted in light of all the circumstances and that the principle purpose of the parties is to be given great weight if ascertainable.\(^{743}\) *Restatement (Second) of Contracts* §202 requires that the writing be interpreted as a whole and that all writings that are part of the same transaction be interpreted together.\(^{744}\)

For example, in *Melander v. Kosrae*,\(^{745}\) the court looked at all three substantive paragraphs in a statement of intent regarding an easement for conduction of a road across Plaintiff’s property. Where two clauses within the agreement were inconsistent, the *Melander* court indicated that a court should attempt to interpret the agreement so that each provision has meaning but the paramount rule is that the contract or statement of intent must be construed so as to give effect to the intention of the parties as collected.

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\(^{741}\) 5 FSM Intrm 342 (Pon. 1992)

\(^{742}\) Id at 345. In *Kihara*, plaintiff loaned defendant $50,000 which defendant claimed was conditional upon a contract being negotiated regarding Ant Atoll. Analyzing the plain language of the loan, the trial rejected this argument and was affirmed on appeal in *Nanpei v. Kihara*, 7 FSM Intrm 319 (App.1995).

\(^{743}\) Restatement (Second) of Contracts §202(1)

\(^{744}\) Restatement (Second) of Contracts §202(2)

\(^{745}\) 3 FSM Intrm 324 (Kos. S. Ct. Tr. 1988)
from the whole instrument.\textsuperscript{746} When the language of a contract is ambiguous or uncertain, the court can look beyond the mere words of the contract to the surrounding circumstances including examining the parties’ actions to determine the parties’ intent without changing the writing.\textsuperscript{747}

\textit{Plain and Ordinary Meaning: Anthropological Implications}

Another rule of contract interpretation requires that the plain or ordinary meaning of the words be employed unless all parties have clearly indicated otherwise.\textsuperscript{748} In construing contract language to determine the intent of the parties, the courts do not try to ascertain the mental processes or secret intent of the parties but look to the actual contract language to determine mutual assent.\textsuperscript{749}

In \textit{Tomomi v. Nelson},\textsuperscript{750} The Palau Supreme Court was asked to determine what “Kliu’s children” meant. In reversing the trial court, the Supreme Court noted that “courts give words their ordinary and plain meaning unless all parties have clearly intended otherwise….Further, courts do not attempt to ‘ascertain the mental processes of the parties’ but rather look to the actual language used.”\textsuperscript{751} (Citations omitted.)

\textsuperscript{746} Id at 327.
\textsuperscript{747} Id at 327. See also \textit{Ponape Transfer v. Wade}, 5 FSM Intrm 354,356 (Pon 1992).
\textsuperscript{748} \textit{Tomomi v. Nelson}, 4 ROP Intrm 169, 170 (1994). See also, \textit{Melander v. Kosrae}, 3 FSM Intrm 324,326 (Kos. S. Ct. Tr. 1988) (The court should interpret the words according to their usual meaning unless that meaning is unclear. Id.) Compare, \textit{Article 4.3} of the \textit{UNIDROIT Principles} which states in pertinent part that in interpreting contract language “regard shall be had to all the circumstances, including…preliminary negotiations between the parties.” \textit{Article 4.3} is slightly different than the plain meaning rule in that it does not set forth an initial stage in which extrinsic evidence is to be considered. See also, \textit{Ngiratkel EtCISION Co.,(NECO) v. RIADF} 2 ROP Intrm 211,217 (1991)(Determining whether a contract is ambiguous to the extent that extrinsic or parol evidence is permitted is a question of law and not a question of fact.)
\textsuperscript{749} \textit{Kihara v. Nanpei}, 5 FSM Intrm 342, 345 (Pon 1992), affirmed 7 FSM Intrm 319 (App 1995); \textit{Tulensru v. Utwe}, 9 FSM Intrm 95, 98 (Kos. S. Ct. Tr. 1999)
\textsuperscript{750} 4 ROP Intrm 169 (1994)
Anthropologically, the *Tomomi* case is significant in that the trial court had adopted a traditional or customary law approach applying a “generational perspective” based upon testimony of participants who attended Kliu’s omengades to conclude that “Kliu’s children” did not include Tomomi. The Palau Supreme Court rejected this “generational perspective” and applied a rule of substantive contract law when adopting the plain meaning doctrine. This rejection by the Palau Supreme Court of the “generational perspective” under the customary law which had been applied by the trial court is a classic example of what Henry Maine referred to as moving from status to contract or Llewellyn’s cultural assimilation.

Additionally, the plain meaning of contract terms in Micronesia must be interpreted under the lens of an “ordinary Micronesian standard” as required by *Semens v. Continental Airlines* which provides:

> [T]he court, when interpreting a contract, may not simply assume that reasonably intelligent Micronesians will perceive the same meaning as would reasonably intelligent Americans… Courts may not blind themselves to pertinent aspects of Micronesian society, such as less facility in the English language, less exposure to business concepts, and the paucity of legal resources, which might cause a reasonably intelligent Micronesian to perceive a meaning differently than would a person from some other nation.

*Typed versus Written*

If there is any inconsistency between contract provisions, generally handwritten or typed provisions prevail over pre-printed.

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752 4 ROP at 170-171  
754 2 FSM Interm 131 (Pon. 1985)  
755 Id at 149  
756 Restatement (Second) of Contracts §203(d)
For example, in *Winterthur Swiss Ins. Co. v. Socio Micronesia*,\textsuperscript{757} the parties crossed out the word “defendant” in a mutual release between defendants and replaced it with the phrase “defendants who are parties to this agreement.”\textsuperscript{758} The court observed that the mental impressions of a party to a settlement agreement do not control over the express terms\textsuperscript{759} and the actual language of the settlement agreement is employed to discern the intention of the parties.\textsuperscript{760} The court concluded that the effect of this change is obvious: non-participating third party defendants were not to receive releases.\textsuperscript{761}

**Custom and Usage Between the Parties**

Occasionally custom and usage between the parties or within the locality can be used to interpret the contract terms.\textsuperscript{762} The court will employ custom and usage between the parties in an effort and prefers to construe contracts as valid and enforceable.

*Restatement (Second) of Contracts* §202 provides that course of performance, course of dealing or usage of trade can be used in contract interpretation.\textsuperscript{763} Where course of performance has been accepted or acquiesced in without objection it will be given great weight where a contract involves repeated occasions for performance.\textsuperscript{764}

\textsuperscript{757} 8 ROP Intrm 169 (2000)
\textsuperscript{758} Id at 172.
\textsuperscript{759} Id at 172. For this proposition, the court relied upon *Tomomi v. Nelson* 4 ROP Intrm 169, 170 (1994) and *Ngerketiit Lineage v. Seid*, 8 ROP Intrm 46, 50 (1999).
\textsuperscript{760} 8 ROP at 172
\textsuperscript{761} Id at 172
\textsuperscript{762} *CISG Article* 9 provides:

1. The parties are bound by any usages to which they have agreed and by any practices which they have established between themselves. 2. The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

\textsuperscript{763} Restatement (Second) of Contracts §202 (5)
\textsuperscript{764} Restatement (Second) of Contracts §202 (4)
Determining Scope and Content of Obligation: Parol Evidence Rule and Statute of Frauds

Parol Evidence Rule: Doctrine of Merger

Although sometimes it is confused with being a rule of evidence, the parol evidence rule is a rule of interpretation utilized in substantive contract law. The parol evidence rule provides that evidence, oral or written, of a prior or contemporaneous negotiation or agreements that contradict, modify, vary or change terms are inadmissible if the written contract is intended as a complete and final expression of the parties.\(^\text{765}\) A partial integration or an agreement that is not intended to be a final expression may be supplemented by consistent additional terms.

An integrated agreement is defined in Restatement (Second) of Contracts §209 as a “writing or writings constituting a final expression of one or more terms of an agreement.”\(^\text{766}\) The effect of an integrated agreement on prior agreements or the parol evidence rule can be found in Restatement (Second) of Contracts §213. Restatement (Second) of Contracts §213 provides that “a binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them.”\(^\text{767}\) Restatement (Second) of Contracts § 215 indicates that “evidence of prior or contemporaneous agreements or negotiations is not admissible in evidence to contradict a term of the writing.”\(^\text{768}\)

\(^{765}\) Restatement (Second) of Contracts §215

\(^{766}\) Restatement (Second) of Contracts § 209

\(^{767}\) Restatement (Second) of Contracts § 213

\(^{768}\) Restatement (Second) of Contracts § 215
The underlying policy reason for this rule as stated in *Kihara Real Estate v. Estate of Nanpei (I)*[^6] is to preserve “the security and credibility of those who contract with good faith belief that what they sign is what they agree to.”[^7] The *Kihara* case involved a lease option agreement for the development of a golf course, condominiums, and resort. One of the arguments raised in this case was that the agreement did not reflect what was actually agreed to by the parties. In the Agreement §12.1 provided that “[t]his agreement constitutes the entire agreement between the parties pertaining to the subject matter contained in it and supersedes all prior and contemporaneous agreements, representations, and understandings of the parties.”[^8] As it relates to the parol evidence rule, the *Kihara* court observed:

Furthermore, by denying the accuracy of the agreement, defendants would have the Court interpret the language of the agreement and thereby put into question the entire contract. If such a request were the rule, parties in any contract conceivably could escape their contractual obligations by asserting new terms to the contract after the signing. Those who negotiate in good faith would lose their protection against those who, either by negligence or in bad faith, do not live up to their contractual obligations. Hence, the Court must avoid such interpretations, especially when the language of the contract is clear. Only when there is ambiguity within a contract and there are various reasonable and practical alternative constructions available is it necessary to employ rules of interpretation. *Semens v. Continental Air Lines, Inc* 2 FSM Intrm 131, 147 (Pon. 1985). Otherwise, a party may not seek to introduce evidence that shows that the clear unambiguous terms of a written agreement are other than as shown on the face of

[^6]: 6 FSM Intrm 48 (Pon 1993)
[^7]: Id. At 55.
[^8]: See also, *Fu Zhou Fuyan Pelagic Fishery Co v. Wang Shun Ren*, 7 FSM Intrm 601 (Pon 1996) which also addressed an integration and parol evidence issue and in relation to one of the parties 1994 agreement it had with the Micronesia Maritime Authority (MMA). The *Fu Zhou* court indicated that where there is a single and final memorial of the understanding of the parties embodied in a written agreement, for evidentiary purposes all prior and contemporaneous negotiations are treated as having been superseded by that written memorial under the parol evidence rule. Consequently, the Justice Amaraich, who was presiding over the trial, and who had previously been a member of the MMA, would not be a material witness to the 1994 agreement and have to disqualify himself because he had left the MMA in 1991 and that only parties to the 1994 agreement would be witnesses providing parol or extrinsic evidence if the agreement was found to be ambiguous and incomplete and in need of clarification. Id at 604-5.
the agreement. Such a prohibition preserves the security and credibility of those who contract with the good faith belief that what they sign is what they agree to.\textsuperscript{772}

In Owens v. House of Delegates\textsuperscript{773} in which Plaintiff claimed breach of employment contract, the Palau trial court observed that when the parties put their agreement in writing, all previous oral agreements or negotiations merge into the written agreement and the contract cannot be modified or changed by parol evidence in the absence of fraud or mistake.\textsuperscript{774}

Similarly, in two other cases, Towai v. ROP,\textsuperscript{775} and Kingon v. ROP,\textsuperscript{776} the Palau Supreme Court indicated that personal action forms separate from the employment contract did not constitute or create independent rights and could not be used to modify the terms of a subsequent employment contract.

Generally, any relevant evidence is admissible to determine whether an agreement is intended as a final expression. After establishing finality, the next step for the court is to determine whether the agreement is complete. In order to determine whether a document is complete, the court will initially examine the four corners of the document to determine whether on its face it is a total integration. When examining the four corners, the court will look for a merger clause which will indicate whether the document is intended as a final expression. The collateral contract rule treats the writing as a partial integration and provides that if a term in a collateral agreement does not contradict the writing it may be received into evidence. Another version of the collateral contract rule

\textsuperscript{772} Id at 55
\textsuperscript{773} 1 ROP Intrm 320 (Tr. Div 1986) rev. and affirmed on other grounds, 1 ROP Intrm 513 E (1988)
\textsuperscript{774} 1 ROP Intrm. 320,325 fn1 (Tr. Div 1986)
\textsuperscript{775} 1 ROP Intrm 658, 662-4 (1989)
\textsuperscript{776} 2 ROP Intrm 72,77 (1990)
provides that if a term is addressed in the initial agreement then, as to that term, the initial agreement is intended as a total integration and that terms from a collateral contract may not be accepted.

UCC 2-202 addresses the Parol or Extrinsic Evidence rule as it relates to the sale of goods between merchants.\textsuperscript{777} UCC 2-202 indicates that terms inconsistent with terms of writing are prohibited.\textsuperscript{778}

For a contract for the sale of goods if the terms of a contract are set forth in a confirmatory memorandum and the terms are intended to be a final expression of the parties agreement, those terms cannot be contradicted by any prior or contemporaneous oral or written agreement.\textsuperscript{779}

\textsuperscript{777} UCC 2-202 provides:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a compete and exclusive statement of the terms of the agreement.

Revised UCC 2-202 submitted to the American Law Institute in May 2003 contains several modifications and provides as follows:

(1) Terms with respect to which the confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (a) by course of performance, course of dealing or usage of trade (Section 1-303); and (b) consistent additional terms unless the court finds the record to have been intended also as a compete and exclusive statement of the terms of the agreement. (2) Terms in a record may be explained by evidence of course of performance, course of dealing, or usage of trade without a preliminary determination by then court that the language used is ambiguous.

\textsuperscript{778} UCC 2-202; Revised UCC 2-202(1).

\textsuperscript{779} UCC 2-202; Revised UCC 2-202(1).
Writing Must be Intended as Final Expression

When assessing proposed evidence under the Parol Evidence rule, it is necessary to determine whether the writing or record was intended to be a final expression. A merger or integration clause in an agreement generally reflects intent of finality. *Restatement (Second) of Contracts* §214 provides that if an agreement is not intended as a final expression, then parol evidence is admissible. ⁷⁸⁰ Also, it needs to be determined whether the writing is a complete or partial integration. If partial, then parol evidence would also be admissible. ⁷⁸¹

Exceptions to the Parol Evidence Rule

There a number of exceptions to the parol evidence rule permitting the admissibility of collateral consistent agreements, subsequent agreements, and extrinsic evidence to attack contract formation, validity or to explain ambiguity. Some would argue that these exceptions have swallowed the rule and some international contract standards such as *CISG* have consequently abandoned the parol evidence rule. In those instances where extrinsic evidence is permitted to attack contract formation, validity, or to explain ambiguity, parol evidence may be admissible to demonstrate that an agreement was never formed or alternatively, if formed, that the agreement is void or voidable, or to establish a basis for granting or denying recission, reformation or specific performance.

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⁷⁸⁰ See also, *UCC 2-202, Revised UCC 2-202(1)* applicable to the sale of goods. See, *Etscheit v. Adams* 6 FSM Intrm 365, 385 (Pon 1994) reversed on other grounds 6 FSM Intrm 580 (App 1994) in which the court in denying a motion for summary judgment indicated that the presumption that a written contract or in this case, a release for $5000, is complete on its face and embodies the final and entire agreement between the parties may be rebutted by evidence presented at trial. Id at 384.

⁷⁸¹ Restatement (Second) of Contracts §214
Consistent Collateral Agreements

Restatement (Second) of Contracts §216 permits the admissibility of collateral consistent additional terms or agreements to explain the terms and conditions. Further, collateral agreements which do not impact the essential terms of the agreement are also permissible. Collateral or contemporaneous agreements are also admissible if not so closely connected as to be construed as an essential part of the contract.

In FSM Dev Bank v. Bruton, the court observed that the parol evidence rule bars evidence of a contemporaneous or prior oral agreement that contradicts or alters the terms of the written agreement but permits parol evidence of a collateral agreement that does not alter or contradict the terms of the written agreement and the collateral agreement is one that might naturally be omitted from the writing. The Bruton court further noted that the parol evidence rule does not bar evidence of subsequent modification of the contract. The Bruton case involved an agreement by the FSM Bank to procure credit life insurance for a mortgage loan which was required in the loan documents.

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782 See also, UCC 2-202 (b); Revised UCC 2-202(1) (b) applicable to the sale of goods.
783 UCC 2-202 (b); Revised UCC 2-202(1)(b)
784 Id.
785 7 FSM Intrm 246 (Chk 1995)
786 Id at 250
787 Id at 251. See also Malem v. Kosrae, 9 FSM Intrm 233, 236 (Kos. S. Ct. Tr. 1999) which reach a similar result involving parol evidence and a construction contract involving reinforced concrete foundations for three rainwater catchment tanks at the Malem Elementary School. In Malem, both plaintiff and the defendant were aware that the specifications for the project had changed. There was a contract provision which precluded any changes to the specifications except those in writing signed by both parties. Suit had been brought to enforce the written modification requirement. Aside from any waiver issues, the court observed that the parol evidence rule does not bar evidence of subsequent modification of a contract. Id at 236.
Nearly two years after the original agreement, the bank realized that it had not obtained the credit life insurance and sent the paperwork to the borrowers indicating that they needed to sign the credit life insurance application and that the premium was several hundred dollars less than what they had paid at the time of the agreement. The bank advised the borrowers that the difference would be credited to the loan. The application for insurance was denied because of the bank’s two year delay. In the two year interim, one of the borrowers had died. The bank sued on the outstanding balance and the defendant counterclaimed. The bank tried to preclude any parol evidence regarding the agreement to purchase credit life insurance that was not in writing. The court observed that the reduction in premium and credit was a modification to the original agreement taking it out of the parol evidence exclusion and that the parol evidence rule does not bar evidence of subsequent modification. The measure of damages for the breach of an agreement to procure insurance is the amount of loss that would have been subject to indemnification by the insurer had the insurance been properly obtained.

**Course of Dealing, Performance, or Usage of Trade**

Likewise, extrinsic evidence of course of dealing, usage of trade, and course of performance may also be utilized to explain the ambiguous terms of the agreement circumventing the parol evidence rule.

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788 7 FSM Intrm at 250-1
789 Id at 250.
790 In original UCC 2-202, “course of dealing” or “usage of trade” were defined in UCC 1-205 and course of performance by UCC 2-208. UCC 1-205 has been converted to Revised UCC 1-303 with some changes and additions. Original UCC 1-205 provides:

1. A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct. 2. A usage of trade is any practice or method of
dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court. (3) A course of dealing between parties and any usage of trade in the vocation or trade which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement. (4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade. (5) An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance. (6) Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter.

UCC 2-208 which addresses course of performance or practical construction states:

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement. (2) The express terms of an agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonably consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (section 1-205).

Revised Article 2 proposes that UCC2-208 be eliminated and incorporates the concept of course of performance into Revised UCC 1-303. Revised UCC 1-303 provides:

(a) A “course of performance” is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection. (b) A “course of dealing” is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct. (c) A “usage of trade” is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law. (d) A course of performance or course of dealing between parties or usage of trade in the vocation or trade which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the agreement, may give particular meaning to specific terms of an agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance. (e) Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing or usage of trade must be construed wherever reasonable as consistent with each other. If such a construction is unreasonable: (1) express terms prevail over course of performance, course of dealing and usage of trade and course of dealing controls usage of trade. (2) course of performance prevails over course of dealing and usage of trade; and (3) course of dealing prevails over usage of trade. (f) Subject to Section 2-209, a course of performance is relevant to show a
Subsequent Negotiations

Extrinsic evidence of subsequent negotiations is also admissible since the parol evidence rule is limited to excluding only prior or contemporaneous agreements.

Validity or Contract Formation

Restatement (Second) of Contracts §214 provides that parol evidence is also admissible when attacking the validity or formation of a contract. Extrinsic or parol evidence is admissible to show illegality, fraud, duress, mistake, lack of consideration or other invalidating clause.\(^{791}\)

Parol evidence may also be introduced to show that a condition precedent to contract formation exists. Restatement (Second) of Contracts §217 permits parol evidence to demonstrate that an integrated agreement is subject to an oral requirement of a condition. An example of this last exception would be “I’ll perform the contract if I can raise $60,000.” In this and similar circumstances, parol evidence would be admissible to demonstrate existence of the condition precedent.

To Interpret Ambiguity

As noted previously, Restatement (Second) of Contracts §214 and §216 permit parol evidence of consistent additional terms and prior or contemporaneous agreements to explain ambiguous terms\(^{792}\) and showing true consideration. As it relates to the sale of waiver or modification of any term inconsistent with the course of performance. (g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

\(^{791}\) Restatement (Second) of Contracts §214 (d).

\(^{792}\) See also, Article 4.3 of the UNIDROIT Principles which states in pertinent part that in interpreting contract language including ambiguous language that “regard shall be had to all the circumstances, including…preliminary negotiations between the parties.” Article 4.3 is slightly different than the plain meaning rule in that it does not set forth an initial stage in which extrinsic evidence is to be considered.
goods, a new provision in Revised UCC 2-202(2) does not even require that there be a preliminary finding or determination by the court that the language used in a writing or record is ambiguous and permits the court to utilize course of performance, course of dealing, or usage of trade to explain terms in a writing or record.

As noted by the Palau Supreme Court in Ngiratkel Etpison v Rdialul,\(^\text{793}\) the common law provides that parol evidence can only be introduced where the terms of the contract are ambiguous and may not be introduced to alter or vary a complete, unambiguous sales agreement.\(^\text{794}\)

**Contract Reformation**

Parol evidence can also be utilized by the courts in an effort at reformation. *Restatement (Second) of Contracts* §214(e) indicates that evidence of prior or contemporaneous agreements is admissible to establish grounds “for granting or denying rescission, reformation, specific performance, or other remedy.”\(^\text{795}\) Parol evidence may be offered to show subsequent modifications of written contract. For example, a party may present proof of an antecedent valid agreement that, by mistake, is incorrectly reflected in the subsequent document.

**Parol Evidence and CISG**

*CISG* does not recognize the parol evidence rule and takes an expansive view regarding the admissibility of parol evidence in explaining the contractual terms and relationship between the parties. If the contractual relationship is international between

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\(^{793}\) 2 ROP Intrm 211 (1991)
\(^{794}\) Id at 222.
\(^{795}\) Restatement (Second) of Contracts § 214 (e)
private parties in signatory member nations subject to CISG, there is no ban and parol evidence is admissible under CISG Article 8.\(^796\)

**Statute of Frauds**

The Statute of Frauds is another rule employed to determine proper form and interpretation of contracts and provides that in certain circumstances oral contracts are unenforceable. The intent of the rule is to obviate perjury, avoid faulty memories, and to promote certainty. The Statute of Frauds usually covers a number of different types of agreements. Although this may vary from jurisdiction to jurisdiction depending upon the scope of legislation, promises or agreements generally covered under the statute of frauds include promises made by an executor or administrator, promises to answer for the debt of another, promises in consideration of marriage, interest in land, promises which cannot be performed within one year, and promise to purchase goods priced at $500 or more.

Each jurisdiction in the Northern Pacific Region has adopted some aspects, if not all, of the Statute of Frauds. The Statute of Frauds has been adopted in the Northern

\(^796\) See, for example, *MCC-Marble Ceramic Center, Inc. v Ceramica Nuova d'Agostino, S.p.A.*, 114 F3rd 1384(11th Cir.1998) (no parol evidence rule recognized under CISG) CISG Article 8 provides:

(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.
Contracts Involving the Transfer, Sale or Lease of Real Property

Generally, contracts for the sale or transfer of land must be in writing. Further, promises to transfer an interest or to pay for an interest in land such as leases or easements must also be in writing. This is particularly true for leases or easements longer than a year because of another provision of the statute of frauds that requires contracts that cannot be performed within a year to be in writing in order to be enforceable. An oral lease or easement which is less than a year may be oral.

There are some exceptions to the writing requirements involving real property. For example, if the seller allows the buyer to move onto the property and the buyer makes improvements, the seller is estopped and the statute of frauds may not be asserted as a valid defense. Payment or part performance may also circumvent the statute of frauds to the extent that payment or part performance has been completed. Part performance as it relates to the sale of land would be the possession of land plus either: 1) the addition of valuable improvements, or 2) payment of the purchase price. In either instance, performance or the partial performance would potentially take the contract out of the Statute of Frauds for purpose of specific performance.

797 2 CMC 4912
798 13 GCA 1206
799 HRS 656-1
800 39 PNC 501 et. seq.
801 For example, the State of Pohnpei Statute of Frauds can be found at Pon. S.L. No. 2L-38-80
803 ASCA 27.1530 applies only to the sale of goods requiring that a contract for the sale of goods in excess of $500 be in writing to be enforceable.
In the Republic of Palau, there was no statute of frauds requiring that the sale or transfer of land be in writing until 1977. Consequently, any oral agreements for the sale or transfer of land prior to 1977 which did not conflict with Palauan custom or tradition were enforceable. Since 1977, however, Palau has required that promises involving an interest in land, like joint tenancy, tenants in common, etc… must be in writing consistent with the Palau Statute of Frauds. Contracts such as leaseholds under one (1) year may not be subject to the statute.

In addition to the sale, lease and transfer of land, the Palau Statute of Frauds tracks many aspects of the common law requiring a writing for an agreement that cannot be performed within a year; a special promise to answer for the debt, default, or misdoing of another; agreements made in consideration of marriage; and special promises made by an executor to answer damages out of his own estate.

The Palau Supreme Court addressed the statute of frauds requirement as it relates to the sale, transfer or lease of land in Arbedul v. Iderbei Lineage, where the defendant purchased 675 square meters of property for $1500 in April 1992 from the Iderbei Lineage, with Rose Kebekol acting as trustee. Kebekol signed a warranty deed in exchange for the $1500 but in February 1993 met with the defendant asking him to rescind the earlier deed in exchange for return of his $1500. In February 1993, the defendant signed a document indicating the land was to be returned and acknowledged

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804 See Palau’s version of the Statute of Frauds found at PPL 6-3-2. The Palau Statute of Frauds adopted in public law, PPL 6-3-2, can be found at 39 PNC 501 et seq. Andreas v. Masami, 5 ROP Intrm 205,206 (1996)
805 Ngiralo v. Faustino, 6 ROP Interm 259 (1997)
806 39 PNC 501 et. seq.
807 See, 39 PNC 504
808 7 ROP Intrm 53 (1998)
receipt of the $1500 which he then deposited. When Arbedul disavowed the February 1993 agreement and filed the April 1992 deed in November 1994, George Kebekol, a son of Rose Kebekol, filed suit to quiet title in the Lineage and to set aside the April 1992 deed. Defendant Arbedul claimed that any oral agreement he had with Rose Kebekol to rescind did not meet the Statute of Frauds which presumed that the February 1993 agreement to rescind the warranty deed was not valid because it was merely a receipt for money and not an exchange of money in return for the property.\textsuperscript{809} The court rejected this argument finding the February 1993 met the statute of frauds requirements, that there was a valid contract in which an offer to rescind was extend, and that it was supported by the exchange of valuable consideration of $1500.\textsuperscript{810} To the extent there was any ambiguity in the contract which would permit examination of extrinsic evidence,\textsuperscript{811} the Supreme Court agreed with the trial court’s determination that credible extrinsic evidence also suggested that defendant appellant understood the agreement and its purpose contrary to his assertions in this case.\textsuperscript{812}

As it relates to the sale of lease of land, the Statute of Frauds was addressed in the Commonwealth of the Northern Mariana Islands in Eurotex Inc. v. Muna.\textsuperscript{813} In Muna, the lessee was assigned all the rights of a lease contract which had an option to lease the remainder of the parcel. On appeal, the Muna court held that the lessee was entitled to

\textsuperscript{809}Id at 54-5
\textsuperscript{810}Id at 55. The court cited Kamiishi v Han Pa Constr. Co. 4 ROP Intrm 37,40-41(1993) which discussed the elements of contract formation, the interrelationship between offer, acceptance and mutual assent, and that a person’s secret intent is irrelevant.
\textsuperscript{811}For this proposition, the Palau Supreme Court relied upon Etpison v. Rdialul, 2 ROP Intrm 211, 217 (1991).
\textsuperscript{812}7 ROP Intrm at 55, fn.4
\textsuperscript{813}4 N. Mar. I 280 (N. Mar. I 1995)
summary judgment and specific performance on the option. The lessee had presented the
signed lease. Additionally, the lessee presented proof that it had paid rent for the leased
property and the option property as consideration for the option. The lessee also
presented proof that the lessor had accepted the consideration and proof that it had taken
possession of the option property and built improvements on it. The court held that the
lessor was unable to controvert the evidence presented by the lessee and only presented
conclusory unsupported factual allegations in response. The court concluded that the
lessee was entitled to specific performance because it had complied with the terms of the
option agreement. The lessor contended that the verbal acceptance of the option was
barred by the Statute of Frauds. However, the court concluded that the lessee’s verbal
acceptance was sufficient to exercise the option where the original lease was in writing
and did not establish the manner of acceptance for the option and where the parties had
agreed on a rent figure for the property covered by the option.

In In re Guerrero, the Guam Supreme Court recently addressed the statute of
frauds and a number of other issues in case involving a land dispute over boundaries. As
it relates to the Guam Statute of Frauds, the court cited the statute and observed: “This
immense area necessitates a finding that Look seeks much more than a mere boundary
adjustment and that such a claim would amount to an oral conveyance of real property,
which is of course prohibited by law.”

814 2001 Guam 22 (Guam Sup. Ct. 2001)
815 Id at 26.
In Micronesia, the State of Pohnpei is the only jurisdiction that has adopted the Statute of Frauds. Yap and Kosrae does not have an equivalent to the Statue of Frauds in their State codes. Customary or traditional law and the strong tradition of binding oral agreements conflict with the concept of the Statute of Frauds in Chuuk and, consequently, the Statute of Frauds has been explicitly rejected in that jurisdiction. In *Marcus v. Truk Trading Corp.*, the court observed:

> There is no statute of frauds – a law requiring that certain agreements or contracts to be in writing be fore they are enforceable in court- in Chuuk. Customarily, any agreement, even that selling land, might be oral.

In *Marcus*, the court found that the absence of written authorization or power of attorney was not fatal to the defendant’s contention that those who signed the lease on the Wito clan’s behalf had authority to do so.

Although some jurisdictions may have the Statute of Frauds as it relates to contracts for the sale, lease or transfer of land and others may not, the Torrens Land Registration System inherited from the Trust Territory applicable in each Micronesian state (Kosrae, Pohnpei, Chuuk and Yap) and previously applied in Palau, the Marshalls, CNMI, and Guam may, although it is unsettled, require a writing to transfer title to land for which a certificate of title had been issued which would be in addition to any requirements of the Statute of Frauds.

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816 Pon, S.L. No. 2L-38-80
817 10 FSM Intrm 387 (Chk 2001)
818 Id at 389.
819 67 TTC 119
**Promise To Pay Debts of An Estate**

As a general rule, the Statute of Frauds requires the promises made by an executor or administrator to pay debts out of the estate must be in writing.821 Promises by the executor or administrator to pay the debts or obligations of an estate out of the executor’s own pocket is comparable to the concept of paying the debt of another and treated similarly.

**Promise To Pay Debt of Another**

If one promises to pay or to answer for the debt or default of another, it must also be in writing under the Statute of Frauds in order to be enforceable.822 In addition to the writing requirement, the promise by one party to pay the debt of a second party must be made to the creditor. If the second party does not pay and is in default, the creditor may then enforce those written promises made by one party to the creditor in which it was agreed that the one party would pay the debts of another.

There are two situations involving surety agreements in which the statute of frauds may be a defense: first, where there is no prior obligation owing from the third party to creditor to which the debtor’s original promise relates and a principal-surety relationship exists between the third party and the debtor with the knowledge of the creditor, and second, those situations where there is a prior obligation owing from the third party to the creditor related to debtor’s original promise. In both of these instances, such promises are collateral and the statute of frauds provides a defense.

As far as answering for the debt of another, the primary or lead purpose test applies and it must not be a collateral promise. If the lead or primary purpose of the

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821 See for example, 39 PNC 504.
822 See for example, 39 PNC 504
promise is to serve the benefit of the promisor and confers a benefit that the promisor did not previously enjoy and not to the other, then the statute of frauds is inapplicable and an oral promise is enforceable.

Promises or contracts to indemnify do not create a surety relationship and are an exception not within the scope of the statute of frauds. A promise by an assignor to the assignee that guarantees performance by the obligor is an original promise that is enforceable and is also an exception not within the statute of frauds. Lastly, a promise to purchase a claim is also not within the statute and is enforceable.

Promises In Consideration of Marriage
Promises in consideration or contemplation of marriage except for mutual promises to marry must also be in writing.\(^ {823} \) The statute of frauds does not apply to mutual promises to marry but is focused primarily upon marriage settlements, pre-nuptial and ante-nuptial agreements. The statute of frauds applies even if a third party makes the promise. If the promise is not made in contemplation of marriage or if marriage is incidental to the contract, the statute of frauds does not apply. The fact that the marriage has already taken place does not take the contract outside the statute of frauds. However, in that particular instance, to avoid any challenges to contract formation or arguments of pre-existing legal duty additional performance or consideration may be required in order to make the contract enforceable.

Promises to Perform Within One Year
A promise which by its terms cannot be performed within a year from the date of contract is also required to be in writing under the statute of frauds in order to be enforceable.

\(^ {823} \) See for example, 39 PNC 504
enforceable.\textsuperscript{824} The focus of the court is on performance and not upon termination. The year runs from the effective date of the agreement, not the date of performance.

The agreement does not fall within the statute if it is possible to fully perform the contract within one (1) year or if either may rightfully terminate within a year. If the contract could have been performed within one year, then the statute of frauds does not apply. Courts have also been known to engage in efforts to demonstrate that the contract even though it was for a period in excess of one year could have been performed within one year in order to defeat this particular requirement.

The statute of frauds applies to bilateral contracts but unilateral contracts requiring the promisee to perform for more than one year are not subject to the statute of frauds because a unilateral contract, even for a term in excess of one year, is not formed until full performance has been completed. An additional exception can be found in \textit{Revised UCC} 2-201(4) submitted to the American Law Institute for consideration in May 2003 which provides for an exemption from this particular rule as it applies only to the sale of goods.\textsuperscript{825}

In a Micronesian case, \textit{Ponape Construction v. Pohnpei},\textsuperscript{826} the State of Pohnpei asserted the defense that a contract it had with plaintiff was unenforceable because it was not in writing as required by the Statute of Frauds and was a contract to be performed in excess of one year. The \textit{Ponape Construction} case involved emergency repairs to the Dekehtik causeway.

\textsuperscript{824} See for example, 39 PNC 504; Pon. S.L. No. 2L-38-80.
\textsuperscript{825} \textit{Revised UCC} 2-201(4) states: “A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.”
\textsuperscript{826} 6 FSM Intrm 114 (Pon. 1993), aff’d 7 FSM Intrm 613 (App. 1996)
The State argued in a motion to dismiss the day before trial that the oral agreement to repair the causeway and to dredge coral was unenforceable in that it failed to comply with the Statute of Frauds. The State argued that the Pohnpei State Statute of Frauds\textsuperscript{827} requires that certain contracts, particularly contracts to be performed for more than a year, be in writing or ascertainable from written memoranda. After trial, the state made a motion to amend its answer to include the statute of frauds defense to conform to the proofs. The trial court rejected this defense offered by the State as being untimely the day before trial and, after the trial, indicated that the issue was not raised or tried with implied consent of the parties and denied the motion to amend to conform with the proofs.\textsuperscript{828}

The FSM Supreme Court indicated that the trial court was incorrect but, nonetheless, found that the evidence presented at trial indicated that the agreement was in compliance with the Statute of Frauds. The FSM Supreme Court observed:

In applying the Statute of Frauds, written memoranda are required not in order to make a contract but to provided written evidence that a contract has been made….Generally, a memorandum in writing meets the requirements of a statute of frauds if it contains the names of the parties, the terms and conditions of the contract, and a reasonable description of the subject of the contract, and is signed by the party or an agent of the party to be charged…. The memorandum need not state the particulars of the contract so long as its substance or essential terms are stated…. The memorandum need not be a single document, but may be pieced together out of separate writings, including writings referred to in the memorandum….\textsuperscript{829}

The FSM Supreme Court considered six pieces of correspondence exchanged between the parties that were part of the trial court record to be sufficient memoranda to

\textsuperscript{827} Pon S.L. No. 2L-38-80.
\textsuperscript{828} 6 FSM Intrm at 120-1; 7 FSM Intrm at 619
\textsuperscript{829} Id at 620. Citations and footnotes omitted.
satisfy the Pohnpei Statute of Frauds and affirmed on different grounds the decision originally reached by the trial court.\(^{830}\)

**Sale of Goods in excess of $500**

The sale of goods costing more than $500 or more\(^{831}\) is also generally covered by the Statute of Frauds and must be in writing in order to be enforceable.\(^{832}\) Some jurisdictions like Guam\(^{833}\) and the *Revised UCC* 2-201 have raised this threshold amount to $5000.\(^{834}\) Goods are defined in general as tangible, moveable property. Contracts for the sale of goods valued at $500 or more\(^{835}\) is particularly addressed by *UCC* 2-201.\(^{836}\)

\(^{830}\) Id at 620

\(^{831}\) This threshold amount has been increased in *Revised UCC* 2-201 to $5000.

\(^{832}\) In addition to *UCC* 2-201, see 39 PNC 501 et seq. (Palau); 23 MIRC Cap. 1 §6(1) (Marshall Islands); ASCA 27.1530 (American Samoa); 2 CMC 4912 (CNMI); 13 GCA 1206 (Guam); HRS 656-1 (Hawaii)

\(^{833}\) 13 GCA §1206

\(^{834}\) The rationale for this change is that the $500 threshold of yesterday is the $5000 threshold of today when inflationary factors are considered.

\(^{835}\) *Revised UCC* 2-201 raises this amount to $5000

\(^{836}\) *UCC* 2-201 provides:

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing. (2) Between merchants if within a reasonable time a writing in conformation of the contract and sufficient against the sender is received and the party receiving it has reason to know if its contents, it satisfies the requirements of subsection (1) against such a party unless written notice of objection to its contents is given within 10 days after it is received. (3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable (a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller’s business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or (b) if the party against which enforcement is sought admits in his pleadings, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this paragraph beyond the quantity of goods admitted; or (c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).

*Revised UCC* 2-201 submitted to the American Law Institute in May 2003 makes several significant changes including raising the dollar threshold to $5000, eliminating the “in court” requirement, addressing contracts to be performed within one year, and substituting the word “record” for the word “writing” to
Similarly, in the Marshall Islands the Sale of Goods Act provides:

A contract for the sale of goods shall not be enforceable by action unless the buyer shall accept part of the goods so sold, and actually receive the same, or pay the price or part thereof, or unless some note or memorandum in writing of the contract be made and signed by the party to be charged or his agent in that behalf.837

As noted in case law, by the UCC, and by the Marshall Islands Statute of Frauds, there are a number of exceptions to the writing requirement of the Statute of Frauds as it relates to the sale of goods. Those exceptions are: 1) specially manufactured goods, 2) estoppel by pleading or by testimony, and 3) where there has been payment or part performance as to goods accepted.

address e-commerce issues. See also, UNCITRAL Model for E-Commerce, Article 6, § 1 which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.” Revised UCC 2-201 states:

(1) A contract for the sale of goods for the price of $5000 or more is not enforceable by way of action or defense unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A record is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in the record. (2) Between merchants if within a reasonable time a record in conformation of the contract and sufficient against the sender is received and the party receiving it has reason to know if its contents, it satisfies the requirements of subsection (1) against such a party unless notice of objection to its contents is given in a record within 10 days after it is received. (3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable (a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller’s business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or (b) if the party against which enforcement is sought admits in the party’s pleadings, or in the party’s testimony or otherwise under oath that a contract for sale was made, but the contract is not enforceable under this paragraph beyond the quantity of goods admitted; or (c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606). (4) A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.

If the product is a specially manufactured good, it must also not suitable for sale to others. The second exception provides for payment and enforceability in those instances where there is an admission by a party in a court proceeding or in legal pleadings that a contract for the sale of goods was formed.

There is also an exception where there has been payment or part or full performance despite the absence of a writing. Part performance as it relates to the sale of goods is part payment or acceptance and receipt of part of the goods. An example of this third exception would be where $1000 of $10,000 for a contract for the sale of goods has already been paid. In that instance, the contract is taken outside of the Statute of Frauds to the extent there has been part payment or partial acceptance and receipt of the goods.

In regard to a contract for sale of goods, the UCC and Section 27.1531 of the Commercial Code of American Samoa provide for a “confirmatory memorandum rule or exception.” If the original offer or agreement is oral and a confirming memorandum is sent confirming the terms, the party has 10 days in which to object to the content of the confirming memorandum. Generally, the “confirmatory memorandum rule” satisfies the requirements of the Statute of Frauds.

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838 UCC 2-202(3)(a); Revised UCC 2-202(3)(a). Even though American Samoa has not adopted the UCC, see also ASCA 27.1532 which provides the same three exceptions for the sale of goods in that jurisdiction.
839 UCC 2-202(3)(b); Revised UCC 2-202(3)(b)
840 UCC 2-202(3)(c); Revised UCC 2-202(3)(c)
841 UCC 2-201(2); Revised UCC 2-201(2) provides for a confirmatory “record.” See also ASCA 27.1531
842 Id. Even though American Samoa has not adopted the UCC, it has adopted the confirmatory memorandum rule in ASCA 27.1531
Detrimental Reliance and the Statute of Frauds

The common law recognizes that detrimental reliance or promissory estoppel may circumvent the Statute of Frauds only as it relates to real property. There is a developing and currently a minority trend that expands promissory estoppel as a defense to the statute of frauds in all circumstances.

The Restatement (Second) of Contracts §139 indicates that if the elements of promissory estoppel are present, the promise should be enforced even if the promise is oral. The concern, however, is that such a broad application of this estoppel exception would quickly swallow the rule and undermine the public policy concern of the statute of frauds that requires all significant agreements be memorialized in a writing or record.

The Republic of Palau has recognized the detrimental reliance exception to the Statute of Frauds in Metes v. Airai State. Plaintiff relied on representations by an Airai State employee that he had certain property rights in the subject land and as a result Plaintiff purchased building materials and began to build a house on the land. He was then advised that the Governor owned the land he was building on and was ordered to stop construction. He filed suit immediately to determine his interest in the property and sought an expedited decision because his house was only half built and subject to the natural elements. The defendants moved for summary judgment claiming, in pertinent part, that the Statute of Frauds which Palau adopted in 1977 precluded the plaintiff from proceeding because there was no evidence that the alleged lease between Plaintiff

843 Restatement (Second) of Contracts §139
844 1 ROP Intrm 261 (Tr. Div 1985)
845 PPL 6-3-2; 39 PNC 501 et. seq.
and the State of Airai was ever executed. The trial court observed that the critical issue in this case was:

[W]hether reliance by plaintiff on the validity of the alleged leasehold estops the defendant from denying plaintiff’s requested relief. It is not the legality of the grant that is at issue here but rather plaintiff’s reliance thereupon. Accordingly, and for the purpose of this Motion only the court finds that the Statute of Frauds (PPL 6-3-2) does not preclude the plaintiff from seeking relief before this Court and Denies the Motion on that ground. 847

**General Requirements Regarding Sufficiency of the Writing**

Under *Restatement (Second) of Contracts* § 131, *UCC* 2-201, and the common law, the writing requirements of the Statute of Frauds mandate that all essential terms be included in the writing and that the writing must include: 1) the identity of the parties sought to be charged, 2) identification of the contract’s subject matter, 3) essential terms and conditions of agreement, 4) recital of consideration, and 5) the signature of the party to be charged or his agent. 848 Other *UCC* provisions in addition to *UCC* 2-201 contain similar writing requirements. For example, *UCC* 1-206 requires a writing signed by a party to be charged if there is an assignment of, or promise to assign, general intangibles such as patents, royalties, or certain bilateral contract rights and the amount sought to be

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846 1 ROP Intrm at 262  
847 Id at 262-3  
848 *Restatement (Second) of Contracts* §131. As e-commerce develops the signature requirement may also include electronic signatures that comply with the requirements of UNCITRAL Model for E-Commerce, *Article 7*, §1 which provides:

(1) Where the law requires a signature of a person, that requirement is met in relation to data message if:  
   a. a method is used to identify that person and to indicate that person’s approval of information contained in the data message; and  
   b. that method is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

See also, the *UNCITRAL Model for Electronic Signatures* (2001) which expands upon *Article 7* and establishes a presumption that electronic signatures that meet certain criteria shall be treated the same as handwritten signatures.
enforced is in excess of $5000. Similarly, UCC 9-203 requires a debtor sign a security agreement that contains a description of the collateral or land involved.

Contracts may be made and signed by a party’s agent as long as the agent was acting within the scope of their authority or apparent scope of their authority.849

Further, the courts may not require that all essential terms be in one writing and, as noted in Ponape Const. v. Pohnpet,850 the essential terms can be contained in several writings.

Inclusion of essential elements and compliance with the Statute of Frauds is not quite as stringent for the sale of goods under UCC 2-201 as it is under the common law. Under UCC 2-201, the quantity and signature of the party to be charged are the primary requirements for compliance with the Statute of Frauds. Because of the other “gap” filling provisions of the Uniform Commercial Code, other essential terms can be supplied or implied. The signature requirement may not even be an essential term under the UCC if the contract of sale is between merchants and there is written confirmation of the

849 See Asher v. Kosrae, 8 FSM Intrm 443 (Kos. S. S. Ct. Tr. 1998) which was a tort case addressing express contractual indemnification and successor corporate liability. In Asher, an 8 year old sustained injuries to his eye when he ran into an electrical guy wire installed by the State of Kosrae. Before the incident at issue, the State of Kosrae had transferred all assets and liability to Kosrae Utility Agency (KUA). The Asher court found the State negligent for the injury sustained by the plaintiff and the State sought express contractual indemnification from KUA. Id at 451. The KUA claimed that its general manager did not have authority to sign the transfer agreement and that its board of directors never ratified the agreement. The court rejected KUA’s argument indicating an officer’s authority to contract for a corporation may be actual or apparent and may result for the officer’s conduct or corporate acquiescence particularly if the corporation accepts the benefits of the contract. Id at 452. Further, a corporation may impliedly ratify an alleged unauthorized act or contract by receiving and retaining the benefits of the contract and ratification need not be a formal board vote or corporate resolution. Id at 452-3. In order to avoid liability, a corporation needs to act promptly to rescind or revoke an alleged unauthorized transaction. Id at 453. A corporation may not accept benefits of a contract and then seek to escape liability claiming that the transaction was not authorized. Id at 452-3. Consequently, where the agreement’s indemnification provision is clear and KUA agreed to accept liability for causes of action and other claims, the KUA is liable to indemnify the State of Kosrae for tort damages attributable to State’s negligence. Id at 453.

850 6 FSM Intrm 114 (Pon. 1993) affirmed 7 FSM Intrm 612 (App. 1996)
contract with a quantity term specified or if upon receipt, the party to be charged does not object within 10 days. The Commercial Code of Samoa contains a similar provision.

Statute of Frauds: Modern Trends

Despite judicial erosion, the Statute of Frauds continues to remain intact, as a formal requirement for certain contracts in the United States.\(^{851}\) There has been an international effort to limit or abolish such formalities. For example, in 1954 the United Kingdom repealed all sections except for those provisions relating to promises to answer for the debts of another (surety contracts) and contracts for the sale of land.\(^{852}\) Similarly, \textit{CISG Article} 11 provides: “A contract for sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form.”

Statute of Frauds: Clash with Customary Law

Pohnpei is the only Micronesian state to have adopted a statute of frauds. Yap and Kosrae have codified their laws and there is no statute of frauds included. Chuuk has expressly rejected the statute of frauds as being inconsistent with customary and traditional law. In \textit{Marcus v. Truk Trading}\(^{853}\) the court observed:

There is no statute of frauds—a law requiring that certain agreements or contracts to be in writing before they are enforceable in court—exist in Chuuk. Customarily, any agreement, even that selling land, might be oral.\(^{854}\)

The \textit{Marcus} court found that the absence of written authorization or power of attorney was not fatal to the defendant’s contention that those who signed the lease on the Wito clan’s behalf had authority to do so.

\(^{851}\) Braucher, \textit{The Commission and the Law of Contracts}, 40 Cornell L.Q. 696, 705 (1955) observes that “a cautious approach to the Statute of Frauds seems to be in harmony with American professional opinion.”

\(^{852}\) Law Reform (Enforcement of Contracts) Act, 1954, 2 & 3 Eliz. II, c.34

\(^{853}\) 10 FSM Intrm 387 (Chk 2001)

\(^{854}\) Id at 389.
Ngeremlengui State Council of Chiefs v Ngeremlengui Gov’t, is a Palau Supreme Court case in which there is an conflict between status based rights recognized under traditional or customary law and the substantive contract law within the context of a dispute regarding the Statute of Frauds. It is also an excellent example of what Henry Maine described in Ancient Law as a society moving “from Status to Contract.”

In Ngeremlengui, the Governor entered into a memorandum of agreement (MOA) and joint venture agreement (JVA) in the mid 1990’s with Palau Organic Farms regarding the use of 400 hectares of public land. In 1998, the Council of Chiefs sued claiming that the agreement and joint venture were invalid because they were executed without the involvement of the Ngeremlengui State Public Lands Authority (NSPLA) and without the knowledge, consultation or consent of the Council of Chiefs. While the case was pending, the state legislature passed a bill directing the NSPLA to ratify the agreement and joint venture. A dispute arose between the English language and Palauan version of the Palau Constitution. The Chiefs claimed that the English version of Ngeremlengui Constitution, Article VIII, Section 3(b) requires the Council of Chiefs “to provide advice and consent on bills dealing with traditional matters or subjects dealing with the use of land and territorial waters for state projects, before approval by the Governor.” The Chiefs asserted that this interpretation of the Constitution is anthropologically consistent with Palauan traditional or customary law which requires that senior strong or ochell members of the clan approve any transfer, sale or lease of any

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855 8 ROP Intrm 178 (2000)
857 The Ngeremlengui State Council of Chiefs is a branch of the Ngeremlengui government and consists of the four Uong, the highest ranking chiefs in Ngeremlengui, and the four hamlet chiefs. Id at 178, fn1
The court observed that the Palauan language version of Section 3(b), however, does not contain the Palauan equivalent of the word “consent” but utilizes the Palauan word equivalent to “thought about” or “take into consideration.” The court also noted that the State Constitution provides that where there is a conflict between English and Palauan versions of the Constitution, the Palauan version prevails. In this instance, the Court rejected what the Council of Chiefs claimed was Palauan traditional or customary law as a useful interpretive device in assessing the meaning of the constitution and concluded contrary to what the Chiefs claimed to be the traditional law. The court concluded that “the Palauan version of section 3(b) indicates that the framers of the state constitution intended the Council not to have a right of consent over the disposition of public lands.”

The Ngeremlengui decision raises a second significant anthropological issue. Although they were not a party to the agreement and lacked privity, the Council of Chiefs was asserting group rights in a third party capacity based on status which is acceptable under customary or traditional law but contrary to the common law of contract which requires privity of contract. The Ngeremlengui court applied the Anglo-American rule of law as opposed to purported customary law observing:

The Council contends that the MOA and JVA are invalid because they violate the statute of frauds in that they purport to lease land to the Palau Organic Farms without requiring the execution of a written lease. The statute of frauds can only be asserted as a defense to enforcement of contract by a party who is sought to be charged thereon and his privies….Not a party to the agreements, the Council lacks

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858 See, for example, Ngiraloi v. Faustino, 6 ROP Intrm 259 (1997); Obak v. Ikelau Bandarii, 7 ROP Intrm 254 (Tr. Div. 1998); and Ngirumerang v. Francisco Gibbons, - ROP – (October 17, 2003) which all discuss the customary law tradition of ochell approval.
standing to assert the Statute of Frauds as a ground for invalidating the MOA and the JVA.\textsuperscript{859}

Consequently, the appellate court reversed the trial court’s grant of summary judgment for the defendants because the legislature did not have authority to ratify the MOA and JVA and affirmed the trial court’s denial of the Council of Chief’s motion for summary judgment because the Governor was not required to get the Chiefs consent.\textsuperscript{860}

\textbf{Failure to Comply with Statute of Frauds}

If a contract is within the Statute of Frauds and is not in writing it is voidable with limited remedies available under traditional contract law. Non-compliance renders any contract, agreement or record unenforceable against a party properly asserting the Statute of Frauds as a defense. However, remedies are also available in equity such as quantum meruit or unjust enrichment for voided contracts under the Statute of Frauds. \textit{Restatement (Second) of Contract} §141 addresses what is classifies as “an action for value of performance” for a contract voided and deemed unenforceable under the Statute of Frauds.\textsuperscript{861}

\textsuperscript{859} 8 ROP Intrm at 182 (Citations omitted)
\textsuperscript{860} Id.
\textsuperscript{861} Restatement (Second) of Contracts §141
PART VI: CONDITIONS, DUTY TO PERFORM AND BREACH

Restatement (Second) of Contracts §224 defines a condition as “an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.” Whether a provision may be interpreted as either a promise or condition is an important distinction in basic contract interpretation. There is a distinction between a promise and a condition. A breach of promise or contract gives rise to a claim for damages. The occurrence or nonoccurrence of a condition either gives rise to a duty to perform or discharges a duty to perform.862 Liability for breach of contract applies to breaches of promises and not to failures of a condition. A failure of condition, however, can also lead to a breach of promise or contract if the promisee has promised or undertaken a duty to perform the condition.

When assessing whether a provision is a condition or promise, courts will focus on the words of the agreement, prior practice between the parties, custom or tradition, and the party that is to perform. Courts prefer to construe provisions as creating a promise rather than a condition in doubtful situations where intent cannot be determined.863 Restatement (Second) of Contracts §229 indicates a court may even “excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange.”864

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862 See, for example, Panuelo v Pepsi Cola Bottling Co. of Guam, 5 FSM Intrm 123, 127 (Pon. 1991)
863 See for example, Restatement (Second) of Contracts §227 which sets forth standards of preference with regard to conditions.
864 Restatement (Second) of Contracts § 229
Conditions

Conditions are classified or categorized in two ways. One way in which conditions are categorized is according to time of occurrence: 1) precedent, 2) concurrent, or 3) subsequent. Another way conditions may be categorized is based on the manner in which they are created. Using this second method, conditions are categorized as either: 1) express, 2) implied in fact, or 3) constructive.

The Restatement (Second) of Contracts §224 defines a “condition” as “an event, not certain to occur, which must occur, unless occurrence is excused, before performance under a contract becomes due.”865 Practically speaking, a condition is an event, other than the passage of time, which if it occurs or does not occur will create, limit, or extinguish the duty to perform by the other party to the contract. Restatement (Second) of Contracts §225 provides that performance of a conditional duty cannot arise unless the condition occurs or its non-occurrence is excused.866 Non-occurrence of a condition discharges the duty when the condition cannot occur unless it has been excused.867 Non-occurrence of a condition is not a breach of contract by a party unless the party is under a duty requiring or has promised that condition to occur.868 In that instance, the failure of the condition to occur would also constitute a breach of contract.

As noted in ROP v. Toribiong,869 under the common law, conditions to contracts were not favored because they could result in or had the effect of creating

865 Restatement (Second) of Contracts, §224
866 Restatement (Second) of Contracts §225(1)
867 Restatement (Second) of Contracts §225(2)
868 Restatement (Second) of Contracts §225(3)
869 2 ROP Intrm 43 (1990)
forfeiture. Palau courts, like others, will not construe terms in a contract as a condition unless an intention to create a condition appears “by plain and unambiguous language or by necessary implication.” Other jurisdictions will employ reasonable construction of the language used and consider that language in light of all the surrounding circumstances to determine the intention of the parties and whether or not language in a contract creates a condition.

Similarly, in Federated Shipping v. Ponape Transfer and Storage, the FSM trial court noted:

Conditions to contracts are not favored in the common law because they tend to have the effect of creating forfeitures. In some jurisdictions, courts will not construe terms in a contract as a condition unless an intention to create a condition appears ‘by plain and unambiguous language or by necessary implication.’ Alternatively, the Federated Shipping court observed:

In other jurisdictions, whether or not the language in a contract creates a condition depends on the intention of the parties, to be ascertained from reasonable construction of the language used, considered in light of the surrounding circumstances.

Under either approach, the Federated Shipping court found the stevedore agreement did not contain the conditions alleged.

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870 See, ROP v. Toribiong, 2 ROP Intrm 43, 48 (1990). See, Restatement (Second) of Contracts §227(1) which states: “In resolving doubts as to whether an event is made a condition of an obligor’s duty, and as to the nature of such an event, an interpretation is preferred that will reduce the obligee’s risk of forfeiture, unless the event is within the obligee’s control or the circumstances indicate that he has assumed the risk.” Id at 48.
871 Id. Whether both standards were employed, the Palau Supreme Court determined in ROP v. Toribiong that the agreement regarding transfer of airport land was not conditional upon the land being transferred to the Airai State Public Land Authority. Id at 49.
872 4 FSM Intrm 3 (Pon. 1989)
873 4 FSM Intrm 3 (Pon. 1989)
874 Id at 10
875 Id.
876 Id. See also, Panuelo v. Pepsi Cola Bottling Co. of Guam, 5 FSM Intrm 123, 127 (Pon 1991) which adopted a similar analysis in analyzing an oral installment agreement to provide Pepsi. Where the
Restatement (Second) of Contracts §227 provides additional standards of preference to courts to aid in interpretation:

(2) Unless the contract is of a type under which only one party generally undertakes duties, when it is doubtful whether
   (a) a duty is imposed on an obligee that an event occur, or
   (b) the event is made a condition of the obligor’s duty, or
(c) the event is made a condition of the obligor’s duty and a duty is imposed on the obligee that the event occur, the first interpretation is preferred if the event is within the obligee’s control.

(3) In case of doubt, an interpretation under which an event is a condition of an obligor’s duty is preferred over an interpretation under which the non-occurrence of the event is a ground for discharge of that duty after it has become a duty to perform. 877

Section 3 of the Sale of Goods Act of 1986 in the Marshall Islands discusses the conditional nature of agreements or contracts of sale. 878 Section 3(2) observes that “a contract of sale may be absolute or conditional.” 879 Section 3(3) and Section 3(4) state:

(3) Where under a contract of sale the title in the goods is transferred from the seller to the buyer the contract is called ‘a sale’, but where the transfer of the title in the goods is to take place at a future time, or subject to some condition thereafter to be fulfilled, the contract is called an ‘agreement to sell’.
(4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the title in the goods is to be transferred. 880

A term amounts to a condition depending upon the objective intention of the parties at the time the contract is made. It is not determinative that a term is designated as “condition” or the contract describes term as a “condition.” The focus is not on the

agreement was not in writing and there was no other manifestation of intent that time was of the essence or that the goods were to arrive in a good condition, the buyer’s obligation to accept shipments was not conditional freeing the plaintiff from a duty to perform but a breach of a promise which gives rise to damages. Id at 127-8. See also, Kihara v. Nanpei, 5 FSM Intrm 342, 344 (Pon. 1992) which was a bond of debt case in which defendant Nanpei agreed to repay a $50,000 loan to plaintiff Kihara. The court rejected defendant’s argument that a contract regarding the Ant Atoll was a condition precedent to repayment. Id at 345. The trial court decision was affirmed in Nanpei v Kihara, 7 FSM Intrm 319 (App. 1995).

877 Restatement (Second of Contracts §227
878 Sale of Goods Act 1986 23 MIRC Cap 1, § 3
879 Sale of Goods Act of 1986,23 MIRC Cap 1, § 3(2)
880 Sale of Goods Act of 1986, 23 MIRC Cap 1, § 3(3) and § 3(4)
designation of the term but upon the objective intent of the parties and what contractually results if the event occurs or does not occur.

In a sale of goods, a stipulation may be a “condition” though called a warranty in the contract. This position has been adopted in the Sale of Goods Act in the Marshall Islands.\textsuperscript{881} Section 13 of the Sale of Goods Act of 1986 provides:

\begin{quote}
(2) Whether a stipulation in a contract of sale is a condition (the breach of which may give rise to a right to treat the contract as repudiated) or a warranty (the breach of which may give rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated) depends on each case on construction of the contract. A stipulation may be a condition though called a warranty in the contract.\textsuperscript{882}
\end{quote}

Further, “time of the essence” clauses are sometimes referred to as “conditions.”

The general rule is that time of the essence clauses are not interpreted as conditions but as a contract term like any others in an agreement between the parties. The Sale of Goods Act in the Marshall Islands clarifies that such clauses are simply a contract term and not a condition in the traditional sense.\textsuperscript{883} Section 12 of the Sale of Goods Act of 1986 states:

\begin{quote}
Unless a different intention appears from the terms of the contract, stipulations as to time are not deemed to be of the essence of a contract of sale. Whether there is any other stipulation whether or not time is of the essence depends on the terms of the contract.\textsuperscript{884}
\end{quote}

The Micronesian court reached a similar conclusion in \textit{Panuelo v. Pepsi Cola Bottling Co. of Guam}.\textsuperscript{885} The \textit{Panuelo} court was asked to address an oral installment agreement between the parties in which the defendant was to provide two shipping containers of Pepsi to plaintiff on a monthly basis. The relationship between the parties

\textsuperscript{881} Sale of Goods Act 1986, 23 MIRC Cap. 1, § 13
\textsuperscript{882} Sale of Goods Act 1986, 23 MIRC Cap. 1, § 13 (2)
\textsuperscript{883} Sale of Goods Act 1986 23 MIRC, Cap 1, §12.
\textsuperscript{884} Sale of Goods Act 1986, 23 MIRC Cap. 1, §12(1).
\textsuperscript{885} 5 FSM Intrm123 (Pon 1991)
deteriorated when a shipment arrived “late” and contained one bad container unfit for human consumption. When the next shipment of two containers arrived, the plaintiff refused to pick them up from the dock and indicated to defendant that it should get a credit for the prior shipment. When the defendant failed to respond, the shipment sat on the dock and two containers spoiled. As to the “time is of the essence” issue, the Panuelo court indicated that in order to avoid forfeiture and for other policy reasons that “courts generally interpret an act or event specified in a contract as a promise, rather than as a condition to further performance.” Consequently, the Panuelo court concluded that delivery of a bad container should not be considered a further obligation under the contract where time of delivery is not of the essence and the contract is flexible regarding time of delivery. Specifically, the Panuelo court observed:

Nor does the nature of the standing order arrangement necessarily imply that the parties regarded time of delivery to be of the essence. The standing order apparently was based upon Panuelo’s general estimate of its needs from month to month. No particular day of delivery was pointed out as crucial. Indeed the agreement itself provided a range of an entire month within which delivery could be made. Given this flexibility in the agreed arrangements, it would anomalous to conclude that the parties originally intended that all obligations of Panuelo’s would simply fizz away if one shipment of soft drinks arrived only eleven days late. Similar considerations [persuade the Court that the one bad container should not be seen as the failure of a condition to Panuelo’s further obligations under the standing order arrangement.]

To the extent that time is of the essence or completion by a date certain are considered contract “conditions,” the issue was addressed by the Kosrae State trial court in O’Byrne v. George. In O’Byrne, the plaintiff orally contracted with the defendant to build a house for $15,500. Of the $15,500, $10,000 was attributable to construction

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886 Id at 127
887 Id at 127
888 9 FSM Intrm 62 (Kos S. Ct. Tr. 1999)
material and $5,500 was allocated to labor. The plaintiff paid $10,000 for the materials and $1800 towards labor. When the defendant requested more money for materials, the plaintiff refused to pay and the defendant halted construction after substantially completing the house. The plaintiff hired a second contractor to complete the work who charged plaintiff $6240.64 for both material and labor. In part, the plaintiff argued that one of the terms agreed upon between the parties was that the house was to have been completed in two months and that defendant breached the agreement by failing to complete it in a timely manner. The defendant denied that there was any agreement to complete the house in two months.\textsuperscript{889} The \textit{O'Byrne} court rejected plaintiff’s argument concluding that time for completion was not condition or a material term to the agreement between the parties and that nothing in the oral agreement indicated that time was of the essence.\textsuperscript{890} Since Plaintiff could not provide a specific date for completion as being crucial, late completion of the house was not construed as a failure of a condition excusing or requiring further obligations under the contract\textsuperscript{891} and the court concluded that problems with timing of performance will not be found to necessarily interfere with a contract’s enforceability.\textsuperscript{892} Consequently, the trial court held that time was not of the essence and was not a material term of the contract interfering with its enforceability. The court concluded that there was no breach of contract by the defendant as it related to this particular allegation.\textsuperscript{893}

\textsuperscript{889} Id at 64
\textsuperscript{890} Id at 64
\textsuperscript{891} Id at 64 citing \textit{Panuelo v. Pepsi Cola Bottling}, 5 FSM Intrm 123, 127 (Pon 1991)
\textsuperscript{892} 9 FSM Intrm at 64 citing \textit{Iriarte v. Micronesian Developers}, 6 FSM Intrm 332, 335 (Pon 1994)
\textsuperscript{893} 9 FSM Intrm at 65.
Condition Precedent

Conditions categorizes according to time are classified as precedent, concurrent, or subsequent. A condition precedent is one that must occur or be performed before a duty of performance of the promise arises in the other party to the contract.\textsuperscript{894}

Prepayment and board authority as conditions precedent were addressed in the Marshall Islands case, \textit{Air Marshall Islands v. Dornier Luftfahrt, GMBH},\textsuperscript{895} where before an agreement to purchase aircraft for Air Marshall Islands (AMI) signed on February 11, 1999 by the Republic of Marshall Islands (RMI) Minister of Finance with Dornier became valid, several conditions precedent had to be fulfilled. For example, AMI had to pay 15\% of the price of each plane pre-delivery and Dornier had to receive the pre-delivery payment. Additionally, the AMI board had to approve the agreement by February 19, 1999 and written approval of the RMI Cabinet was required by February 19, 1999.\textsuperscript{896} Because none of these precedent conditions were fulfilled, the agreement signed by the Minister of Finance did not take effect.\textsuperscript{897}

Conditions precedent need to be established through plain and unambiguous language or necessary implication by the contract itself.

In the Micronesian case, \textit{Kihara v. Nanpei},\textsuperscript{898} the defendant argued that a contract regarding Ant Atoll was a condition precedent to repayment of a $50,000 bond debt.\textsuperscript{899} The trial court rejected this argument indicating that the language in the “loan of debt” agreement was clear and that the loan agreement was to be repaid within 6 months.

\textsuperscript{894} Calamari and Perillo, \textit{Contracts}, 3rd ed., 222 (West 1999)
\textsuperscript{895} 2 MILR 211 (December 24, 2002)
\textsuperscript{896} Id at 213-214.
\textsuperscript{897} Id at 214.
\textsuperscript{898} 5 FSM Intrm 342 (Pon. 1992)
\textsuperscript{899} Id at 344
The trial court decision was affirmed on appeal in Nanpei v. Kihara. On appeal, the FSM Supreme Court took the opportunity to address a number of significant issues regarding interpretation of conditions precedent. The FSM Supreme Court initially observed that “conditions precedent to contractual obligations are not favored in the law and courts will not construe terms to be such unless required to do so by plain and unambiguous language or by necessary implication.”

Next, the Nanpei court, relying on its earlier decision in Adams v Etscheit, indicated that there are two approaches the court can take when presented with claims of ambiguous conditional language:

One preference is for an interpretation that imposes on a party a duty to see that an event occurs, rather than one that makes the other party’s duty conditional on the occurrence of the event. The other preference is for an interpretation that will reduce an obligee’s risk of forfeiture if the event does not occur.

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900 Id at 345.
901 7 FSM Intrm 319,324 (App. 1995)
902 Id at 324. See also, Adams v Etscheit, 6 FSM Intrm 580, 582-3 (App. 1994) which addresses the requirements that the language creating conditions precedent be definite and certain, identify the subject matter, and contain the essential agreements and commitments of the parties. The trial court addressed these same requirements at 6 FSM Intrm at 387-8. On appeal, the FSM Supreme Court reversed the trial court’s earlier determination granting plaintiff’s motion for summary judgment on defendants’ counterclaim asserting that a question of fact existed as to the 1982 family agreement which allegedly resolved this land dispute issue at 6 FSM Intrm at 383-4.
903 6 FSM Intrm 580, 582-3 (App. 1994) which was an interlocutory appeal of Etscheit v. Adams, 6 FSM Intrm 365 (Pon 1994) in which the FSM Supreme Court reversed the trial court’s ruling granting plaintiffs motion for summary judgment indicating that “approved subject to survey” created a condition precedent that had not been fulfilled rendering a 1982 settlement agreement void. The FSM Supreme Court observed that that language “meant, not that the agreement to divide was void if there was no survey, but that the location of the boundaries and dividing line on the map were approved subject to a survey to locate that line on the ground.” Id at 583. The appellate court also reversed the trial court’s granting summary judgment on the issue that the location of the boundaries was “insufficiently definite and certain” for the alleged agreement to be enforceable and binding. Id at 584. Consequently, it was inappropriate for the trial court to summarily dismiss defendant’s counterclaim alleging that the partition of the property was resolved by a March 1982 agreement. Issues to be resolved on remand were whether the implications of the statute of frauds and statute of limitations as it related to this purported agreement. Id at 584.
904 7 FSM Intrm at 324. See also Adams, 6 FSM Intrm at 583.
The Nanpei court explored the reason why the second option is preferred when interpreting conditional language indicating:

Courts manifest the second preference [if]... nonoccurrence of the condition results in the obligee’s loss of his reliance interest when he loses his right to that exchange. This loss...is often described as ‘forfeiture.’ If the obligee’s reliance has conferred a benefit on the obligor, the reliance interest will include a restitution interest, so that forfeiture will result in unjust enrichment unless restitution is granted.\(^{905}\)

The Nanpei court indicated that it must be unambiguous and clear from the agreement or the surrounding circumstances that the obligee assumed the risk of forfeiture.\(^{906}\) If not, an interpretation reducing the risk of forfeiture is preferred by the court.\(^{907}\)

The Nanpei court observed that the second approach is preferred when there is an effort to construe terms of payment or, in this case, repayment as a condition precedent.

The Nanpei court concluded:

Cases in which this interpretation is preferred often involve agreements with terms that provide that payment is due ‘when’ or ‘not until’ a stated event occurs. Such terms are generally not considered to be conditions, but merely a means of measuring time, and if the stated event does not occur then the payment is nevertheless due after a reasonable time... We hold that to be the proper legal interpretation of this ‘bond of debt.’ The language did not unambiguously create a condition precedent.\(^{908}\)

The defendant in Nanpei had attempted to raise an ambiguity argument regarding the debt bond hoping to prevail. However, the FSM Supreme Court observed that these alternative arguments were in conflict and that the defendant could not prevail on alternative theories. The defendant’s contention that a contract provision is ambiguous

\(^{905}\) 7 FSM Intrm at 324. See also, Adams, 6 FSM Intrm at 583.
\(^{906}\) 7 FSM Intrm at 324
\(^{907}\) Id.
\(^{908}\) Id. (Citations omitted)
defeats the defendant other contention that it creates a condition precedent which requires clear and concise language.\textsuperscript{909}

Obtaining financing for an automobile may be a condition precedent to a conditional sale as was noted in \textit{Phillip v. Aldis} \textsuperscript{910} by the Pohnpei State trial court. The \textit{Phillip} court observed that “a conditional sale is one in which the vendee receives possession of and the right to use the goods sold, but transfer of the title depends upon performance of a condition or the occurrence of a contingency, which is usually full payment of the purchase price.”\textsuperscript{911} If the condition precedent does not occur, the vendor is entitled to repossess the goods. Although this case is categorized or framed as a condition precedent case, use and payment, as observed in the \textit{Nanpei} decision, are not generally considered classic conditions and perhaps this case would be more appropriately considered a remedies case.

As noted in \textit{Nahnken of Nett v. United States},\textsuperscript{912} the signature by the U.S. Secretary of Interior approving a 1956 memorandum of understanding which involved the transfer of property from the Trust Territory back to its rightful owners may be a condition precedent to the issuance of a quitclaim deed. Even though there is no evidence of such signature, the existence of the quitclaim deed is evidence that the parties had fulfilled their respective agreed conditions precedent as it related to the transfer of the land at issue.\textsuperscript{913}

\textsuperscript{909} Id.
\textsuperscript{910} 3 FSM Intrm 33 (Pon S. CT. Tr. 1987)
\textsuperscript{911} Id at 37.
\textsuperscript{912} 7 FSM Intrm 581,588-9 (App 1996)
\textsuperscript{913} Id. \textit{Nahnken of Nett v. United Status, supra}, is anthropologically significant in that a claim was brought by a traditional Pohnpeian leader, Salvadore Iriarte, seeking monetary damages against defendants
Discharge of a prior lawsuit may constitute both consideration for a new agreement and be a condition precedent requiring performance on the new contract as was noted in Marshall Islands Dev. Bank v. Alik and Alik.\textsuperscript{914}

Similarly in the Palau case Sumang v. Pierantozzi,\textsuperscript{915} dismissal of a prior lawsuit served as both consideration for the new agreement and a condition precedent. In Sumang, Pierantozzi gave Sumang a $3000 loan which was secured by a parcel of land in Koror. When she was not paid, Pierantozzi filed suit to foreclose on the land securing the debt. Sumang offered to convey the disputed property in exchange for the dismissal of a lawsuit plus a six month period to negotiate a re-conveyance. Pierantozzi accepted and acted accordingly. The court observed that dismissal of the lawsuit is sufficient consideration for the new agreement and also serves as a condition precedent requiring performance on the new contract. The Palau Supreme Court noted that dismissal of the suit and subsequent negotiations are sufficient consideration. Much like an option contract, the agreement became a valid contract when the suit was dismissed and

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regarding the alleged loss of possession of land it he claimed was traditional tribal land that was wrongfully returned by the Trust Territory to defendants. Under customary law, traditional tribal leaders are permitted to seek relief on behalf of the group.
\textsuperscript{914} 1 MILR 193 (December 12, 1989). In Marshall Islands Development Bank v. Alik and Alik, the Marshall Islands Supreme Court reversed the underlying High Court decision in part because the High court failed to address whether an agreement settling a prior claim between the parties was a valid contract before enforcing that agreement in subsequent litigation. The Supreme Court stated:

Aside from the fact that the March 11, 1998 agreement was subsequent to and not mentioned in the complaint and answer, unless the parties have stipulated that the agreement is valid, the High Court must before rendering judgment on the agreement find that the agreement is valid under contract law and that it has not been superseded by any subsequent agreement. There does not appear to have been any stipulation nor was any evidence taken as to whether there was a valid contract. For example, was dismissal of the lawsuit, allegedly relied upon by Alik, a condition precedent to or consideration for the contract?

\textsuperscript{915} 7 ROP Intrm 36 (1998)
subsequent negotiations began despite the absence of a redemption price.\textsuperscript{916} Because a duty arises on both sides, this case may also be categorized as an election of remedies case.

Late payments on a promissory note may constitute a condition precedent triggering an acceleration clause.

For example, in Western Caroline Trading Co. \textit{v. Fritz},\textsuperscript{917} the defendant entered into a contract with plaintiff for the lease of land owned by plaintiff through 2009. In 1994, the defendant wanted to terminate the lease early and the parties negotiated a promissory note for $135,000 to compensate the plaintiff for lost business income and improvements it had made to the property. At the outset of the agreement, the defendant failed to pay on a timely basis on the note fulfilling what the court categorized as a condition precedent to an acceleration clause in the note requiring the defendant to pay the entire amount due.\textsuperscript{918} As an aside, although the court referred to this as a condition precedent, it may also be classified as a condition subsequent resulting in the activation of the acceleration clause. Nonetheless, in October 1995 the plaintiff notified defendant of its intent to exercise the acceleration clause but continued to accept payments until that time in which the Defendant fell so far behind that Plaintiff sent a second letter in September 1996 notifying Defendant that it was $14,649.14 behind and that it was accelerating the loan. The Plaintiff filed suit a year later in September 1997 but after sending the second note in September 1996 and before filing suit in 1997 accepted $16,500 from the defendant. Applying American common law precedent, the court found

\textsuperscript{916} Id at 37
\textsuperscript{917} 7 ROP Intrm 264 (Tr. Div. 1998)
\textsuperscript{918} Id at 266.
that defendant cured the default existing at the time of the second letter in September 1996 and that by accepting payments between the second notice and filing suit the plaintiff waived it right to accelerate as to those payments.\(^9\)

**Condition Concurrent**

A condition concurrent is the common law equivalent of “tender”. A condition concurrent is one that is capable of occurring simultaneously with the duty to tender full and complete performance.\(^9\) Since the parties are bound to perform simultaneously with the condition, it is often referred to as the constructive condition of exchange i.e. each party’s performance is subject to the condition precedent that the other party simultaneously tender performance. As noted in the Marshall Islands Sale of Goods Act of 1986, § 29, an example of a concurrent condition would be that payment is due when services are provided or goods are delivered unless a contract provides otherwise.\(^9\)

**Condition Subsequent**

A condition subsequent is rare. A condition subsequent is one where the occurrence of the condition terminates an already existing absolute duty to perform.\(^9\) The Palau case, *Western Caroline Trading v. Fritz*, \(^9\) in which a failure to pay triggered an acceleration clause could be construed as a condition subsequent case.

Another example of a condition subsequent would occur where a contract specifies the period of its duration and the contract is terminated on the occurrence of the

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\(^9\) Id. at 267
\(^9\) Calamari & Perillo, *Contracts*, 222 (3\(^{rd}\) ed. 1999)
\(^9\) Marshall Islands Sale of Goods Act of 1986, §29 specifically indicates the payment and delivery are concurrent conditions. See also, *Ngirausui v. Baiei*, 4 ROP Intrm 140, 141 (1994) (Unless a contract indicates otherwise, payment is due when the services have been rendered.)
\(^9\) Calamari & Perillo, *Contracts*, 222 (3\(^{rd}\) ed. 1999)
\(^9\) 7 ROP Intrm 264 (Tr. Div. 1998)
condition subsequent, i.e. date of contract expiration period.\footnote{For example, see \textit{Nakatani v. Nishizono}, 2 ROP Intrm 7, 16-17 (1990) which set a date of completion for a construction contract. The contractor let the subcontractor continue to perform after the expiration date waiving the obligation of the subcontractor to meet the contract deadline but the contractor did not waive the right to terminate the subcontractor who failed to complete the project in the time proscribed by contract.} An example of this would be an automobile insurance policy that indicates that no action may be brought under the policy unless notice is provided within 6 months from the date of the accident.

\textit{Conditions and Burden of Proof}

Aside from classification of the condition by timing, classification of condition has an impact on burden of proof and burden of persuasion. Generally, the plaintiff has the burden of proof and persuasion for a condition precedent. The plaintiff must demonstrate whether the condition precedent occurred or not. In other instances, the person taking advantage of the condition would have the burden of proof. The defendant has the burden of proof of occurrence or non-occurrence of a condition subsequent.

\textit{Express, implied or constructive conditions}

In addition to categorizing conditions according to time as precedent, concurrent, or subsequent, conditions may also be categorized by the way in which they are created such as express, implied-in-fact, or constructive conditions.\footnote{Calamari & Perillo, \textit{Contracts}, 222 (3\textsuperscript{rd} ed. 1999)}

Express conditions are those that are explicitly set forth or understood in the written or oral agreement. Express conditions and implied-in-fact conditions must be fully performed but constructive conditions need only be substantially performed.

An example of an express condition which would also be a condition precedent would be where A offers B $1000 if B unilaterally walks across the Pohnpei causeway to the airport. B does not perform. B’s walking across the causeway is an express condition
precedent to A’s duty to pay. If B does not walk, she is not entitled to the $1000 nor is she liable to A because she has not promised anything to A.

An example of a constructive condition occurs where B promises A to build a house in Majuro and to complete the house by September 1. A agrees to pay B on September 1. Completing the house is a constructive condition to A’s promise to pay B because there is no express language of “condition.” The only language in the contract is language of “promise.” In the absence of language of “condition,” the courts “construct” a condition that B must complete the work before being paid, i.e. a “constructive condition precedent to payment.” Constructive conditions require only substantial performance whereas express and implied in fact conditions require strict compliance.

Implied-in-fact conditions are rare and usually limited to circumstances involving cooperation. For example, A agrees to sell a garment factory in Koror, Palau to B. B is short of cash but promises to pay A the purchase price in garments. A promises to instruct B in the process of manufacturing garments, however A fails to instruct B. The implied-in-fact condition is A’s promise to instruct B in garment making and must be strictly performed before B would be required to pay.

**Excuses for Non-Performance: Conditions Excused**

If a condition to a contract does not occur, the obligor is entitled to suspend its performance due to the fact that performance is not due. If it becomes too late for the condition to occur, the duty to perform is discharged and the contract terminated. The non-occurrence of a condition excuses performance and is not technically classified as a
Liability for breach attaches to promises not for failure of a condition. If the promise to perform is linked to the occurrence or non-occurrence of a condition, the failure of the condition would also constitute a breach.

An issue that occasionally arises during contract performance is whether the condition has been excused. A condition may be excused by actual breach of contract or by prevention, hindrance or failure to cooperate. A breach of contract discharges the innocent party from performance and terminates the contract. The innocent party may consider the contract discharged and is then permitted to sue for damages.

If the condition is breached, the innocent party may treat the broken condition as a breached warranty and must sue for damages and may not to terminate the contract unless there is an express or implied term in the contract to the contrary. The Marshall Islands have adopted this rule in Section 13(3) of the Sale of Goods Act of 1986 which provides:

Where a contract of sale is not severable, and the buyer has accepted the goods or part thereof, or where the contract is for specific goods, the property in which has passed to the buyer, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, and not as a ground for rejecting the goods and treating the contract as repudiated, unless there be a term of contract, express or implied, to that effect.  

Anticipatory Repudiation

Performance of a condition may be excused by anticipatory repudiation.

Restatement (Second) of Contracts §§250-257 address the effect of prospective non-performance or anticipatory repudiation. Anticipatory repudiation occurs where one party clearly terminates or repudiates the contract before time of performance, appears

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926 Restatement (Second) of Contracts §225(3)
927 Sale of Goods Act 1986, 23 MIRC cap 1, § 13(3)
unwilling or unable to perform,\textsuperscript{928} and there is a failure to provide adequate assurance of performance upon request.\textsuperscript{929} The anticipatory repudiation must be unequivocal. The party may retract the repudiation if there has been no reliance on the repudiation or the other party has not yet sued for breach.

In those circumstances where there is anticipatory repudiation, the non-breaching party to the contract may treat the repudiation as a total repudiation and has a number of remedies: 1) sue immediately for breach of contract;\textsuperscript{930} 2) may suspend performance and wait to sue on the performance clause; 3) treat as offer to rescind and a contract discharge; or 4) ignore the repudiation and encourage promisor to perform.\textsuperscript{931} This fourth option presents somewhat of a risk since the other party can retract the repudiation as long as there has been no detrimental reliance on the retraction and the non-breaching party must be ready to perform.\textsuperscript{932}

One of the earliest cases recognizing the concept of anticipatory repudiation is \textit{Hochster v. De La Tour}.\textsuperscript{933} In \textit{Hochster}, the plaintiff was retained by the defendant as a courier in April. His employment as a courier was to commence June 1. In May, three weeks before June 1, the defendant wrote to the plaintiff indicating that plaintiff’s services would not be required June 1 despite their agreement. Plaintiff sued on May 22. The court held that the defendant’s express and unequivocal repudiation was an

\textsuperscript{928} Restatement (Second) of Contracts §250
\textsuperscript{929} Restatement (Second) of Contracts §251
\textsuperscript{930} Restatement (Second) of Contracts §253 (1)
\textsuperscript{931} Restatement (Second) of Contracts §257
\textsuperscript{932} Id.
\textsuperscript{933} 118 ER 922 (1853)
anticipatory breach. The plaintiff need not wait until the time of performance to sue and was entitled to damages for the breach.

The modern version of Hochster decision may be found in *Restatement (Second) of Contracts*, §250 through §253.⁹³⁴

*Prospective Inability or Unwillingness to Perform*

Performance of a condition may also be excused by prospective inability or unwillingness to perform. Prospective inability occurs when a party indicates by conduct that they are unable to perform when performance is due. This may occur despite the party sending adequate assurances of performance, i.e. in those instances where conduct speaks louder than words. The modern approach is to treat this form of excuse like anticipatory repudiation.⁹³⁵

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⁹³⁴ *Restatement (Second) of Contracts* § 250 states:

A repudiation is (a) a statement by the obligor to the obligee indicating that the obligor will commit a breach that would of itself give the obligee a claim for damages for total breach under §243, or (b) a voluntary affirmative act which renders the obligor unable or apparently unable to perform without such a breach.

Restatement (Second) of Contracts § 251 provides:

(1) Where reasonable grounds arise to believe that the obligor will commit a breach by non-performance that would of itself give the obligee a claim for damages for total breach under §243, the obligee may demand adequate assurance of due performance and may, if reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance.

(2) The obligee may treat as a repudiation the obligor’s failure to provide within a reasonable time such assurance of due performance as is adequate in the circumstances of the particular case.

Restatement (Second) of Contracts §253 indicates:

(1) Where an obligor repudiates a duty before he has committed a breach by non-performance and before he has received all of the agreed exchange for it, his repudiation alone gives rise to a claim for damages for total breach

(2) Where performances are to be exchanged under an exchange of promises, one party’s repudiation of a duty to render performance discharges the other party’s remaining duties to render performance.

⁹³⁵ See previous discussion regarding *Hochster v De La Tour*, 118 ER 922 (1853)
Like anticipatory repudiation, an excuse of condition based upon prospective inability or unwillingness to perform may be retracted if there has been no reliance by the non-breaching party. 936

**Substantial Performance**

Performance of a constructive condition may also be excused by the doctrine of substantial performance or substantial completion. Express or implied in fact conditions, however, must be fully performed. The common law doctrine of substantial completion is frequently employed in construction or building contracts. The doctrine of substantial performance is rarely applied to contracts for the sale of goods under the common law, the *UCC*, or comparable statute where the “perfect tender” rule applies. 937

When assessing whether performance of a condition has been excused by substantial performance, the focus is upon whether the breach is material or immaterial. If the breach is material, the doctrine of substantial performance does not apply. 938

Substantial performance only arises if a breach is minor. Substantial performance is also unavailable if a breach is deliberate or willful.

936 Restatement (Second) of Contracts §256
937 For example, in the Marshall Islands it is implied in the Sale of Goods Act 1986, 23 MIRC Cap 1, § 15, that goods will correspond exactly with the description contained in the contract. § 15 states:

> Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

23 MIRC Cap 1, § 15.
938 See, *Nakatani v. Nishizono*, 2 ROP Intrm 7, 12-18 (1990) in which the Palau Supreme Court found that plaintiff subcontractor had not substantially completed construction work related to the construction of an airport terminal in Airai State. Although the subcontractor’s efforts did not amount to substantial performance, the subcontractor was still entitled to recovery under an equitable theory of quantum meruit for labor and materials expended on behalf of the owner. Id at 18.
Under the doctrine of substantial performance, the non-breaching party receives a substantial benefit but damages for cost of completion are offset. Damages for substitute performance sustained by the non-breaching party in order to complete the contract may be deducted from the contract price due to the breaching party’s incomplete but substantial performance. The diminished value rule is often applied if the cost of completion measure of damages results in economic waste.

In *O’Byrne v. George*, the Kosrae State trial court applied the doctrine of substantial performance but departed from standard practice in calculating damages by off-set. In *O’Byrne*, the trial court found that both parties breached an oral contract to build a home for $15,500. Plaintiff paid defendant $10,000 to buy the construction materials and $1800 of $5,500 for labor. When defendant wanted more money for materials, plaintiff refused to pay any more and defendant terminated the work leaving only doors, windows, and material for room partitions and the ceiling to be completed. Defendant also claimed he was entitled a second installment payment for labor. Both parties claimed the other party breached the contract. The court properly noted that in order for a breach of contract to halt performance of a construction contract the breach must be material. The court also observed that whether a breach is material depends on several factors particularly where the breach deprives an injured party of the contract benefits. The trial court found that plaintiff breached and owed the defendant $1800 for

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939 9 FSM Intrm 62 (Kos. S. Ct. Tr. 1999)  
940 See, for example, *Heller Elec. Co. v. William Klingensmith, Inc.* 670 F2d 1227 (DC Cir. 1982) where both parties were in breach due to delay and the trial indicated that neither could recover damages due to mutual breach. The Court of Appeals reversed indicating that damages should be off-set.  
941 Id at 65 citing *Panuelo v Pepsi Bottling*, 5 FSM Intrm 123, 128 (Pon 1991)
labor because defendant contractor had substantially performed.942 Further, the court found that the cost of construction materials was a material term of the contract; that plaintiff did not breach by refusing to pay more than $10,000 for construction materials; and that defendant breached by failing to purchase construction materials with the $10,000 plaintiff had already paid for those materials.943 Defendant’s breach required plaintiff to hire a second contractor to complete the work paying $6240.64 which were the plaintiff’s damages for additional labor and materials attributable to the breach.944

The trial court correctly noted that when the defendant contractor substantially completed performance in constructing plaintiff’s house defendant contractor was entitled to the second of three installments for labor in the amount of $1800 and that plaintiff’s failure to pay the second installment was a breach of contract.945 However, instead of offsetting the damages due to mutual breach, awarding $1800 to the contractor for the labor performed, or awarding damages to the owner due to defendant’s breach for the amount paid to the original contractor ($11,800), plus the amount paid ($6240.64) to the second contractor to complete the work, less the contract price of $15,500,946 the trial court deviated from accepted contract law damage principles finding that neither party was entitled to recover anything from the other due to their mutual breach and remarkably dismissed all claims.947

942 9 FSM Intrm at 65
943 Id at 65
944 Id at 64
945 Id. It could be argued that where both parties breach the defendant would be entitled to all of his labor costs since he substantially completed the project and that the cost of completion should be deducted from the contract price or alternatively each parties’ damages ($6240.64 for plaintiff and $3700 for defendant) should be offset leaving plaintiff with a net judgment of $2540.64 attributable to the breach.
946 See for example, *Wright v. Stevens*, 445 So 2d 791 (Miss. 1984)
947 9 FSM at 65-66.
Divisibility of Contract

Performance of a condition may also be excused by divisibility of a contract. Specifically, in those instances where it is not a condition precedent that whole contract be completed, performance of a condition may be excused by divisibility. The contract must be divisible by parts. An example would be an installment contract. An installment sales contract permits delivery in separate lots to be accepted separately. The perfect tender rule does not apply to installment contracts and the buyer only has the right to reject the installment that is substantially impaired if the defect in that installment cannot be cured.

In pertinent part, the defendant in *Palau Marine Indus. Corp. v. Pac. Call Inves. Ltd*\(^{948}\) argued that a five-year contract between the parties was divisible into five separate one year contracts. In addition to severability of contract, defendant presented a conditional discharge defense. The *Palau Marine* case involved a five-year contract that the defendant argued was five separate one (1) year contracts which was clearly an effort on its part to minimize its damages for the alleged breach. Pursuant to the agreement, the defendant was to provide fish to the plaintiff in Guam who would then off load, process and ship the fish to Japan. Due to Plaintiff’s corporate status change, two agreements were negotiated with the defendant: one by the old corporation in March 1991 and a second by the new corporation in July 1991. The defendant claimed that a letter sent August 28, 1991 from defendant’s counsel to plaintiff indicating that defendant Palau Marine was not to be released from their obligations under the March contract unless and until plaintiff Pacific Call performed its obligations under the July contract somehow

\(^{948}\) 9 ROP 67 (2002)
made the July contract conditional. The court rejected this argument as well looking to the language of the July contract and concluded that it was not conditional stating: “This argument is baseless. The text of the July contract does not suggest any such conditionality.”

**Waiver or Estoppel**

Performance of a contract condition may also be excused by waiver or estoppel. Waiver or estoppel can release or excuse conditional performance without

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949 Id at 71

950 See, for example, *Phillip v. Marianas Ins. Co.*, 12 FSM Intrm 301, 307 (Pon 2004), the plaintiff argued that defendant should be estopped from exercising a bailment lease exclusion because the defendant insurance company knew or ought to have known that the policy provided was not suited for its intended use. The *Phillip* court noted: “Estoppel is an equitable remedy that ‘may be invoked only by parties who themselves have acted properly concerning the subject of the litigation.’ *Carlos Etscheit Soap v. Epina*, 8 FSM Intrm 155, 163 (Pon 1997); *Ponape Transfer & Storage v. Federated Shipping*, 3 FSM Intrm 174, 178 (Pon. 1987).” Id. Because the plaintiff had unclean hands, the plaintiff in *Phillip* was not entitled to summary judgment on an equitable estoppel theory. Id. In *E. M Chen & Associates, v. Pohnpei Port Authority*, 9 FSM Intrm 551 (Pon 2000) plaintiff claimed that defendant was estopped from denying payment for a master plan the plaintiff provided to defendant but the court precluded this estoppel claim indicating that it had not been brought with in the appropriate two year statute of limitations applicable to claims against the state government. Id at 559. In *Owens v. House of Delegates*, 1 ROP Intrm 513E (1988) the defendant was required by contract to give plaintiff an opportunity to cure before termination but, after having been given such notice, plaintiff voluntarily waived her right to cure any deficiencies in her work. See also, *Western Caroline Trading Co. v. Fritz*, 7 ROP Intrm 264 (Tr. Div 1998) in which defendant entered into a contract with plaintiff for the lease of land owned by plaintiff through 2009. In 1994, the defendant wanted to terminate the lease early and the parties negotiated a promissory note for $135,000 to compensate the plaintiff for lost business income and improvements it had made to the property. At the outset of the agreement, the defendant failed to pay on a timely basis on the note fulfilling a condition precedent to an acceleration clause in the note requiring the defendant to pay the entire amount due. Id. at 266. In October 1995, plaintiff notified defendant of its intent to exercise the acceleration clause but continued to accept payments until that time in which time the Defendant fell so far behind that Plaintiff sent a second letter in September 1996 notifying Defendant that it was $14,649.14 behind and that it was accelerating the loan. The Plaintiff filed suit a year later in September 1997 but after sending the second note in September 1996 and before filing suit in 1997 accepted $16,500 from the defendant. Applying American common law precedent, the court found that defendant cured the default existing at the time of the second letter in September 1996 by paying more than was due at the time of the second letter and that by accepting payments between the second notice and filing suit, the plaintiff waived its right to accelerate as to those late payments.
consideration when it involves the sale of goods. *UCC* 1-107 provides for an “intentional waiver of a known right.”

In *Carolson Commercial v. Sawej Bros.*, the Marshall Islands Supreme Court addressed the issue of conditional waiver of the right to receive interest payments. Carolson had obtained a judgment of $3,488.11 including costs and would have been entitled to interest at a rate of 9%. The parties orally stipulated in court that Carlson would waive the right to interest as long as the Sawej Brothers would pay $600 per month. Failure of Sawej Brothers to pay timely would result in reinstatement of the interest obligation. When the Sawej Brothers failed to comply, Carlson returned to court seeking enforcement of the order. The trial court refused to enforce the order and reinstate interest. The Supreme Court of the Marshall Islands reversed the trial court decision indicating that the waiver of the right to receive interest payments was conditional upon payment of $1600 per month and that Sawej Brothers failed to comply entitlement Carlson to the interest payments.

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951 *UCC* 1-107 states “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.” *UCC* 1-107 was modified and renumbered *Revised UCC* 1-306 in the version submitted to the American Law Institutes in May 2003. *Revised UCC* 1-306 provides: “Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.”

952 1 MILR (Rev) 24 (February 4, 1986).

953 Id. at 26. Even though the *Sawej* case was treated as a “condition” and a “waiver” of the right to interest matter, this case could have also been addressed from a pre-existing legal duty standpoint in that there was no consideration for the subsequent agreement (to waive) what the other side already had a pre-existing legal duty to pay (interest).
Discharge of Duty to Perform

In addition to substantial performance and anticipatory repudiation which serve as excuses for non-performance of conditions as well as a basis for discharge of the duty to perform, the duty to perform may also be discharged in a number of other ways.

Performance

The duty to perform can be discharged by performance or tendering performance. The duty to perform may also be discharged by the occurrence of a condition subsequent. Supervening illegality of the contract subject matter may also result in discharge of the duty to perform.

Restatement (Second) of Contracts §261 recognizes that the duty to perform for contracts in general may also be discharged by impossibility, imprevicability, or frustration. Similarly, impossibility, impracticability, or frustration may excuse performance of contracts for the sale of goods and these concepts are addressed in UCC 2-613 to UCC 2-616.

Sale of Goods: Destruction of the Contract Subject Matter

The duty to perform a contract involving the sale of goods may be discharged by destruction or injury to the identified goods. For example, Section 9 of the Sale of Goods Act of 1986 in the Marshall Islands provides:

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954 In Palau Marine Indus. Corp v. Pac Call Inves Ltd. 9 ROP 67 (2002) a defendant supplier of fish unsuccessfully tried to raise an impossibility defense claiming that it should be relieved of liability because the plaintiff off loader, processor and transporter of the fish would not have been able to perform its obligation even if defendant had provided the fish.
Where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller or buyer perish before the risk passes to the buyer the agreement is thereby voided.\textsuperscript{955}

\textit{UCC} 2-613 similarly addresses casualty to identified goods.\textsuperscript{956} If the loss under \textit{UCC} 2-613 is total, the contract is terminated and duty to perform is discharged. If the loss is partial or the goods have deteriorated, the buyer has the option to terminate or deduct from the original contract price.

In order to discharge the duty to perform, the casualty must occur after contract is formed but before risk passes to the buyer and the goods must be destroyed without fault of either party. Both Section 9 of the Marshall Islands’ Sale of Goods Act of 1986 and the \textit{UCC} 2-613 provide that in those circumstances, the contract is voided. If there is injury, the contract may be modified and the buyer may elect to take the goods at a deduction in price.

\textsuperscript{956} \textit{UCC} 2-613 provides:

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before risk of loss passes to the buyer in a proper case under a “no arrival, no sale” term (Section 2-324) then (a) if the loss is total the contract is avoided; and (b) if the loss is partial or the goods have so deteriorated as no longer conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quality but without further right against the seller.

\textit{Revised UCC} 2-613 makes minor grammatical changes and provides as follows:

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before risk of loss passes to the buyer then (a) if the loss is total the contract is terminated; and (b) if the loss is partial or the goods have so deteriorated as no longer conform to the contract the buyer may nevertheless demand inspection and at its option either treat the contract as terminated or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quality but without further right against the seller.
Sale of Goods: Impracticability or Substituted Performance

UCC 2-614 addresses discharge of duty by impracticability and substituted performance. If the facility for berthing, loading, or unloading is unavailable or the manner of delivery is commercially impracticable, the seller may select a commercially reasonable alternative and the buyer must accept substitute tender.

For example, if domestic or foreign governmental regulation prohibits the agreed means or manner of payment, the seller is excused from performance unless the buyer can provide a commercially and substantial equivalent method of payment. If the seller has already performed, the buyer can pay pursuant to the regulatory manner which will be considered in compliance unless the regulation is discriminatory, oppressive or predatory.

Sale of Goods: Failure of Presupposed Conditions

UCC 2-615 discusses excuse of performance due to failure of presupposed conditions. The seller may be unable to perform or performance may be impracticable

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957 UCC 2-614 and Revised UCC 2-614 state:

(1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted. (2) If the agreed means or manner of payment fails because of domestic or foreign government regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by means or in the manner provided by the regulation discharges the buyer’s obligation unless the regulation is discriminatory, oppressive or predatory.

958 UCC 2-614(1); Revised UCC 2-614 (1)
959 UCC 2-614(2); Revised UCC 2-614(2)
960 UCC2-614(2); Revised UCC 2-614(2)
961 UCC 2-615 provides:

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in delivery or non-delivery in whole or part by a seller who complies with paragraphs (b) and ((c) is not a breach of his duty under a contract for
or delayed by the occurrence of a contingency the non-occurrence of which was a basic assumption of the contract.

For example, the seller may also be required to comply with foreign or domestic governmental order or regulation which makes performance impracticable or which may delay performance. Where these two scenarios partially affect the seller’s ability to perform, *UCC* 2-615 permits allocation after notice is given by the seller among all its customers in a manner which is fair and reasonable. \(^{962}\) Where the occurrence of a contingency or governmental regulation preclude performance, notice is also required. \(^{963}\)

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sale if performance as agreed has been made impracticable by occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid. (b) Where the causes mentioned in paragraph (a) affect only a part of the seller’s capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable. (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

*Revised UCC* 2-615 makes minor grammatical changes to the original and provides as follows:

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in performance or non-performance in whole or part by a seller that complies with paragraphs (b) and (c) is not a breach of the seller’s duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid. (b) Where the causes mentioned in paragraph (a) affect only a part of the seller’s capacity to perform, the seller must allocate production and deliveries among its customers but may at its option include regular customers not then under contract as well as its own requirements for further manufacture. The seller may so allocate in any manner which is fair and reasonable. (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

\(^{962}\) *UCC* 2-615(2); *UCC* 2-615(2)  
\(^{963}\) *UCC* 2-615(2); *UCC* 2-615(2)
UCC 2-616 provides the buyer with several options when seller gives notice claiming excuse under UCC 2-615. If the delay is material or indefinite or if there is going to be an allocation and the deficiency substantially impairs the value of the contract, the buyer may terminate the contract and discharge the seller from further performance or modify the contract by agreeing to accept the available quota in substitution. The buyer has 30 days after notification is given to advise the seller of its intent to modify or the contract is terminated in regard to any duty to perform.

Common Law: Impossibility

Contracts other than those involving the sale of goods may be discharged by impossibility. In order to be discharged by impossibility of performance, the

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964 UCC 2-616 states:

(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (Section 2-612), then also as to the whole, (a) terminate and thereby discharge any unexecuted portion of the contract; or (b) modify the contract by agreeing to take his available quota in substitution. (2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected. (3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.

Revised UCC 2-616 makes several minor changes and provides:

(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section it may by notification in a record to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (Section 2-612), then also as to the whole, (a) terminate and thereby discharge any unexecuted portion of the contract; or (b) modify the contract by agreeing to take his available quota in substitution. (2) If after receipt of such notification from the seller the buyer fails to modify the contract within a reasonable time not exceeding thirty days the contract is terminated with respect to any performance affected. (3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.

965 UCC 2-616(1); Revised UCC 2-616(1)
966 UCC 2-616(2); Revised UCC 2-615(2)
impossibility must be “objective” and not subjective. The impossibility must also occur after the contract was formed.

Impossibility may occur in conjunction with other excuses discharging the duty to perform. For example, the duty to perform may be discharged for impossibility if there is death, physical incapacity or illness in a personal services contract, supervening illegality, or if the subject matter of the contract is subsequently destroyed as long as the promisor is not at fault for its destruction.

Although it is a difficult standard to prove objective impossibility, if it is proven, the obligation owed is discharged in full.

If the cause of the “impossibility” is the negligence of party seeking to be excused, performance will not be excused under those circumstances.

A duty to perform may also be discharged by partial impossibility which only discharges the duty to the extent it is impossible to perform. There is also temporary impossibility which temporarily suspends the duty to perform.

Common Law: Impracticability and Frustration of Purpose

Although impracticability and frustration of purpose are recognized by the UCC and applicable to contracts for the sale of goods, these are two minority rules as far as personal service, non-goods, and other contracts are concerned under the common law of contract. Restatement (Second) of Contracts §261 recognizes discharge by supervening impracticability and Restatement (Second) of Contracts §265 addresses discharge by

967 In Palau Marine Indus. Corp v. Pac Call Inves Ltd. 9 ROP 67 (2002) a defendant supplier of fish unsuccessfully tried to raise an impossibility defense claiming that it should be relieved of liability because the plaintiff off loader, processor and transporter of the fish would not have been able to perform its obligation even if defendant had provided the fish. The Supreme Court of Palau found it would have clearly erroneous for the trial court to have found that the supplier’s performance was impossible.
supervening frustration. Even though recognized by the *Restatement (Second) of Contracts* and applicable under the *UCC* to contracts for the sale of goods, impracticability and frustration of purpose are exceptions to the general rule of no-fault contractual liability and remain minority views in most jurisdictions including in the Northern Pacific region.

Discharge by impracticability requires that changed circumstances have rendered performance substantially more difficult or expensive and that the changed circumstances were not anticipated at the time the parties entered into the contract. *Restatement (Second) of Contracts* §261 indicates “a party’s performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made.” Temporary or partial impracticability only suspend the duty to perform until that time in which performance can be accomplished.

Discharge of the duty to perform by frustration of purpose is also a minority rule. Discharge by frustration requires changed circumstances causing frustration. The cause of the frustration must not be the fault of the party seeking discharge and must not have been foreseeable at the time of entering into the contract. The purpose of the contract must be completely or nearly completely destroyed and that purpose must have been understood by both parties. If so, then performance of both parties is excused.

Relief for discharge by impracticability or frustration of purpose includes restitution as provided for in *Restatement (Second) of Contracts* §272.

**Act of God**

Discharge by intervening Act of God is related to the concept of supervening impossibility, impracticability, or frustration of purpose. Many contracts have a provision
defining what is or what is not considered an Act of God. If the Act of God is an expected or anticipated condition at the time of contract, it does not excuse performance.\textsuperscript{968} In order to be discharged from the duty to perform, the Act of God defense is only available in those instances unforeseeable at the time of contract and which are overwhelming, natural occurrences occurring without any human intervention. Rain, snow and inclement or poor weather conditions are considered foreseeable and not generally considered intervening Acts of God discharging the duty to perform.\textsuperscript{969}

\textbf{Discharge by Mutual or Unilateral Rescission}

The duty to perform may also be discharge by mutual or unilateral rescission. Mutual rescission is where both parties agree to release each other from the duty to perform. The contract must be executory.

If the contract is unilateral, a contract to mutually rescind will not be effective where one party still has the duty to perform unless the unilateral agreement is a gift or obligation owed, where new consideration given, or where there is promissory estoppel.

Discharge by rescission in a partially performed bilateral contract will usually be enforced even where both parties have partially performed.

\textsuperscript{968} For example in \textit{Walker v. Signal} 84 Cal. App. 3\textsuperscript{rd} 982 (1978) the court indicated that rainfall might have been anticipated and that such rainfall may or may not interrupt work progress. Consequently, the rainfall was not unanticipated condition or an Act of God excusing performance or entitling one to additional compensation.

\textsuperscript{969} See \textit{Shea-S&M Ball v. Massman-Kiewit Early} 606 F2d 1245 (DC Cir. 1979) which notes the general proposition that inclement weather is not considered an Act of God unless there are unusual or extraordinary circumstances. In \textit{Concrete Construction v. City of Atlanta}, 339 SE 2d 266 (Ga. App. 1985) the contractor negligently installed electrical and gas lines next to each other, knowing that proper engineering practice required a 6 inch separation. During a severe ice storm, electricity discharged through the underground conduit came into contact with the gas line causing an explosion. The contractor unsuccessfully tried to assert that the severe ice storm was an Act of God but the court held that it was not a defense where the contractor was negligent in the initial installation.
One can rescind the duty to perform orally unless the matter is within the Statute of Frauds or involves the sale of goods over $500. If the contract involves the sale of goods over $500 or a matter within the Statute of Frauds, a writing or record is required to discharge from duty to perform. In addition, detrimental reliance may also limit the ability to rescind.

If rescinding a third party beneficiary contract, notice also has to be provided to the intended beneficiary.

Unilateral rescission is rare due to the fact that one must have adequate legal grounds which would permit recission such as mistake, misrepresentation, or duress.

**Discharge by Modification of Contract**

The duty to perform may be partially discharged by modification of contract. In order to modify the contract, the parties must mutually assent to partially discharge the duty to perform. Under the common law, any modification to discharge would require additional consideration.

There are exceptions where the modification is only a correction or scrivener’s error. Also, UCC 2-209 does not require consideration for modification of a contract for the sale of goods.\(^{970}\) The modification of a contract subject to the Statute of Frauds or the UCC involving modification, rescission and waiver provides:

\(^{970}\) UCC 2-209 involving modification, rescission and waiver provides:

1. An agreement modifying a contract within this Article needs no consideration to be binding.
2. A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by a merchant must be separately signed by the other party. (3) The requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions. (4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver. (5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any
modification of contract for sale of goods pursuant to *UCC* 2-209 which is subject to the Statute of Frauds may need to be in writing.\(^971\)

The contract may contain a provision prohibiting oral modification or requiring that any modification be in writing.\(^972\) The provisions are valid and binding but may be knowledgeably waived by the parties.\(^973\) A party may also retract the waiver unless there has been detrimental reliance.\(^974\)

The issue of discharge of duty to perform and of waiver attributable to subsequent conduct was addressed in a non-goods case in *Malem v. Kosrae*.\(^975\) This case involved the construction of catch basins at the Malem Elementary School. In *Malem*, the memorandum of understanding signed by both parties required that any changes to the terms and conditions of the contract must be in writing.\(^976\) Changes were made to the

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*Revised UCC* 2-209 makes only slight grammatical changes and states as follows:

1. An agreement modifying a contract within this *Article* needs no consideration to be binding.
2. An agreement in a signed record which excludes modification or rescission except by a signed record cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by a merchant must be separately signed by the other party. (3) The requirements of the statute of frauds section of this *Article* (Section 2-201) must be satisfied if the contract as modified is within its provisions. (4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver. (5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

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\(^{971}\) *UCC* 2-209(3); *Revised UCC* 2-209(3)

\(^{972}\) *UCC* 2-209(2); *Revised UCC* 2-209 (2)

\(^{973}\) *UCC*2-209(4); *Revised UCC* 2-209(4). See also, *Tulensru v. Utwe*, 9 FSM Intrm 95, 98 (Kos. S. Tr. Ct. 1999) where the court found that the parties’ verbal agreement and specifications were not modified by the parties’ later actions because plaintiff failed to sustain his burden of proof.

\(^{974}\) *UCC* 2-209(5); *Revised UCC* 2-209 (5)

\(^{975}\) 9 FSM Intrm 233 (Kos. S. Ct. Tr. 1999)

\(^{976}\) Id at 236
construction drawings regarding the concrete block. These changes were not in writing but made with the knowledge of the defendant.\textsuperscript{977} The Malem court indicated that “in determining whether the terms of a contract should be enforced, the court will consider the parties’ justified expectations, any forfeiture that will result if enforcement were denied and any special public interest in the enforcement of the particular term.”\textsuperscript{978}

Addressing the issue of waiver by conduct, the Malem court concluded that it would be unfair to enforce the contract term requiring a writing signed by both parties to amend the agreement’s terms and conditions where plaintiff and defendant were aware of the change in the drawings and specifications; where the defendant had a representative on the job site the first day of construction and on several other days during the project; and when defendant had ample notice and knowledge that the specifications had been changed and did not notify, stop, or interfere with Plaintiff’s work and completion of the project.\textsuperscript{979} Defendant’s conduct constituted waiver of the writing requirement.

Consequently, the court found that the defendant breached its contract with the plaintiff when it failed to fulfill its duty to perform its promise to pay for the work.\textsuperscript{980}

The court also concluded that plaintiff was also entitled to prejudgment interest from the date of completion of the work to the date of judgment at a rate of nine (9) percent which is consistent with the usury and post judgment interest statutes.\textsuperscript{981}

\begin{flushleft}
\tiny
\textsuperscript{977} Id
\textsuperscript{978} Id. Citing \textit{Falcam v. FSM}, 3 FSM Intrm 194, 197-8 (Pon. 1987) (a case involving a determination of whether Falcam was entitled to be employed by the State as postmaster.)
\textsuperscript{979} 9 FSM Intrm at 236
\textsuperscript{980} Id citing \textit{Ponape Constr. Co v. Pohnpei}, 6 FSM Intrm 114, 123 (Pon 1993)
\textsuperscript{981} 9 FSM Intrm at 236-7. The Kosrae State Usury Interest Statute is found in Kosrae State Code, § 13.518.
\end{flushleft}
Discharge by Substituted Contract

The duty to perform may also be discharged by substituted contract in which a new contract is substituted for the old. A related concept is discharge by novation in which the duty to perform may also be discharged. In a novation, however, the original contract is valid and there is an agreement among all parties including new parties. The old contract is then extinguished between the original parties and a new contract is formed.

One of the issues in *Marshall Islands Development Bank v. Alik and Alik*\(^{982}\) was whether the settlement of a prior lawsuit was a substituted contract or novation. The Supreme Court of the Marshall Islands indicated that in order to determine whether the prior resolution was a settlement or novation would depend on the intent of the parties. The High Court had not developed a sufficient trial record on this and other issues and it was unclear whether the settlement was intended as a resolution of the motion seeking injunctive relief or was intended as a resolution of the entire suit. Consequently, the Marshall Islands Supreme Court remanded the case in part to determine what the intent of the parties was as to the prior claim.

Cancellation of Contract

The duty to perform may also be discharged by cancellation of the original agreement or release. A similar concept to discharge of duty to perform by cancellation or by a release is a covenant not to sue. In order to be effective, the release generally needs to be supported by written consideration or promissory estoppel. Forbearance to sue may be considered an equivalent of consideration sufficient to support such an

\(^{982}\) I MIRL (Rev) 193 (December 12, 1989)
agreement. *UCC* 1-107 does not require additional consideration for a release or waiver in a contract for the sale of goods.

**Accord and Satisfaction**

The duty to perform may also be discharged by accord and satisfaction. An accord is an agreement. Satisfaction occurs upon performance of the agreement. Satisfaction results in discharge of prior contract’s duties upon completion of performance.

Generally, there is a requirement of consideration if there has been partial payment of the original debt. The accord would be sufficient if new consideration is of a different type or the claim is to be paid to 3rd party. The accord is also sufficient if there is a bona fide dispute as to amount. There are different implications stemming from the breach if the accord and satisfaction is breached by the debtor or creditor before satisfaction.

Accord and satisfaction was raised as defense and addressed in the Palau case, *Kerradel v. Micronesian Dev. Corp.* In *Kerradel*, Plaintiff employee was a third party beneficiary of the defendant foreign corporation’s contract with the Palau Economic Development board and was entitled to indemnification for loss of wages when the defendant employer violated Palau’s overtime wage law. The defendant argued that a payment it made to the plaintiff which Plaintiff accepted was an accord and satisfaction of the outstanding debt owed for overtime wages. The trial court rejected this

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983 *UCC* 3-311 addresses accord and satisfaction by use of instrument.
984 1 ROP Intrm.118 (Tr. Div 1984)
985 Id at 121
986 Id
argument noting that the payment was an effort to avoid statutory overtime requirements and, because it was an effort to avoid the law, it was contrary to public policy and could not be considered an accord and satisfaction of a disputed matter.\textsuperscript{987} The court permitted the payment as an offset to damages due to the plaintiff.\textsuperscript{988}

A Micronesian case raising the defense of accord and satisfaction is \textit{Richmond Wholesale Meat Co. v. Kolonia Consumer Coop Ass’n},\textsuperscript{989} which involved an open account stated claim in the amount of $30,874.38 where plaintiff, Richmond, provided product to defendant KCCA and where defendant was supposed to pay. The dispute was over the difference in one invoice and a claim for $20.80 escalated to a claim of $1039.99 with compounding interest.

The Plaintiff moved for summary judgment which the trial court granted in part and denied in part indicating that the only issues for trial are the amount of the one invoice in dispute and what interest the Plaintiff may claim.\textsuperscript{990} As to the issue of accord and satisfaction, the court first looked to Micronesian authority.\textsuperscript{991} There being none, the court turned to guidance from the common law of the United States.\textsuperscript{992} The \textit{Richmond} court noted:

\begin{quote}
For there to be an accord and satisfaction, there must be an offer in full satisfaction of a debt accompanied by acts and declarations that amount to a condition that if the offer is accepted, it is full satisfaction of the obligation…The condition must be such that the party to whom the offer is made is bound to
\end{quote}

\begin{itemize}
\item \textsuperscript{987} Id
\item \textsuperscript{988} Id
\item \textsuperscript{989} 7 FSM Intrm 387 (Pon. 1996)
\item \textsuperscript{990} Id a 389-90
\item \textsuperscript{991} Id at 389,citing \textit{Semens v Continental Airlines}, 2 FSM Intrm 131,140 (Pon. 1985)
\item \textsuperscript{992} Id at 389
\end{itemize}
understand that if it accepts the offer in full satisfaction, it does so subject to the condition imposed." 993

Because the plaintiff Richmond accepted only partial payment and defendant KCCA acknowledged it only paid plaintiff a portion of the obligation, there was no accord and full satisfaction of the debt and KCCA was denied summary judgment on this basis. 994

Discharge by Account Stated

The duty to perform may also be discharged by an account stated. An account stated is created when debtor and creditor compute a balance of matured debts or where creditor sends debtor a statement of account and debtor fails to object or contest it within a reasonable time. Where there is an account stated created, the parties agree to a specified amount as a final balance due. The account stated settles all previous transactions between the parties. To discharge by account stated, it is required that there be more than one transaction between the parties. A writing is generally not required to discharge by account stated unless the subject matter is within the Statute of Frauds like the sale of goods in excess of $500. An account stated may also be implied where debtor fails to object within a reasonable time when creditor sends an account stated.

Lapse of Time

The duty to perform may also be discharged by lapse where time is of the essence or if the contract is to be performed within a specific time. An agreement that time is of the essence is an express condition of contract. Failure to perform by a specified date or

993 Id
994 Id
failure to complete performance in a timely manner where time is of the essence permits the aggrieved party to suspend performance or, alternatively, cancel the contract.

**Operation of Law**

The duty to perform may also be discharged by operation of law. Discharge by operation of law includes discharge by illegality, death and incapacity which are addressed elsewhere in this text. The duty to perform may also be discharged by operation of law due to insolvency or bankruptcy. Discharge by operation of law due to insolvency or bankruptcy is a form of prospective inability to perform which has been previously discussed.

An example of discharge by operation of law would be where the duty to perform becomes part of a court judgment or bankruptcy and is discharge by the judgment or bankruptcy.

As it relates to contracts for the sale of goods, *UCC* 1-201(23) sets forth three situations that constitute insolvency and which would potentially justify discharge by operation of law: 1) the failure to pay debts in the regular course of business, 2) the inability to pay debts when they mature, or 3) insolvency as defined by the Federal Bankruptcy Act, i.e. where one’s debts are greater than one’s assets.\(^{995}\)

**Supervening Illegality**

A related topic to discharge by operation of law would be discharge by supervening illegality. Both an offer may be terminated and the duty to perform may be discharged by supervening illegality. In the event that what was once legal becomes

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\(^{995}\) *UCC* 1-203(23). The definition of insolvency under the Federal Bankruptcy Act is subject to the qualifications set forth in 11 U.S.C. 100(26).
illegal prior to or during the performance of the contract, the duty to perform is 

discharged by operation of law.

Statute of Limitations

The duty to perform may also be discharged by the running of the statute of 

limitations, a statute of repose, or by the equitable doctrine of laches.
**Allocation of Risk and Performance Issues: Contract for the Sale of Goods**

In a contract for the sale of goods both the buyer and seller have various obligations. Generally, the obligation of the seller is to tender or transfer and deliver the goods and the buyer is obliged to accept and pay in accord with the terms of the agreement. Similarly, in the Marshall Islands, Section 28 of the Sale of Goods Act of 1986 states: “It is the duty of the seller to deliver the goods, and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.”

**Seller’s Obligations: Tender and Delivery**

The seller has an obligation of tender and delivery. In the Marshall Islands, a reasonable time or hour of delivery, i.e. during daylight working hours, is implied in the Sale of Goods Act of 1986. The *UCC* has a comparable provision requiring tender at a reasonable hour. Where the parties did not intend that goods be moved by carrier, the seller must store and hold conforming goods at the buyer’s disposition for a reasonable time or time sufficient for the buyer to take possession. In absence of an agreement, the *UCC* 2-308...
provides that the place of delivery is the seller’s place of business, or if he has none, then the seller’s residence.\textsuperscript{1001}

The risk of loss from a non-merchant seller generally shifts when the seller tenders the goods to the buyer. The risk of loss from a merchant seller shifts on the buyer’s receipt of goods where seller has not agreed to deliver to destination. Where seller agrees to deliver goods to a place of shipment, the seller has the risk of loss and bears the expense of putting those goods into the possession of the carrier. Where seller agrees to a particular destination, the contract will generally allocate risk of loss and cost of delivery upon seller until tendered at the designated destination. Unless the contract specifies otherwise, risk of loss is generally dictated in the terms of the contract and will be reflected by such terms as free on board (hereinafter F.O.B) or free alongside (hereinafter F.A.S.).\textsuperscript{1002}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{1001} \textit{UCC} 2-308 provides:


\begin{quote}
Unless otherwise agreed (a) the place for delivery of goods is the seller’s place of business or if he has none his residence; but (b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and documents of title may be delivered through customary banking channels.
\end{quote}

\end{itemize}

\end{footnotesize}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{1002} \textit{Revised UCC} 2-308 makes slight grammatical changes and states:


\begin{quote}
Unless otherwise agreed (a) the place for delivery of goods is the seller’s place of business or if it has none the seller’s residence; but (b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and documents of title may be delivered through customary banking channels.
\end{quote}

\end{itemize}

\end{footnotesize}

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\item \textsuperscript{1002} \textit{UCC} 2-319 addresses F.O.B and F.A.S. terms and provides:

\begin{quote}
(1) Unless otherwise agreed the term F.O.B. (which means “free on board”) at a named place, even though used only in connection with the stated price, is a delivery term under which (a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this \textit{Article} (Section 2-504) and bear the expense and risk of putting them into the possession of the carrier; or (b) when the term is F.O. B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this \textit{Article} (2-503); (c) when under either (a) or (b) the term is also F.O.B.
\end{quote}

\end{itemize}

\end{footnotesize}
**Buyer’s Obligations: Inspection and Payment**

In a contract for sale of goods, the buyer has the right to inspect the goods and has an obligation to pay. Unless a contract indicates otherwise, payment is due when the vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this Article on the form of the bill of lading (Section 2-323). (2) Unless otherwise agreed the term F.A.S. (which means “free alongside”), at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must (a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and (b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading. (3) Unless otherwise agreed in any case falling within subsection (1)(a) or (c) or subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this Article (Section 2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment. (4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

In the Revised Uniform Commercial Code, UCC 2-319 through UCC 2-324 have been eliminated because the drafters believe that they are inconsistent with modern commercial practices. Original UCC 2-320 addresses C.I.F. and C & F. Terms. UCC 2-321 deals with C.I.F. or C. & F.: “net landed weights”; “Payment on Arrival”; and Warranty of Condition on Arrival. UCC 2-322 discusses Delivery “Ex-Ship.” UCC 2-323 is entitled Form of Bill of Lading Required in Overseas Shipment; “Overseas”. UCC 2-324 addresses the “No arrival, No sale” term. Although the drafters of the Revised UCC submitted to the American Law Institute in May 2003 believe that original UCC 2-319 through 2-324 are no longer applicable to modern commercial practice, these provisions may still be applicable in those jurisdictions which have yet to adopt the Revised UCC and continue to follow the original code.

1003 UCC 2-301; Revised UCC 2-301. The buyer’s right to inspect the goods is set forth in UCC2-513 and Revised UCC 2-513. UCC 2-513 provides:

(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival. (2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected. (3) Unless otherwise agreed and subject to the provisions of this Article on C.I.F. contracts (subsection (3) of Section 2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides (a) for delivery “C. O.D.” or on other like terms; or (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection. (4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.
goods are shipped or, in other types of contracts, when services are rendered.  

Delivery of the goods and payment are generally concurrent conditions. A shipment may also be made under reservation where the buyer pays prior to receipt of the goods.  

**Risk of Loss: Sales Contracts**

Risk of loss is allocated differently in the absence of breach and when breach occurs. In cases involving merchants, *UCC* 2-509 and *UCC* 2-510 allocate risk between the buyer and seller. *UCC* 2-509 addresses risk of loss in the absence of a breach.  

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Revised *UCC* 2-513 deletes the reference to C.I.F., C.O.D. contracts and *UCC* 2-321 and provides as follows:

1. Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival. (2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected. (3) Unless otherwise agreed the buyer is not entitled to inspect the goods before payment of the price when the contract provides (a) for delivery on terms that under applicable course of performance, course of dealing, or usage of trade are interpreted to preclude inspection before payment; or (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection. (4) A place, method or standard of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place, method or standard fixed was clearly intended as an indispensable condition failure of which avoids the contract.

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1005 *UCC* 2-512; Revised *UCC* 2-512

1006 *UCC* 2-509 states:

1. Where the contract requires or authorizes the seller to ship the goods by carrier (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but (b) if it does not require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery. (2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer (a) upon receipt of a negotiable document of title covering the goods; or (b) on acknowledgment by the bailee of the buyer’s right to possession of the goods; or (c) after his receipt of a non-negotiable document of title or other written direction to deliver, as provided in subsection (4)(b)
UCC 2-510 addresses the effect of breach on risk of loss. Generally, the risk of loss from non-merchant seller shifts when seller tenders goods. The Marshall Islands Sale of Section 2-503. (3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery. (4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (Section 2-327) and on effect of breach on risk of loss (Section 2-510).

Several grammatical changes are made in Revised UCC 2-509 and Revised UCC 2-509(3) eliminates the qualification as it relates to merchant-sellers. Revised UCC 2-509 provides:

(1) Where the contract requires or authorizes the seller to ship the goods by carrier (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but (b) if it does not require him to deliver them at a particular destination and the goods are there tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there so tendered as to enable the buyer to take delivery. (2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer (a) upon the buyer’s receipt of a negotiable document of title covering the goods; or (b) on acknowledgment by the bailee to the buyer of the buyer’s right to possession of the goods; or (c) after the buyer’s receipt of a non-negotiable document of title or other direction to deliver in a record, as provided in subsection (4)(b) of Section 2-503. (3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on the buyer’s receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery. (4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (Section 2-327) and on effect of breach on risk of loss (Section 2-510).

UCC 2-510 provides:

(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of loss remains on the seller until cure or acceptance. (2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning. (3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of the loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

Revised UCC 2-510 makes slight grammatical adjustments and states:

(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of loss remains on the seller until cure or acceptance. (2) Where the buyer rightfully revokes acceptance the buyer may to the extent of any deficiency in the buyer’s effective insurance coverage treat the risk of loss as having rested on the seller from the beginning. (3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of the loss has passed to the buyer, the seller may to the extent of any deficiency in seller’s effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.
of Goods Act of 1986 is consistent indicating that risk of loss prima facie passes with the property.\textsuperscript{1009}

**Risk of Loss: Absence of Breach**

Risk of loss is generally determined by and in the following order of priority: 1) the agreement between the parties, 2) if there is a breach independent of the loss or destruction of goods, the breaching party bears the loss, 3) delivery obligations such as whether it is a shipment or destination contract may also govern, and 4) if there is no agreement, breach, or delivery by common carrier, risk of loss depends on whether the seller is a merchant or non-merchant. Depending upon the above factors, if the risk of loss is on the buyer, the buyer would have to pay the full contract price for the lost or damaged goods. If the risk of loss is on the seller, the buyer has no obligation to pay, the seller bears the loss, and seller must send buyer new goods or pay damages if unable to do so.

**Sale of Goods Act of 1986**

Occasionally, goods are lost or damaged and neither the buyer nor seller is at fault. Section 9 of the Marshall Islands Sale of Goods Act of 1986 voids contracts where goods perish after the agreement to sell but before the sale occurs\textsuperscript{1010} and under Section 22 of the Sale of Goods Act of 1986,\textsuperscript{1011} risk of loss in this situation remains with the seller unless delay or fault is attributable to the buyer.

Before risk of loss can be assessed, title to the goods must be ascertained. Generally speaking, whoever has title bears the risk. Under Section 18 of the Sale of Goods Act of 1986 in the Marshall Islands “no title of goods is transferred to the buyer

\textsuperscript{1008} UCC 2-509(3); Revised UCC 2-509(3)
\textsuperscript{1011} Marshall Islands Sale of Goods act of 1986, §22
unless or until the goods are ascertained.”\textsuperscript{1012} Once the goods and title are ascertained, the terms of the contract dictate when title is to be passed. \textsuperscript{1013} Section 20 of the Sale of Goods Act of 1986 sets forth the rules for ascertaining the intent to pass title. \textsuperscript{1014} The delivery of property generally corresponds with the passage of title and, under Section 22 of the Marshall Islands Sale of Goods Act of 1986; delivery is prima facie evidence of the shifting of risk of loss from the seller to the buyer. \textsuperscript{1015} Allocation of risk as it relates to the rules of delivery,\textsuperscript{1016} delivery to carrier,\textsuperscript{1017} and risk where goods are to be delivered to a distant place\textsuperscript{1018} are also addressed by the Sale of Goods Act. Section 33 of the Sale of Goods Act of 1986 addresses risk of loss and delivery of goods to a common carrier.\textsuperscript{1019} If the buyer requests that the seller deliver the goods to a place other than where they are sold, Section 34 of the Sale of Goods Act states: “Where the seller of the goods agrees to deliver them to a place other than that where they are when sold, the buyer must, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incident to the course of transit.”\textsuperscript{1020}

UCC

The provisions of \textit{UCC} 2-509 are more detailed but similar in nature to those provisions of the Marshall Islands Sale of Goods Act of 1986 which govern risk of loss where there is no breach.

In the absence of a breach and in those situations where a merchant seller has not agreed to deliver at a certain destination, the risk of loss from merchant seller shifts to

\begin{footnotesize}
\begin{enumerate}
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §18
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §19
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §20
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §22
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §30
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §33
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §34
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §33
\item Sale of Goods Act 1986, 23 MIRC Cap 1 §34
\end{enumerate}
\end{footnotesize}
buyer only on buyer’s receipt of goods.\textsuperscript{1021} The buyer may acquire those goods at the seller’s place of business or the goods may be shipped by seller to the buyer.

Risk of loss shifts from a non-merchant seller of goods to the buyer when the seller tenders the goods to the buyer.

Risk of loss in absence of a breach in carrier cases is generally determined by the terms of the contract, i.e. if it is a destination freight on board (FOB) or free alongside (FAS) contract, or if it is a place of shipment FOB or FAS contract.\textsuperscript{1022} Generally, if it is a shipment contract, risk of loss shifts to the buyer when the goods are placed in the stream of commerce. If it is a destination contract, risk of loss remains with the seller through the steam of commerce until received by the buyer.

For example, if shipped by common carrier and if contract requires delivery of the goods to the point of destination, it is a “destination” contract and the risk of loss remains with the seller until delivered.\textsuperscript{1023} Contracts expressly contain language F.O. B. “buyer’s place of business” would be a destination contract. If F.A.S. “buyer’s place or city of business,” the contract is a destination contract and the risk of loss remains with the seller until delivered to the destination by the vessel.

If shipment is to be by common carrier and the contract does not specify or require delivery to point of destination, the risk of loss is on the buyer when the goods are delivered to the common carrier to be shipped.\textsuperscript{1024} Most contracts are “shipment” contracts and the risk is on the buyer when tendered to the carrier. A contract specifying

\begin{footnotesize}
\textsuperscript{1021} UCC 2-319; UCC 2-509(1)(b) and Revised UCC 2-509(1)(b) \\
\textsuperscript{1022} UCC 2-509; Revised UCC 2-509. \\
\textsuperscript{1023} UCC 2-509(1); Revised UCC 2-509 (1) \\
\textsuperscript{1024} UCC 2-509(1); Revised UCC 2-509 (1)
\end{footnotesize}
F.O. B. “seller’s place of business” would be a shipment contract. A contract indicating F.A.S “seller’s city of business” is a shipment contract and the seller bears risk until along side vessel at which point the risk would shift to buyer. The risk is on buyer once in carrier’s possession and buyer may acquire insurance to cover any potential loss.

In the absence of breach and in those instances where the buyer does not request or the contract does not specify a particular destination or require delivery, the seller bears the risk of loss and is responsible to hold the goods for a reasonable time enabling the buyer to take possession.\textsuperscript{1025}

The goods may also be held by a bailee to be delivered without being moved.\textsuperscript{1026} The “bailee rule” provides that the risk of loss passes to the buyer without goods being moved when buyer gets rights to possess even if goods are in custody of a bailee.\textsuperscript{1027} The buyer assumes risk of loss if a negotiable document of title is received by buyer or the bailee notifies buyer of right to possession because buyer has the right to the goods.\textsuperscript{1028}

In the instance in where there is a breach of contract independent of the loss or destruction of the goods, the breaching party bears the risk of loss.\textsuperscript{1029}

In a no breach, non-carrier situation involving a merchant, the risk of loss passes from the merchant seller to the buyer when title passes and the buyer takes possession. In a non-carrier, non-merchant case, the risk of loss passes from the non-merchant seller to

\textsuperscript{1025} UCC 2-319
\textsuperscript{1026} UCC 2-509(2), Revised UCC 2-509(2)
\textsuperscript{1027} UCC2-509(2); Revised UCC 2-509(2)
\textsuperscript{1028} UCC 2-509(2); Revised UCC 2-509 (2)
\textsuperscript{1029} See for example, Sale of Goods Act 1986,23 MIRC Cap 1, §22
the buyer when goods are tendered. Such rule differentiation can be confusing and, consequently, the Revised UCC eliminates any distinction regarding risk of loss between merchant and non-merchant sellers.

**Risk of Loss: Breach**

Allocation of risk of loss is affected by breach. Generally, risk of loss passes to the breaching party. As noted, in pertinent part, of Section 22 of the Marshall Islands Sale of Goods Act of 1986, “where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault with regard to any loss which might not have occurred but for such fault.”

*UCC* 2-510 addresses risk of loss for contracts for the sale of goods when breach occurs. When tender or delivery of goods gives the right to the buyer to reject, the risk of loss remains with the seller until cured by the seller or there is acceptance by the buyer. If the seller tenders goods that are so non-conforming as to constitute a breach, the risk remains with the seller until the seller cures the defect or the buyer accepts the defective goods notwithstanding the seller’s lack of compliance.

**Passage of Title**

Passage of title is associated with assessing risk and is generally determined by agreement of the parties. Absent agreement, title passes when the seller tenders or completes performance and risk prima facie passes with title to the property.

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1030 *UCC* 2-509(3); *Revised UCC* 2-509(3) eliminates any merchant and non-merchant distinction.
1032 *UCC* 2-510(1); *Revised UCC* 2-510(1)
1033 *UCC* 2-510
1034 See for example, Sale of Goods Act 1986, 23 MIRC Cap 1, §22
of title differs in a carrier case and non-carrier case. In a carrier case, title may pass to the buyer as early delivery to the carrier or when buyer has a right of possession to the goods which may depend upon the terms of the contract. In a non-carrier situation, title generally passes to the buyer upon receipt of the goods.

Allocation of Risk: Warranties in Sales Contracts

The law of warranty lies between the substantive law of contract and tort. A warranty is a collateral term supplemental to the main purpose of the contract. Warranties may be express where there is a promise, description, affirmation of fact or where a sample or model is provided. A warranty may also be implied. As it relates to contracts for the sale of goods, there are two implied warranties: the warranties of merchantability and fitness for a particular purpose.

The general rule is that a breach of warranty entitles the innocent party only to damages for breach of warranty and does not permit the buyer to reject the goods. Section 13(2) of the Marshall Islands Sale of Goods Act of 1986 provides, in pertinent part, that a breach of warranty “may give rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.”

If the loss is purely economic, the breach of warranty action lies in contract. Pure economic loss for breach of warranty is not recoverable in tort and is precluded by the “economic loss” doctrine. Damages for breach of warranty in which there is personal injury may be filed as a tort claim or a strict product liability claim.

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1035 See for example, Sale of Goods Act 1986, 23 MIRC Cap 1, §33
**Warranty of Title**

In a contract for the sale of goods, there are a number of warranties which arise.

In a contract for the sale of goods, *UCC* 2-312 provides that there is a warranty of title and against infringement. Section 14 of the Sale of Goods Act of 1986 in the Marshall Islands also contains a comparable warranty of title provision. As it relates to this particular warranty, the seller warrants good title free of any security interest or lien and that there are no claims or infringement upon the title. Warranty of title is difficult to waive and any waiver must be specific and buyer must know seller is not warranting title to the goods.

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1037 *UCC* 2-312 provides:

1. Subject to subsection (2) there is in a contract for sale a warranty by seller that (a) the title conveyed shall be good, and its transfer rightful; and (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge. (2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have. (3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

1038 Revised *UCC* 2-312(1) (a) expands the seller’s warranty to buyer, re-arranges paragraph structure, and makes other modifications. Revised *UCC* 2-312 states:

1. Subject to subsection (3) there is in a contract for sale a warranty by seller that (a) the title conveyed shall be good and its transfer rightful and shall not unreasonably expose the buyer to litigation because of any colorable claim to or interest in the goods; and (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge. (2) Unless otherwise agreed a seller that is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer that furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications. (3) A warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the buyer reason to know that the seller does not claim title, that the seller is purporting to sell only the right or title as the seller or third person may have, or that the seller is selling subject to any claims of infringement or the like.

Express Warranties

There may also be express warranties contained in the contract which are particular to the goods or contract at issue. *UCC* 2-313 addresses the creation of express warranties by affirmation of fact, promise, and description or through conduct by providing a model or sample. The Marshall Islands Sale of Goods Act of 1986 has a

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1039 *UCC* 2-313 provides:

(1) Express warranties by the seller are created as follows: (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise. (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description. (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model. (2) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion or commendation of the goods does not create a warranty.

*Revised UCC* 2-313 makes several changes, narrows the scope of express warranties to the “immediate buyer,” adds a new section, and indicates as follows:

(1) In this section, “immediate buyer” means a buyer that enters into a contract with the seller. (2) Express warranties by the seller to the immediate buyer are created as follows: (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise. (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description. (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model. (3) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that the seller have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion or commendation of the goods does not create a warranty. (4) Any remedial promise made by the seller to the immediate buyer creates an obligation that the promise will be performed upon the happening of the specified event.

The authors of the *Revised UCC* also add additional provisions after *UCC* 2-313. A new *UCC* 2-313A entitled “Obligation to Remote Purchaser created by Record Packaged with or Accompanying Goods” and *UCC* 2-313B entitled “Obligation to Remote Purchaser created by Communication to the Public.” These new provision are intended to extend seller’s warranty to “records” sent through e-commerce. See also, *UNCITRAL Model for E-Commerce, Article 6, § 1* which provides: “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”
comparable provision which addresses sale by description or sale by sample and description.\textsuperscript{1040}

An express warranty is any affirmation or statement of facts or promise made by seller to buyer which relates to the goods and is a basis for the bargain. Such express warranties may include warranties of performance or durability.

**Implied Warranties**

In contracts for the sale of goods, there may be an implied warranty of merchantability and implied warranty of fitness for a particular purpose. The implied warranty of merchantability may be found in *UCC* 2-314.\textsuperscript{1041} It applies only when seller is a merchant and deals in goods of that kind or by occupation has special knowledge of goods.

A breach of warranty of merchantability alleges that the goods are: 1) not fit for ordinary purpose for what they are intended, 2) not adequately contained, or 3) not adequately packaged.\textsuperscript{1042}

\textsuperscript{1040} Sale of Goods Act of 1986 §15

\textsuperscript{1041} *UCC* 2-314 and *Revised UCC* 2-314 state:

(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale. (2) Goods to be merchantable must be at least such as (a) pass without objection in the trade under the contract description; and (b) in the case of fungible goods, are of fair average quality within the description; and (c) are fit for the ordinary purposes for which such goods are used; and (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and (e) are adequately contained, packaged, and labeled as the agreement may require; and (f) conform to the promises or affirmations of fact made on the container or label if any. (3) Unless modified or excluded (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

\textsuperscript{1042} *UCC* 2-314(2); *Revised UCC* 2-314(2).
The second implied warranty, the implied warranty of fitness for a particular purpose, is located in *UCC* 2-315. This implied warranty is broader in scope than the implied warranty of merchantability in that the seller need not be a merchant. A claim of breach of implied warranty for fitness for a particular purpose can be brought against either a merchant or non-merchant. If the seller has knowledge of a particular purpose and seller knows buyer is relying on that knowledge, it would constitute a breach for the seller to provide goods to the buyer that do not conform. The reliance must be reasonable and the buyer must in fact rely on seller’s knowledge of the particular purpose.

In the Marshall Islands, the Sale of Goods Act 1986 also provides for similar implied warranties. Section 14 of the Sale of Goods Act of 1986 provides for an implied warranty of title. Section 15 and Section 17 address sale by description,

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1043 *UCC* 2-315 and *Revised UCC* 2-315 provide:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller’s skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

1044 *UCC* 2-315; *Revised UCC* 2-315

1045 *UCC* 2-315; *Revised UCC* 2-315


1047 Sale of Goods Act 1986, 23 MIRC Cap 1, § 14

**Limitation of Warranties and Remedies**

There may also be a disclaimer or limitation of both express and implied warranties. *UCC* 2-316 and *UCC* 2-719 specifically address disclaimers and limitations of remedy.

Although the general rule is that express warranties cannot be disclaimed, *UCC* 2-316 permits disclaimer of express or implied warranties if both parties knowingly and clearly intend to disclaim.

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1048 Sale of Goods Act 1986, 23 MIRC Cap 1 §15 states:

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

1049 Sale of Goods Act 1986, 23 MIRC Cap 1, §17


1051 *UCC* 2-316 provides:

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other, but subject to the provisions of this *Article* on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable. (2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be in writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “There are no warranties which extend beyond the description on the face hereof.” (3) Notwithstanding subsection (2) (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is”, “with all faults” or other language which in common understanding calls the buyer’s attention to the exclusion of warranties and makes plain that there is no implied warranty; and (b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination in the circumstances to have revealed to him; and (c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade. (4) Remedies for breach of warranty can be limited in accordance with the provisions of this *Article* on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).
A disclaimer of implied warranty of merchantability must mention merchantability and, if in writing, the disclaimer must conspicuous.\textsuperscript{1052} A disclaimer for a particular purpose must be in writing and be conspicuous.\textsuperscript{1053} The words “as is” or “with all faults” must be conspicuous to sell without warranty.\textsuperscript{1054}

\textit{Revised UCC} 2-316 adds heightened protection in the consumer contract context and makes other grammatical changes as follows:

Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable. (2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it in a consumer contract the language must be in a record, be conspicuous, and state “The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract,” and in any other contract the language must mention merchantability and in case of a record must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be in writing and conspicuous. Subject to subsection (3), to exclude or modify the implied warranty of fitness, the exclusion must be in a record and be conspicuous. Language to exclude all implied warranties of fitness in a consumer contract must state “The seller assumes no responsibility that the goods will be fit for any particular purpose for which you may be buying these goods, except as otherwise provided in the contract,” and in any other contract the language is sufficient if it states, for example, that “There are no warranties which extend beyond the description on the face hereof.” Language that satisfies the requirements of this subsection for exclusion and modification of a warranty in a consumer contract also satisfy the requirements for any other contract. (3) Notwithstanding subsection (2): (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is”, “with all faults” or other language which in common understanding calls the buyer’s attention to the exclusion of warranties and makes plain that there is no implied warranty, and, in a consumer contract evidenced by a record, is set forth conspicuously in the record; and (b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods after a demand by seller there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to the buyer; and (c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade. (4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

\textsuperscript{1052} UCC 2-316(2); \textit{Revised UCC} 2-316(2)
\textsuperscript{1053} UCC 2-316(2); \textit{Revised UCC} 2-316(2)
\textsuperscript{1054} UCC 2-316(3); \textit{Revised UCC} 2-316 (3). For an example of inspection and an “as is” contract explicitly disclaiming any warranties in a non-goods case, see \textit{Lenawee v. Messerly} 331 NW 2d 203 (Mich. 1982)
Examination of goods by buyer may constitute a waiver of warranties if the defect reasonable should have been found.\textsuperscript{1055} The Marshall Islands Sale of Goods Act has a comparable provision where sale is by sample indicating that there is an implied condition that the goods will be free from defect except those that would be apparent upon reasonable examination of the sample.\textsuperscript{1056}

\textsuperscript{1055} UCC 2-513; Revised UCC 2-513. UCC 2-513 provides:

1. Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.  
2. Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.  
3. Unless otherwise agreed and subject to the provisions of this Article on C.I.F. contracts (subsection (3) of Section 2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides (a) for delivery “C. O.D.” or on other like terms; or (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.  
4. A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

Revised UCC 2-513 deletes the reference to C.I.F., C.O.D. contracts and UCC 2-321 and provides as follows:

1. Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.  
2. Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.  
3. Unless otherwise agreed the buyer is not entitled to inspect the goods before payment of the price when the contract provides (a) for delivery on terms that under applicable course of performance, course of dealing, or usage of trade are interpreted to preclude inspection before payment; or (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.  
4. A place, method or standard of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place, method or standard fixed was clearly intended as an indispensable condition failure of which avoids the contract.

\textsuperscript{1056} Sale of Goods Act 1986 §17(2)(c)
Course of dealing, usage of trade, and course of performance can also result in waiver of warranties.\textsuperscript{1057} The Marshall Islands Sale of Goods Act of 1986 also provides that implied warranties as to quality or fitness for a particular purpose may be annexed by usage of trade.\textsuperscript{1058}

The contract for the sale of goods may expressly limit warranties to those warranties to those set forth in the written contract and may exclude or limit any implied warranties. \textsuperscript{1059}

Implied warranties may be disclaimed by language, by inspection or refusal to inspect, or by course of dealing.\textsuperscript{1060} There may be an express disclaimer of the warranties of merchantability and warranty of fitness for a particular purpose.

The concept of unconscionability may also impact or limit disclaimers of warranties particularly in consumer contract for the sale of goods. Any clause which limits or determines recovery for breach of warranty cannot be unconscionable or cause the contract to fail of its essential purpose.

Similar to the approach adopted by the \textit{UCC}, the Sale of Goods Act of 1986 in the Marshall Islands generally provides that any contractual right, duty or liability, including express and implied warranties, may be excluded by express agreement, course of dealing, or usage binding upon both parties to the contract.\textsuperscript{1061} Section 55 of the Sale of Goods Act of 1986 which applies to exclusion of implied terms and conditions provides:

\footnotesize{\textsuperscript{1057} UCC 2-208 (1); Revised UCC 1-303(d)  
\textsuperscript{1058} Sale of Goods Act 1986 §16(2)  
\textsuperscript{1059} UCC 2-316; Revised UCC 2-316  
\textsuperscript{1060} For an example of inspection and an “as is” contract disclaiming any warranties in a non-goods case, see \textit{Lenawee v. Messerly} 331 NW 2d 203 (Mich. 1982)  
\textsuperscript{1061} Sale of Goods Act 1986, 23 MIRC Cap 1, § 55.
“Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negated or varied by express agreement or by the course of dealing between the parties or by usage if the usage be such as to bind both parties to the contract.”

UCC 2-719 broadly permits contractual modification or limitation of remedies for both breach of contract or warranty. In part, UCC 2-719 permits limitation or alteration of damages to return of the goods or repayment of price. For example, remedies for breach of contract or warranty can be limited to liquidated damages or, alternatively, consequential damages. A frequent provision of this type found in contracts would limit damages to repair or replace and only actual injury. The parties may also contractually exclude consequential damages in commercial contracts. Exclusion or limitation of consequential damages for personal injury in consumer contracts is prima facie unconscionable. Limitation of remedies may also be unconscionable if parties

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1063 UCC 2-719 and Revised UCC 2-719 provide:
(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages, (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer’s remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. (2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act. (3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

1064 UCC 2-719 (2); Revised UCC 2-719 (2)
1065 UCC 2-719 (1)(a); Revised UCC 2-719(1)(a)
1066 UCC 2-719(4); Revised UCC 2-719(4)
1067 UCC 2-719(4); Revised UCC 2-719 (4). See also, UCC 2-302(1)
are of disproportionate bargaining power. If a limitation of remedies fails of its essential purpose, other remedies are available.

Limitation of remedies for breach of contract or warranty may also contain a notice requirement. *UCC 2-607(3)* limits the seller’s exposure if the buyer within a reasonable time discovers or should have discovered the breach and fails to notify the seller of the breach. The concept of “vouching in” is also addressed by *UCC 2-607(5)* and *Revised UCC 2-607(5)* in which the buyer exerts pressure on the seller to indemnify or defend an action against the buyer based on some defect in the goods sold.

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1068 *UCC 2-302(1)*
1069 *UCC 2-719(2); 2-719(2)*
1070 *UCC 2-607(3)* provides:

Where a tender has been accepted: (a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and (b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach he must notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

There is a slight modification of this section in *Revised UCC 2-607(3)*(a) limiting the effect of non-notification to those situations in which the seller would suffer prejudice due to the non-notification. *Revised UCC 2-607 (3)* provides:

Where a tender has been accepted: (a) the buyer must within a reasonable time after the buyer discovers or should have discovered any breach notify the seller. However, failure to give timely notice bars the buyer from a remedy only to the extent that the seller is prejudiced by the failure and (b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach the buyer must so notify the seller within a reasonable time after the buyer receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

1071 *Revised UCC 2-607(5)* provides:

Where the buyer is sued for indemnity, breach of warranty or other obligation for which another party is answerable over (a) the buyer may give the other party notice of the litigation in a record. If the notice states that the other party may come in and defend and that if the other party does not do so the other party will be bound in any action against the other party by the buyer by any determination of fact after seasonable receipt of the notice does come in and defend the other party.
The concept of privity also controls the availability of remedies for breach of warranty. Privity can be vertical or horizontal. Vertical privity determines who shall be sued. Horizontal privity determines who can sue. Privity needs to exist between the parties in order to sue or to be sued in contract or warranty. Privity is generally established by express contract terms.

A warranty extends to the consumer and may also extend to family members, members of the household, or to guests in home who may reasonably be expected to use product.¹⁰⁷²

Warranties in consumer transactions for the sale of goods are generally covered in consumer protection legislation which is prevalent in the United States and in the Northern Pacific Region.

In the United States, the Federal Consumer Protection Product Warranties Law of 1973 (also known as the Magnusson-Moss Warranty Act) classifies warranties as full warranties and limited warranties. It encourages informal dispute resolution. It also sets forth the duration of implied warranties. It applies to contracts involving consumer goods and involves warranties regarding workmanship, materials, or level of performance.

Because it is a federal statute, one must meet the jurisdiction requirements of the statute before filing a claim in U.S. federal court. A full warranty may not disclaim or modify

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¹⁰⁷² See, for example, ASCA 27.0701 which extends implied warranties of merchantability and fitness for a particular purpose to products “which are purchased primarily for personal, family, or household use.”
implied warranties and may not limit their duration. The Magnusson-Moss Act also contains a “lemon” law providing that if there are repeated attempts to repair, the consumer may return and get a refund or replacement. A consumer contract cannot disclaim implied warranties. Implied warranties may be limited to the duration of the express warranties. Also, reasonable attorney fees may be recovered under the act for any violation.

The Consumer Protection Acts for Hawaii, the Commonwealth of the Northern Mariana Islands, and Guam are patterned after United States’ Magnusson-Moss Consumer Protection Act and provided similar remedies.

One of the leading Consumer Protection Act cases in the CNMI is ISLA Fin. Serv. v. Sablan. ISLA loaned money to Mrs. Sablan who passed away a few months later without having made any payments on the loan. ISLA called the decedent’s household to inform the now deceased that the insurance on her loan had been denied. The deceased daughter informed ISLA that her mother had died. ISLA then convinced the daughter to take out another loan to pay the mother’s loan telling the daughter that her mother “could not rest in peace” as long as this loan was outstanding. The daughter made sporadic payments on the loan for as long as she could but then ISLA brought suit demanding payment. The trial court determined that ISLA violated the CNMI Consumer Protection Act and that the daughter was entitled to relief. The CNMI Supreme Court observed:

A CPA violation consists of (1) an unlawful act or practice, (2) in the conduct of trade or commerce. ISLA does not dispute that its business constitutes commerce,

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1073 Hawaii Consumer Protection Statute, HRS §487 et seq.
1074 Commonwealth of the Northern Mariana Islands Consumer Protection Statute, 4 CMC §5101 et. seq.
1075 Guam Consumer Protection Act, 5 GCA §32101 et seq.
1076 2001 MP 21 (N. Mar. I 2001)
as defined in the CPA. Therefore, the only issue is whether ISLA created a “likelihood of confusion or misunderstanding” or was “unfair or deceptive to the consumer” when it influenced Ms. Sablan to sign a promissory note and thereby assume her mother’s debt. As its title connotes, the intent of the Consumer Protection act is to protect consumers. The operative question is not whether ISLA actually deceived Ms. Sablan, but whether ISLA acted in a way that was unfair or would likely cause confusion to a hypothetical person. Ms Sablan need only show that it was more probable than not that ISLA’s conduct created a likelihood of confusion or misunderstanding or was unfair or deceptive to a hypothetical consumer.

There can be little doubt that the type of conversation Ms. Castro had with Ms. Sablan was likely to cause misunderstanding in any similarly situated consumer’s mind. From an objective point of view, such mention of the deceased’s outstanding debt and her ability to rest in peace carried the implication of moral and legal obligation. The record and the lower court’s findings show by a preponderance of the evidence that ISLA violated the CPA. Accordingly, the trial court’s judgment is supported by sufficient evidence, and is affirmed.

The Marshall Islands similarly imply certain terms or warranties into contracts to protect purchasers and consumers in the Sale of Goods Act 1986, however, these terms may be excluded or varied under the Act by “express agreement or by course of dealing between the parties, or by usage if the usage be such as to bind both parties to the contract.”

Any exclusion in consumer transactions of warranties under the Sale of Goods Act 1986, must not conflict, however, with the Marshall Islands Consumer Protection Act which provides similar protections to those afforded under the Magnuson Moss Warranty Act. The Marshall Islands Consumer Protection Act provides for enforcement of the Act by the Attorney General and a penalty of $1000 per violation with a $10,000 penalty.

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1078 Sale of Goods Act, 23 MIRC Cap 1, § 55.
1079 Consumer Protection Act, 20 MIRC, Cap 4.
if an injunction is breached that was obtained by the Government under the Act.\textsuperscript{1080} Fines are to be paid to the Government.\textsuperscript{1081} A private individual may also sue the seller or goods or provider of service under the Act with recovery of $100 per violation or actual damages, whichever is greater.\textsuperscript{1082} Under the Act, it is unlawful to engage in any unfair or deceptive practice; pass off goods as those of another; cause confusion or misunderstanding as to the source of the goods; cause confusion or misunderstanding as to connection with another body; make deceptive representations as to geographic origins of goods or service; make deceptive representations of approval, attributes, quantities or connection regarding goods or services; misrepresentation of goods as new or original if they are not; misrepresentation as to a particular standard, quality, grade, style or model of goods or service; false advertising; or any other conduct that creates likelihood of confusion or misunderstanding.\textsuperscript{1083}

Similarly, the Republic of Palau has adopted comparable provisions in its Consumer Protection Act\textsuperscript{1084} and also prohibits any consumer or commercial transactions within the Republic which include usurious interest rates.\textsuperscript{1085}

American Samoa has statutorily established a Consumer Protection Commission and has created an entire system for addressing consumer issues.\textsuperscript{1086} Pursuant to statute,\textsuperscript{1087} an accused offender may voluntarily submit to an investigation and avoid

\begin{footnotes}
\footnote{1080}{Consumer Protection Act, 20 MIRC, Cap 4, §§ 405,409, 410-12}
\footnote{1081}{Consumer Protection Act, 20 MIRC, Cap 4, § 413}
\footnote{1082}{Consumer Protection Act, 20 MIRC, Cap 4, § 406}
\footnote{1083}{Consumer Protection Act, 20 MIRC, Cap 4. The Palau Consumer Protection Act a}
\footnote{1084}{Consumer Protection Act, 11 PNCA §201 et seq.}
\footnote{1085}{Usurious Interest Act, 11 PNCA § 301, et seq.}
\footnote{1086}{American Samoa Consumer Protection Act, ASCA 27.0401 and ASCA 27.0402}
\footnote{1087}{ASCA 27.0403}
\end{footnotes}
certain damages, not including restitution. The parties may stipulate to reimbursement. The statute also provides applicable penalties for unlicensed acts. Comparable to other consumer protection acts, the offense is a civil infraction and is punishable by a fine not less than $500 and not more than $2500 for each act. The statutory penalty provisions also provide that contracts by unlicensed person may be voided. The statute sets forth the criteria for accepting restitution and precludes any other form of recovery if restitution is accepted. American Samoa has also statutorily adopted specific provisions prohibiting a merchant from excluding, modifying, or limiting express or implied warranties of merchantability or fitness for a particular purpose in consumer transactions. The American Samoa Warranties Act sets forth civil penalties and consumer remedies in those instances where a merchant attempts to exclude express or implied warranties but expressly and narrowly applies to only two types of merchants: automobile dealers and retailers of major appliances worth over $150. This limitation is understandable in that these two categories cover most consumer transactions. The statute also provides that a merchant may also recover against a manufacturer for a breach of the implied warranties of merchantability or fitness for a particular purpose. There may also be a limitation of damages for breach of warranty and consequential damages may be limited if not unconscionable.

1088 ASCA 27.0404
1089 ASCA 27.0405
1090 ASCA 27.0701 et seq.
1091 ASCA 27.0703 and 27.0704
1092 ASCA 27.0702
1093 UCC 2-719; Revised UCC 2-719
Breach of warranty damages may also be limited by a liquidated damage provision in the contract.\textsuperscript{1094} \textit{UCC 2-719} provides for the limitation of damages and \textit{UCC 2-718} allows for liquidation of damages in contracts for the sale of goods.\textsuperscript{1095}

\textsuperscript{1094} \textit{UCC 2-718}; Revised \textit{UCC 2-718}. Î‘UCC 2-718 regarding liquidated damages states:

\begin{enumerate}
\item Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty. (2) Where the seller justifiably withholds delivery of goods because of the buyer’s breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds (a) the amount to which the seller is entitled by virtue of terms liquidating the seller’s damages in accordance with subsection (1), or (b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller. (3) The buyer’s right to restitution under subsection (2) is subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this \textit{Article} other than subsection (1), and (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract. (4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer’s breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this \textit{Article} on resale by an aggrieved seller (Section 2-706).
\end{enumerate}

\textit{Revised UCC 2-718} (1) distinguishes between consumer and other contracts, establishes a reasonable test, deletes the second sentence, and includes a reference to \textit{Revised 2-719}. Also \textit{Revised UCC 2-718}(2) deletes original clause (b) and provides additional situations in which restitution is owed. \textit{Revised UCC 2-718} provides:

\begin{enumerate}
\item Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach and, in a consumer contract, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. Section 2-719 determines the enforceability of a term that limits but does not liquidate damages. (2) Where the seller justifiably withholds delivery of goods or stops performance because of the buyer’s breach or insolvency, the buyer is entitled to restitution of any amount by which the sum of the buyer’s payments exceeds the amount to which the seller is entitled by virtue of terms liquidating the seller’s damages in accordance with subsection (1). (3) The buyer’s right to restitution under subsection (2) is subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this \textit{Article} other than subsection (1), and (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract. (4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer’s breach before reselling goods received in part performance, the resale is subject to the conditions laid down in this \textit{Article} on resale by an aggrieved seller (Section 2-706).
\end{enumerate}

\textsuperscript{1095} The UN Sales Convention does not address liquidated or stipulated damages. However, \textit{Article 7.4.13} of the \textit{UNIDROIT} Principles provides:


**DUTY OF GOOD FAITH**

Most international standards governing contract law indicate that it is implicit that every contract contains a duty to act in good faith.

*International Standards*

There are a number of provisions in the *UCC* which address the good faith requirement in contracts for the sale of goods. The accepted consensus is that good faith, at a minimum, means “honesty in fact in the conduct or transaction involved.” The *Revised UCC* defines “good faith” as both “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” *UCC* 1-203 provides that every contract for the sale of goods requires that the parties act in good faith. Although the parties cannot disclaim the requirement to act in good faith, the parties can determine what the standards of good faith are that govern the agreement as long as they are not considered objectively unreasonable.

There exists an implied duty of

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1. Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm. (2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.

1096 *UCC* 1-201(19)

1097 *Revised UCC* 1-201(20); *Revised UCC* 2-103 (1)(j)

1098 *UCC* 1-203 indicates that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” Good faith is defined in *UCC*1-201(19) as “honesty in fact in the conduct or transaction concerned.” *Revised UCC* 1- 201(20) submitted to the American Law Institute in May 2003 materially alters the definition of “good faith” by including a requirement of “fair dealing.” *Revised UCC* 1-201(20) defines “good faith” as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”

1099 *UCC* 1-102(3) provides:

The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement
cooperation and one is not to hinder or prevent the ability of another to perform. As it relates to lender liability and the exercise of reserved discretion, there is also an implied duty to act in good faith.

The Restatement (Second) of Contracts, § 205, which is broader in its application than contracts for the sale of goods covered by the UCC, applies the duty of good faith requirement to all contracts. Since the duty of good faith must be met in a variety of contexts, its meaning varies depending on the context.

In addition to the UCC and the Restatement of Laws, the UNIDROIT Principles of Contract Law elevate the good faith requirement to an international level. Article 1.7 of the UNIDROIT Principles of Contract law requires a party to “act in accordance with good faith and fair dealing in international trade.” In pertinent part, UNIDROIT Principles require a party to negotiate in good faith in three particular situations: (1) where one party voluntarily commences to negotiate with the other party under Article

determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

UCC 1-102(3) has been modified and shifted to Revised UCC 1-302 which states:

(a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be varied by agreement. 
(b) The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement. (c) The presence in certain provisions of [the Uniform Commercial Code] of the phrase “unless otherwise agreed”, or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

Restatement (Second) of Contracts, § 205 states: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”

See, Restatement (Second) of Contracts, § 205, Comment a.
1.7(1);\textsuperscript{1102} (2) where the duty is implied from the nature, purpose or relationship of the contract under Article 5.2;\textsuperscript{1103} and (3) where, after hardship has occurred, the other (disadvantaged) party makes a timely request to renegotiate the contract or its terms under Articles 6.2.2 and 6.2.3.\textsuperscript{1104} The \textit{UNIDROIT Principles} also state that “a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.”\textsuperscript{1105} It is also “bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.”\textsuperscript{1106}

Although included in the \textit{UCC}, the Restatement and the \textit{UNIDROIT} Principles, the 1980 UN Sales Convention (\textit{CISG}) governing the international sale of goods does not have a comparable good faith requirement in \textit{Article} 7(2) because of a conflict that arose between delegates at the time of adoption. It was noted that “[a]t a late stage in the preparation of the Sales Convention this language was adopted as a compromise between divergent views: (a) Some delegations supported a general rule that…the parties must

\textsuperscript{1102} In pertinent part, \textit{UNIDROIT} Article 1.7(1) states that: “each party must act in accordance with good faith and fair dealing in international trade.”

\textsuperscript{1103} \textit{UNIDROIT} Article 5.2 states: “Implied obligations stem from (a) the nature and purpose of the contract; (b) practices established between the parties and usages; (c) good faith and fair dealing; (d) reasonableness.”

\textsuperscript{1104} The \textit{UNIDROIT Principles} which have influenced standards of international trade also recognize that events subsequent to contractual formation may cause hardship and require that upon request of the disadvantaged party that the advantaged party must, at a minimum, negotiate in good faith toward some sort of equilibrium. See \textit{UNIDROIT} Article 6.2.2 and \textit{UNIDROIT} Article 6.2.3. If the parties are unable to reach an agreement within a reasonable time, a court, if it finds hardship, is permitted, if reasonable to “(a) terminate the contract at a date and on terms to be fixed, or (b) adapt the contract with a view to restoring its equilibrium. See \textit{UNIDROIT} Article 6.2.3(4). \textit{Article} 6.2.3 (Comment 5) states:

Although nothing is said in this \textit{Article} to that effect, both the request for negotiations by the disadvantaged party and the conduct of both parties during the renegotiation process are subject to the general principle of good faith (Art. 1.7) and to the duty of cooperation (Art. 5.3).


\textsuperscript{1105} \textit{UNIDROIT} Article 2.15(2)

\textsuperscript{1106} \textit{UNIDROIT} Article 2.15(3)
observe principles of ‘fair dealing’ and must act in ‘good faith’; Others resisted this step on the ground that ‘fair dealing’ and ‘good faith’ had no fixed meaning and would lead to uncertainty.” 1107 The compromise reached among delegates was that the convention was generally to be interpreted in light of good faith in international trade.

**Marshall Islands**

The Sale of Goods Act of 1986 in the Marshall Islands also implies a good faith requirement and states: “A thing is deemed to be done ‘in good faith’ within the meaning of this Act when it is in fact done honestly, whether negligent or not.” 1108

**Good Faith and Customary Law**

Customary and traditional law impact upon the duty of good faith by imposing a higher duty of good faith and due regard for the interests of each other where the parties share a sufficiently close relationship, i.e. blood, business, friendship, or other special circumstances.

For example, in *Arbedul v. Isimang*, 1109 the Palau Supreme Court observed that defendant Arbedul was considered to be a “nephew” of the Plaintiff Isimang in the Omrekongel Clan, that a confidential relationship existed between the parties, and that they had close feelings for each other. 1110 Because of this relationship, the court found that she was more likely to rely on his characterization of a legal document than she

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1107 See, J. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* 99(3rd ed. 1999) Honnold points out that ultimately it was “decided that an obligation of ‘good faith’ should not be imposed loosely and at large, but should be restricted to a principle for interpreting the provisions of the Convention.” Id. Although it does not directly address performance by the parties to a contract, Article 7(2) of the UN Sales Convention provides that in “the interpretation of this convention, regard is to be had to… the observance of good faith in international trade.”


1109 7 ROP Intrm 200 (1999)

1110 Id at 204
would believe a stranger. Consequently, the court found it reasonable for this 93 year-old senior female member of the Omrekongel Clan to rely on her “nephew’s” mischaracterization of the contents of the document and voided the deed.

CHANGED CIRCUMSTANCES: FRUSTRATION OF PURPOSE, IMPOSSIBILITY OR IMPRACTICABILITY

Impracticability may result in the discharge of contract performance. Impracticability may be existing or supervening. If parties at time of contract know of a particular stated purpose of the agreement and, if the essential purpose is destroyed by impossibility, impracticability or frustration of purpose, the parties may be discharged from their respective duties and obligations under the terms of the contract.

Restatement (Second) of Contracts §261 sets for the requirement for discharge by supervening impracticability while Restatement (Second) of Contracts §265 addresses supervening frustration of purpose. The remedy or relief for discharge of duty due to impracticability or frustration of purpose includes restitution as noted by Restatement (Second) of Contracts §272.

Impracticability has broad applicability in various contractual arrangements but has specifically been recognized as a valid excuse discharging the duty to perform contracts for the sale of goods.

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1111 Id at 204
1112 Id at 204
1113 UCC 2-613; Revised 2-613 to UCC 2-615; Revised 2-615. UCC 2-613 provides:

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before risk of loss passes to the buyer in a proper case under a “no arrival, no sale” term (Section 2-324) then (a) if the loss is total the
contract is avoided; and (b) if the loss is partial or the goods have so deteriorated as no longer
conform to the contract the buyer may nevertheless demand inspection and at his option either
treat the contract as avoided or accept the goods with due allowance from the contract price for the
deterioration or the deficiency in quality but without further right against the seller.

_Revised UCC 2-613_ makes minor grammatical changes and provides as follows:

Where the contract requires for its performance goods identified when the contract is made, and
the goods suffer casualty without fault of either party before risk of loss passes to the buyer then
(a) if the loss is total the contract is terminated; and (b) if the loss is partial or the goods have so
deteriorated as no longer conform to the contract the buyer may nevertheless demand inspection
and at its option either treat the contract as terminated or accept the goods with due allowance
from the contract price for the deterioration or the deficiency in quality but without further right
against the seller.

_UCC 2-614_ and _Revised UCC 2-614_ state:

(1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or
an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes
commercially impracticable but a commercially reasonable substitute is available, such substitute
performance must be tendered and accepted. (2) If the agreed means or manner of payment fails
because of domestic or foreign government regulation, the seller may withhold or stop delivery
unless the buyer provides a means or manner of payment which is commercially a substantial
equivalent. If delivery has already been taken, payment by means or in the manner provided by the
regulation discharges the buyer’s obligation unless the regulation is discriminatory, oppressive or
predatory.

_UCC 2-615_ provides:

Except so far as a seller may have assumed a greater obligation and subject to the preceding
section on substituted performance: (a) Delay in delivery or non-delivery in whole or part by a
seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for
sale if performance as agreed has been made impracticable by occurrence of a contingency the
non-occurrence of which was a basic assumption on which the contract was made or by
compliance in good faith with any applicable foreign or domestic governmental regulation or
order whether or not it later proves to be invalid. (b) Where the causes mentioned in paragraph (a)
affect only a part of the seller’s capacity to perform, he must allocate production and deliveries
among his customers but may at his option include regular customers not then under contract as
well as his own requirements for further manufacture. He may so allocate in any manner which is
fair and reasonable. (c) The seller must notify the buyer seasonably that there will be delay or non-
delivery and, when allocation is required under paragraph (b), of the estimated quota thus made
available for the buyer.

_Revised UCC 2-615_ makes minor grammatical changes to the original and provides as follows:

Except so far as a seller may have assumed a greater obligation and subject to the preceding
section on substituted performance: (a) Delay in performance or non-performance in whole or part
by a seller that complies with paragraphs (b) and (c) is not a breach of the seller’s duty under a
contract for sale if performance as agreed has been made impracticable by the occurrence of a
contingency the non-occurrence of which was a basic assumption on which the contract was made
or by compliance in good faith with any applicable foreign or domestic governmental regulation or
order whether or not it later proves to be invalid. (b) Where the causes mentioned in paragraph (a)
Two of the earliest English cases recognizing impracticability or frustration of purpose involved a room rental and lease of a music hall.

In *Krell v Henry*, 1114 the plaintiff rented a room to the defendant for one day to view the coronation procession of Edward VII. Both parties clearly understood that the essential purpose of the contract was to view the coronation procession. When the procession was cancelled due to the King’s illness, the court held that it discharged both parties from further performance dismissing plaintiff’s suit.

An earlier English case recognizing both supervening impracticality and destruction of something essential to the contract as a basis for relief is *Taylor v. Caldwell*. 1115 In *Taylor*, the defendant agreed to hire out a music hall to plaintiff on certain dates in order to hold concerts. Six days before the first concert was to take place, the hall was accidentally destroyed by fire. Plaintiff sued claiming damages due to defendant’s failure to make the premises available. The court indicated that it was implied that the existence of the hall was an essential term of the contract and its destruction discharged the parties from further performance under the contract.

The difficulty court’s encounter when addressing the concept of frustration of purpose, impossibility and impracticability is that there is frequently some level of difficulty which may subjectively be construed as frustration, impracticability or

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affect only a part of the seller’s capacity to perform, the seller must allocate production and deliveries among its customers but may at its option include regular customers not then under contract as well as its own requirements for further manufacture. The seller may so allocate in any manner which is fair and reasonable. (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

1114 2 KB 740 (1903)
1115 122 ER 309 (1863)
impossibility associated with many contractual agreements. The problem in application occurs when the court is asked to assess what level of frustration, impracticability, or impossibility warrants excuse from performance. This difficulty in application has led to some judicial reluctance in its adoption and consequently these options remain a minority view for contracts other than contracts involving the sale of goods.

In *Palau Marine Indus. Corp v. Pac Call Inves Ltd.*, a defendant supplier of fish unsuccessfully tried to raise an impossibility defense claiming that it should be relieved of liability because the plaintiff off loader, processor and transporter of the fish would not have been able to perform its obligation even if defendant had provided the fish.

Similar to the concepts of frustration, impracticability or impossibility is the concept of “hardship” which would under international standards would require good faith negotiation and may excuse performance. The *UNIDROIT Principles* which have influenced standards of international trade recognize that events subsequent to contractual formation may cause hardship and require that upon request of the disadvantaged party that the advantaged party must, at a minimum, negotiate in good faith toward some sort of equilibrium. If the parties are unable to reach an agreement within a reasonable time, a court, if it finds hardship, is permitted, if reasonable to “(a) terminate the contract at a date and on terms to be fixed, or (b) adapt the contract with a view to restoring its equilibrium.”

\[\text{References}\]

1116 9 ROP 67 (2002)
1117 *UNIDROIT* Article 6.2.2 and 6.2.3 (Comment 5)
1118 *UNIDROIT* Article 6.2.3(4)
ISSUES GIVING RISE TO BREACH OF CONTRACT

As noted previously, liability for breach of contract applies only to breaches of promises and does not necessarily occur when there is a failure of a condition. However, failure of a condition may result in the inability to enforce a promise resulting in a breach if the party protected by the condition has promised that the condition will occur. Since non-occurrence of a condition is not necessarily a breach of contract unless a party is under a duty that that the condition occur, it is important to examine a number of issues may not only discharge the performance of a condition but may also give rise to breach of contract. The non-occurrence of a condition may in many instances also constitute a basis for breach. For example, express and implied in fact conditions must be fully performed and any failure to perform would constitute a breach. Constructive conditions need only be substantially performed. The type of contract involved will also determine whether a breach has occurred. In construction and most other contracts, the doctrine of substantial performance is applicable. In sale of goods contracts, the perfect tender rule applies except in installment contracts. There are peculiar issues that arise with the sale of goods such as sending nonconforming goods which may constitute both an acceptance and a breach. As a general rule, in order to constitute a breach, the breach must be a material breach of contract. However, the perfect tender rule applicable to contracts the sale of goods does not require that the breach be material and any failure to comply with perfect tender will constitute a breach. In addition to failure of a condition potentially giving rise to breach of contract, a breach may occur involving independent or

1119 Restatement (Second) of Contracts §225(3)
non-conditional promises. Before the time scheduled for performance, there may be anticipatory repudiation and prospective inability or unwillingness to perform a condition giving rise to breach. At the time of performance, there may be a present breach or the breach may occur if there is a failure to timely perform. This section will examine some of the issues which may discharge performance because of non-occurrence of a condition but may also give rise to a claim of breach of contract.

**Anticipatory Repudiation and Prospective Inability or Unwillingness to Perform**

As noted in the discussion regarding contract conditions, lack of adequate assurance may justify suspension or excuse contract performance. It may also constitute a breach of contract. Specifically, *Restatement (Second) of Contracts* §251 indicates that lack of adequate assurances may constitute a breach of contract. An anticipatory breach occurs before the time specified for performance due to circumstances of anticipatory repudiation, prospective inability or unwillingness to perform.\(^1\)\(^2\)\(^0\) If a party has doubt as to whether the other party intends to perform, there may be a duty to mitigate damages by ceasing preparation to perform. The anticipatory repudiation must be clearly expressed and unequivocal. Anticipatory repudiation may not amount to breach of contract if before the time for performance there is a retraction and the other party has not relied on the repudiation. Pursuant to *Restatement (Second) of Contracts* §256, the party may retract its repudiation if there has been no reliance on the repudiation or the other party has not yet sued.

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\(^{1120}\) See, *Hochster v. De La Tour* 118 ER 922 (1853)
Where there has been an unequivocal repudiation, the non-breaching has several remedies: 1) sue immediately for breach of contract; 2) suspend performance and wait to sue on the performance clause; 3) treat the repudiation as offer to rescind and a contract discharge; or 4) ignore the repudiation and encourage promisor to perform. This fourth option is somewhat of a risk since the other party can retract the repudiation as long as there has been no detrimental reliance on the retraction and the non-breaching party must be ready to perform.

Present Breach

A present breach differs from anticipatory repudiation or anticipatory breach in that a present breach of contract occurs when a party who has an immediate duty to perform fails to perform. The non-breaching party is then entitled to sue immediately seeking appropriate remedies for the breach due to the breaching party’s failure to perform.

Failure to Perform Timely

If there is a failure to perform within a reasonable time, it may also constitute breach of contract. If there is no time specified or a contract indicating time is of the essence, a reasonable time to perform will be implied by the court.

Failure to timely perform can be waived. It must be an elective waiver. If it is a contract involving the sale of goods, there is no need for additional consideration for such a waiver under the Uniform Commercial Code.

Material Breach

In non-sale of goods contracts in order for a breach to occur, it must be a material breach. Sale of goods contracts require perfect tender and any failure to comply constitutes breach. The Restatement (Second) of Contracts § 241 provides a guide to
determine whether the failure to render or offer performance is material. In determining whether the breach is material, the following are significant:

1) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
2) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
4) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking into account of all the circumstances including any reasonable assurances;
5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.\(^\text{1121}\)

If it is a minor breach, the doctrine of substantial performance would apply except in a contract for the sale of goods. In the event that there is substantial compliance, damages accrued to complete the contract are deducted from the contract price unless economic waste results. A minor breach coupled with anticipatory repudiation may also constitute a breach of contract.

In determining whether a breach is material, factors that are to be considered are the amount of the benefit received, adequacy of damages, the extent to which there has been part performance, hardship to breaching party, negligent or willful behavior, or the likelihood of full performance.

**Sale of Goods: Breach of Contract**

In a contract for sale of goods, there may be breach of contract by either the seller or buyer. Breach of contract by the buyer includes the buyer’s wrongful rejection, wrongful attempt to revoke acceptance, wrongful failure to perform a contractual

\(^{1121}\) Restatement (Second) of Contracts §241
obligation, failure to make a payment when due, and repudiation.\textsuperscript{1122} A breach of contract by the seller includes the seller’s wrongful failure to deliver or to perform a contractual obligation, the failure to comply with the perfect tender rule by making a non-conforming tender of delivery or performance without cure, and repudiation.\textsuperscript{1123}

\textit{Sale of Goods: Acceptance and Breach}

A seller can send non-conforming goods which simultaneously constitutes both an acceptance and a breach. As long as the seller cures before the time specified for performance in the contract, the seller complies with the rule of perfect tender and there is no breach. In the absence of cure, the seller breaches and the buyer has all contract remedies available to it.

The doctrine of substantial completion does not apply to the sale of goods. The perfect tender rule applies under the common law and Article 2 of the \textit{UCC}. The Marshall Islands has adopted the perfect tender rule in Section 15 of the Sale of Goods Act of 1986.\textsuperscript{1124}

\begin{flushright}
\textsuperscript{1122} \textit{UCC} 2-703; \textit{Revised UCC} 2-703(1) \\
\textsuperscript{1123} \textit{UCC} 2-711; \textit{Revised UCC} 2-711(1) \\
\textsuperscript{1124} In the Marshall Islands there is an implied condition that the goods will correspond exactly with the description contained in the contract. Sale of Goods Act 1986, 23 MIRC Cap 1, § 15 provides:
\end{flushright}

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.
PART VII: REMEDIES FOR BREACH OF CONTRACT AND EQUITABLE RELIEF

IN GENERAL: RIGHT TO SUSPEND PERFORMANCE

Upon breach or prospective inability to perform, a party has at the outset the right to suspend performance or cancel. A party may also seek specific performance. Alternatively, the party may also complete performance and then sue for damages. In additions to the right to suspend performance and those remedies for breach which may be specified by the parties in the contract, Professors Cooter and Ulen note in Law and Economics\(^{1125}\) that specific performance and damages are the two general types of court imposed remedies for breach of contract:

Damages and specific performance are the two general types of court-designed remedies for breach of contract. Different legal systems in different countries disagree about the preferred remedy. In common law countries and in France, courts say that damages are the preferred remedy, whereas German courts say that specific performance is the preferred remedy. The difference between alternative legal traditions, however, is greater in theory than in practice. In practice, each legal system prescribes damages as the remedy in some circumstances and specific performance as the remedy in other circumstances. Furthermore, the prescriptions largely overlap in many different legal systems. Presumably the prescriptions overlap because different systems of law respond

\(^{1125}\) Cooter and Ulen, Law and Economics (2\textsuperscript{nd} ed. Addison-Wesley 1997). This text is an excellent resource for those who wish to employ an economic analysis of the law when interpreting the substantive law of contract. An additional law and economics resource would be Posner, Economic Analysis of the Law, (Little Brown and Co. 1992)
to the same economic logic. Common law and civil law traditions both tend to specify the efficient remedy for breach of contract.\textsuperscript{1126}

**DAMAGES**

The trial court has wide discretion in determining damages in a contract case.\textsuperscript{1127} As noted in *Restatement (Second) of Contracts* §344, the purpose of contract remedies are to protect the promisee’s expectation, reliance, or restitution interests.

The theory and intent of damages in contract cases is to provide the non-breaching party with the benefit of the bargain and to compensate the aggrieved party for realistic expectation interest.

This was best summarized in *Palau Marine Indus. Corp. v. Seid*,\textsuperscript{1128} where the Palau Supreme Court observed that contract damages are ordinarily based on the injured party’s expectation interest and are intended to give the non-breaching party the benefit of the bargain by awarding compensation that will, to the extent possible, place the non-breaching party in as good a position as they would have been had the contract been performed.\textsuperscript{1129} Once a claimant’s entitlement to damages has been established, the amount of damages is a fact issue to be determined by the trier of fact.\textsuperscript{1130}

\textsuperscript{1126} Id at 204
\textsuperscript{1127} See, for example, *Kihara Real Estate, Inc. v. Estate of Nanpei (III)* 6 FSM Intrm 502 (Pon. 1994) which involved the development of a golf course and condominium project; *O’Byrne v. George*, 9 FSM Intrm 62, 65 (Kos. S. Ct. Tr. 1999)
\textsuperscript{1128} 9 ROP 173 (2002)
\textsuperscript{1129} Id at 177. See also, *Restatement (Second) of Contracts*, § 347.
\textsuperscript{1130} *Kosrae v. Langu*, 9 FSM Intrm 243, 250 (App 1999) which involved an issue of whether cooks, who claimed they were Kosrae State Employees, were entitled to back pay and a jurisdictional issue as to whether the state court had jurisdiction to award damages or whether the administrative agency should have
In general, damages awarded in contract cases are intended to compensate and not to punish. There are several types of damages which may be awarded for breach of contract: 1) actual or compensatory, 2) consequential, 3) punitive, in rare instances, 4) nominal, 5) liquidated damages, or 6) restitution which may be both a contract and equitable remedy. As noted by Cooter and Ulen in Law and Economics, “[t]he best remedy for breach secures optimal commitment to the contract, which causes efficient performance and reliance” whether that be specific performance, or what Cooter and Ulen classify as expectation damages, reliance damages, or opportunity costs.\textsuperscript{1131}

**Compensatory Damages**

Compensatory damages or actual damages are the standard measure of damages. *Restatement (Second) of Contracts* §347 sets forth the measure of damages in general. In order to be entitled to consequential or special damages, they must be reasonably foreseeable at the time of contracting.\textsuperscript{1132}

The majority rule is best articulated by the English case, *Hadley v. Baxendale*,\textsuperscript{1133} which defines the modern standard in assessing consequential damages resulting from the breach. The Plaintiff’s mill broke a crankshaft and sent for a replacement. The defendant was a common carrier and was to deliver it the next day. Due to the defendant’s neglect, the crankshaft was delayed and the plaintiff sued for lost profits due to the delay because the mill was idle longer than it would have been had the crankshaft been delivered timely.

\textsuperscript{1131}Cooter and Ulen, *Law and Economics*, 203 (2\textsuperscript{nd} ed. Addison-Wesley 1997)
\textsuperscript{1132}Restatement (Second) of Contracts §351
\textsuperscript{1133}9 Exch. 341 (1854)
In assessing causation and remoteness, the court held that the defendant was not liable for the loss of profit. The rule in *Hadley v. Baxendale* specifies that a party is entitled to all damages which consequently flow from the breach if contemplated by the parties and foreseeable at the time the contract was formed. The carrier had not been told at the time of contract of the consequences that might result from the delay. The carrier was only told what the article was and that the plaintiff was a mill proprietor. The court held it was not reasonable to hold the carrier liable for the loss. The standard is a reasonable person standard and Plaintiff has burden of persuasion and proof.

Numerous cases have adopted the concept of foreseeability as pronounced in *Hadley*. A more modern statement of the rule in *Hadley* is embodied in *UCC* 2-715(2) (a)\textsuperscript{1134} applicable to contracts for the sale of goods and *Restatement (Second) of Contracts* §351\textsuperscript{1135} applicable generally to contracts other than those involving the sale of goods. Both have adopted the foreseeability test enunciated in *Hadley*.

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\textsuperscript{1134} For those contracts involving the sale of goods, *UCC* 2-715(2) provides:

Consequential damages resulting from the seller’s breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.

\textsuperscript{1135} *Restatement (Second) of Contracts* §251 provides:

1. Damages are not recoverable for loss that the party in breach did not have reason to foresee as the probable result of the breach when the contract was made.
2. Loss may be foreseeable as a probable result of a breach because it follows from the breach (a) in the ordinary course of events, or (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.
3. A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.
One of the leading Micronesian cases setting the standard for compensatory contract damages is *Kihara Real Estate v. Estate of Nanpei.*\(^{1136}\) In *Kihara*, the plaintiff entered into a lease option agreement with the defendant as part of a resort, condominium and golf course development project paying $12,500 as consideration. Plaintiff sued for breach of the lease option agreement seeking $54,405.96 in damages. The court noted that some of the damages requested were incurred prior to the negotiation of the option agreement and others were sustained subsequent to notification of the breach. The defendant breached the agreement by failing to give a final list of properties and by failing to permit the plaintiff right of first refusal.\(^{1137}\) The court noted, however, that some of the conditions contained in the option were unrealistic such as the Pohnpei legislature extending the permissible length of leases from 25 to 75 years and were ambiguous in that no set duration was set for any leases.\(^{1138}\)

Under the standard set forth in *Semens v. Continental*,\(^{1139}\) the *Kihara* court looked to the common law of the United States since the contract issues raised in the case were not resolved by statutes, decisions of the constitutional courts of Micronesia, or by custom or tradition law within Micronesia.\(^{1140}\)

The *Kihara* court then observed:

The trial court has wide discretion in determining the amount of damages in a contract case…. In a breach of contract case the non-breaching party is entitled to damages that will put the party in the position he or she would have been in if not for the breach….The plaintiff may be compensated for the injuries flowing from

\(^{1136}\) 6 FSM Intrm 502 (Pon. 1994)  
\(^{1137}\) Id at 504  
\(^{1138}\) Id at 504  
\(^{1139}\) 2 FSM Intrm 141,142 (Pon 1985)  
\(^{1140}\) 6 FSM Intrm at 505
the breach either by awarding compensation for lost profits, or by awarding compensation for expenditures.\textsuperscript{114}\textsuperscript{1}

After indicated that plaintiff has the burden of proving damages, the \textit{Kihara} court then proceeded to limit plaintiff’s damages to those reasonably made in reliance on the contract.\textsuperscript{114}\textsuperscript{2} The \textit{Kihara} court noted:

Therefore, the right to recover expenditures made in reliance on the contract is not without limitation. If it can be shown that the plaintiff would have suffered the same losses even if the defendant had performed under the contract, then the plaintiff cannot recover them, since recovery would put the plaintiff in a better position than he would have been in had the defendant performed….If the plaintiff could recover his reliance expenditure from the defendant, even if those expenditures would have been lost had the defendant fully performed, then the defendant would essentially be made the ‘insurer’ of the plaintiff’s venture.\textsuperscript{114}\textsuperscript{3}

The \textit{Kihara} decision then took a unique approach for a contract case applying a tort-like proximate causation requirement in its effort to determine what was “foreseeable” at the time of contract in order to recover contract damages. The \textit{Kihara} court required:

\begin{quote}
[I]n order to be recoverable the damages must be one of ‘the proximate… consequences of the breach by defendant.’ A proximate consequence is flowing from the act complained of ‘unbroken by any independent cause….’ ‘That which, in a natural and continuous sequence, unbroken by an efficient intervening cause, produces injury, and without which the result would not have occurred….’ Here the loss is not a proximate consequence of the breach, since indications are that the loss would have occurred for other reasons even if the contract had been performed.\textsuperscript{114}\textsuperscript{4}
\end{quote}

Because of the unrealistic condition in the lease option agreement that required the Pohnpei Legislature to extend the 25 year lease limit to 75 years which would have precluded any recovery for plaintiff despite defendant’s breach and the fact that the lease

\begin{footnotesize}
\textsuperscript{114}\textsuperscript{1} Id. (Citations omitted)
\textsuperscript{114}\textsuperscript{2} Id.
\textsuperscript{114}\textsuperscript{3} Id. (Citations omitted)
\textsuperscript{114}\textsuperscript{4} Id at 506 (Citations omitted)
\end{footnotesize}
agreement did not contain a lease price for a single parcel, the court permitted the
plaintiff to recover the $12,500 paid as consideration for the lease option agreement. In
awarding damages under a theory of restitution, the *Kihara* court observed:

> The purpose of the remedy of restitution is not to compensate the non-breaching
> party for reliance expenditures, but rather to prevent unjust enrichment of the
> breaching party by forcing them to give up what they have received under the
> contract….In this case, the return of the $12,500 consideration is not based on it
> being a loss attributable to the breach, but on the theory that the defendants would
> be unjustly enriched if they were allowed to keep the consideration after failing to
> live up to their end of the option agreement.\footnote{1145}

The Kihara court concluded that reliance expenditures are recoverable in breach
of option agreements in Micronesia but that the unique aspects of this case precluded
their award.\footnote{1146}

**Punitive Damages**

Punitive damages are generally awarded in tort and not awarded for breach of
contract unless there is fraud or the breach is deliberate, willful or wanton, or if the
contract subject matter is personal in nature. *Restatement (Second) of Contracts* §355
provides that the conduct constituting breach must also be a tort in order to recover
punitive damages.

If the contract is so personal in nature and it is foreseeable at the time of contract
that special injury or mental anguish could result from a breach, then punitive damages
may also be appropriate. A classic example of a contract of this type warranting punitive
damages would be mishandling the deceased body in a contract for funeral arrangements.

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\footnote{1145} Id at 507 (Citations omitted)
\footnote{1146} Id.
Punitive damages may also be provided for by statute or court rule in contract cases where the breach is a result of deceit, fraud or misrepresentation.\textsuperscript{1147}

In \textit{Guaschino v. Reimers and Reimers}\textsuperscript{1148} the Supreme Court of the Marshall Islands citing \textit{Restatement (Second) of Contracts}, §355 (1979)\textsuperscript{1149} observed: “In an action for breach of contract, punitive damages may be awarded only if the conduct constituting the breach is also a tort for which punitive damages are recoverable.” The Marshall Islands Supreme Court also relied on \textit{Restatement (Second) of Torts}, § 908, comment b (1964) which discussed the purpose of punitive damages and their nexus to outrageous tortious conduct. Because punitive damages were not requested in the pleadings and the torts involved in the case were negligence and misrepresentation but were not egregious in nature, the \textit{Guaschino} court held that the award of punitive damages was inappropriate.

The issue of punitive damages was also addressed in \textit{Air Marshall Islands (AMI) v. Dornier},\textsuperscript{1150} in which AMI sued Dornier over the sale of two aircraft in which AMI alleged fraud, misrepresentation, tortious interference of contractual relationship with another, unjust enrichment, conversion or duress. In this case, the lower court record indicated that the High Court did something quite unusual in that it awarded a default

\textsuperscript{1147}See for example, § 162 of the Marshall Islands Civil Procedure Act which provides:

\begin{quote}
In a civil case where the defendant has been found liable because of fraud, or deceit, or misrepresentation, the court shall add to the judgment, as punitive damages, an amount equal to three (3) times the actual amount of damages found by the trier of facts.
\end{quote}

\textsuperscript{1148}I MILR 350 ( March 8, 1995)
\textsuperscript{1149}\textit{Restatement (Second) of Contracts}, § 355 provides: “Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.”
\textsuperscript{1150}2 MILR 211,222 ( December 24, 2002)
judgment of $1.6 to AMI for money paid to Dornier under a theory of breach of contract when that theory was not pled by the plaintiff.\textsuperscript{1151} AMI also argued that under § 162 of the Marshall Islands’ Civil Procedure Act\textsuperscript{1152} they should be entitled to treble punitive damages of $4.8 million for fraud because it was one of the theories they pled and a default judgment is a judgment on the merits. The High Court awarded a total of $2.1 million to AMI which included the $1.8 that AMI paid to Dornier and an additional $300,000 for losses incurred for tortious interference with contractual relations regarding the collateral sale of a SAAB 2000. The High Court did not award punitive damages and the Supreme Court rejected AMI’s argument on appeal indicating that there was nothing in the lower court transcript of the default judgment hearing which indicated that the High Court found fraud or misrepresentation. The Supreme Court concluded that in the absence of such a finding on the record, punitive damages would not be appropriate.\textsuperscript{1153}

Somewhat related to the concept of punitive damages are civil or criminal fines which may be imposed for breach of contract. For example, in \textit{FSM v. Ting Hong Oceanic Enterprises},\textsuperscript{1154} the Federated States of Micronesia brought two separate cases against the Ting Hong Oceanic Enterprise Company for separate violations on different ships due to breaches of the Foreign Fishing Agreement it had signed with the Micronesia Maritime Authority. In one case, a ship had failed to maintain its daily catch log and civil and criminal penalties were sought for the breach.\textsuperscript{1155}

\textsuperscript{1151} Id at 222.
\textsuperscript{1152} See Marshall Islands Civil Procedure Act §162
\textsuperscript{1153} Id at 222.
\textsuperscript{1154} FSM v. Ting Hong Oceanic Enterprises, 8 FSM Intrm 79 (Pon 1997); FSM v. Ting Hong Oceanic Enterprises, 8 FSM Intrm 166 (Pon 1997)
\textsuperscript{1155} FSM v. Ting Hong Oceanic Enterprises, 8 FSM Intrm 79 (Pon 1997)
In the other case, several other ships of the same foreign fishing entity had failed to maintain their daily catch logs, failed to maintain the VHF radios, exceeded the crew size limitations, and transported fish that it caught in violation of the law and the Federated States of Micronesia sought and was awarded criminal and civil fines for the breach of agreement.  

Other instances in which civil or criminal fines may be imposed usually occur in consumer protection situations which have been previously discussed in this text.

**Nominal Damages**

Nominal damages are awarded where the breach is technical, insignificant or minor.

**Liquidated Damages**

*Restatement (Second) of Contracts* §356 addresses liquidated damages and sets forth the standard in which they may be awarded. Liquidated damages are frequently employed in commercial contracts where the damages for a breach are set forth in the contract and are negotiated by the parties in advance. An example of a liquidated damages clause would be where a contractor agrees to pay a $100 a day to the owner for every day that the project goes beyond the date of completion.

The Uniform Commercial Code provides that in sales contracts for goods the parties may contractually liquidate damages. If there is a liquidated damages

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1156 FSM v. Ting Hong Oceanic Enterprises, 8 FSM Intrm 166 (Pon 1997)

1157 UCC 2-718; Revised UCC 2-718. The UN Sales Convention does not address liquidated or stipulated damages. However, Article 7.4.13 of the *UNIDROIT Principles* provides:
provision, actual damages are somewhat irrelevant but may be utilized to determine “reasonableness” of the liquidated damages clause.

In order for liquidated damages to be enforced, damages must be difficult to ascertain at time contract is formed, the amount agreed upon must be a reasonable forecast of compensatory or actual damages, and the liquidated damages provision does not provide that actual damages may be recovered in addition to or in lieu of liquidated damages. If the liquidated damage provision is unreasonable in light of actual damages or construed as a penalty, courts will be reluctant to enforce the liquidated damage provision. Alternatively, Article 7.4.13 of the UNIDROIT Principles permits liquidated damages to be reduced by the courts to a reasonable amount when grossly excessive in relation to the harm caused by the breach.

**Duty to Mitigate Damages**

There is a general duty to mitigate damages in all breach of contract cases where consequential damages are sought. Restatement (Second) of Contracts §350 requires mitigation or avoidability of damages indicating that the injured party is not precluded from recovery for failure to mitigate to the extent that the party has undertaken

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(1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm. (2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.

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1158 Restatement (Second) of Contracts §356; UCC 2-718; Revised UCC 2-718
1159 Restatement (Second) of Contracts §356 (1); UCC 2-718
1160 UNIDROIT Article 7.4.13(2)
reasonable but unsuccessful efforts to avoid the loss. Otherwise, the *Restatement (Second) of Contracts* provides that failure to mitigate will preclude recovery.\(^{1161}\)

*CISG Article 77* provides:

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages by which the loss should have been mitigated.\(^{1162}\)

*CISG Article 77* is consistent with *Restatement (Second) of Contracts*, § 350 which provides that a failure to mitigate does not preclude a party from recovering losses it could not have taken reasonable steps to avoid.\(^{1163}\)

The duty to mitigate damages was addressed in the Republic of Palau in *Palau Marine Indus. Corp. v. Seid*.\(^{1164}\) In *Palau Marine*, plaintiff, PMIC, sued defendant for breach of a contract that required defendant to present a certain number of fishing boat applications and pay associated licensing and dockage fees for those boats. The trial court ruled that defendant breached its contract but concluded that it was not entitled to any recovery other than the initial deposit of $10,000 paid by defendant because plaintiff had failed to mitigate its damages. The trial court was reversed on appeal and the case was

\(^{1161}\) Restatement (Second) of Contracts §350(1)

\(^{1162}\) CISG Article 77 (1980)

\(^{1163}\) Restatement (Second) of Contracts § 350(1). Particularly, see comment b and comment d to Restatement (Second) of Contracts, § 350 which provide:

> [t]he mere fact that an injured party can make arrangements for the disposition of the goods or services that he was able to supply under the contract does not necessarily mean that by doing so he will avoid loss. If he would have entered into both transactions but for the breach, he has ‘lost volume’ as a result of the breach. Id.

\(^{1164}\) 9 ROP 173 (2002)
remanded to the trial court for calculation of damages on one particular claim because

Restatement (Second) of Contracts, § 347 provides:

Contract damages are ordinarily based on the injured party’s expectation interest and are intended to give him the benefit of the bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he would have been had the contract been performed.\footnote{9 ROP at 177}

The trial and appellate court found that all other damage claims of plaintiff were speculative.\footnote{Id at 177-8}

Mitigation is an affirmative defense that must be pled and proven by the party asserting it.\footnote{See, Palau Marine Indus. Corp v. Seid, 9 ROP 173, 174(2002); Palau Marine Indus Corp v. Pac. Call Invest. Ltd 9 ROP 67 (2002); Klsong v. Orak 7 ROP Intrm 184, 187 (1999)
5 FSM Intrm 123 (Pon. 1991)}

The duty to mitigate is also recognized in Micronesia. In Panuelo v. Pepsi Cola Bottling Co. of Guam,\footnote{5 FSM Intrm 123 (Pon. 1991)} the failure to mitigate damages completely precluded recovery when Pepsi failed to mitigate damages even though Pepsi would have been entitled to $11,000 damages when plaintiff breached an oral installment contract. The Panuelo court observed: “A court ordinarily will not compensate an injured party for loss that he could have avoided by making efforts appropriate, in the eyes of the court, to the circumstances.”\footnote{Id at 128-9} Because Pepsi was advised by plaintiff that it wanted a credit for a prior shipment in which one of the containers was spoiled against the cost of the new shipment of two containers of Pepsi and because Pepsi failed to respond, the court found Pepsi failed to mitigate. Consequently, the new shipment sat on the dock and spoiled. The court noted that after notification from plaintiff Pepsi could have attempted to resell the
Pepsi in Pohnpei and would have been entitled to the difference between the agreed price that Panuelo’s was to have paid and the general market price at which Pepsi could have sold to another buyer in Pohnpei. If they made the effort, could not resell, and the product spoiled, then Pepsi would have been entitled to the entire contract amount of $11,000. Because they failed to make any effort to cover, however, Pepsi was precluded from any recovery due to their failure to mitigate.\(^{1170}\) Although this case is framed as a mitigation of damages case and is consistent with the Restatement (Second) of Contracts, it may also be considered an “avoidance” of damage case.

In addition to providing a good basic review of the essential elements of contract, the requirement of mitigation of damages was also addressed in the recent Kosrae case, George v. Alik,\(^{1171}\) which involved vehicle damage. Defendant damaged Plaintiff’s car and they entered into a written agreement in which Defendant agreed to pay Plaintiff $2400 and Plaintiff would give him the damaged car. When the defendant failed to abide by the agreement, the Plaintiff sold the car to a third party for $800. The trial court observed that the injured party is expected to take appropriate action to mitigate or lessen damages and did so by selling the car for $800. Consequently, the court entered a judgment for the Plaintiff for the difference in the amount of $1600.\(^{1172}\)

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\(^{1170}\) Id at 129  
\(^{1171}\) 13 FSM Intrm 12 (Kos. S. Ct. Tr. 2004)  
\(^{1172}\) Id at 15.
Traditional Law and the Duty to Mitigate

The duty to mitigate and its interrelationship to traditional and customary law were addressed in a Micronesian case, *Phillip v. Aldis*. The *Phillip* case involved the rental of a vehicle by defendant from plaintiff that converted to a conditional sale. The vehicle sustained damage during the lease and defendant tried to return the vehicle after the rental period but the plaintiff refused the vehicle and told the defendant to fix it or defendant could buy it. Defendant agreed to purchase the vehicle if he could get financing which ultimately was not obtained. Plaintiff was advised and they tried to negotiate an assignment of the account payable to defendant’s employer who refused. The plaintiff still refused to repossess the vehicle and defendant was involved in a second accident.

The *Phillip* case is legally and anthropologically significant in that the court tied customary and traditional law to the common law duty to mitigate. The court noted that local customary law was superior to the common law. The *Phillip* court observed:

Plaintiff’s failure to repossess the vehicle when he ought to and his acceding to the defendant’s continued possession and use (realizing that wear and tear would normally occur) made him guilty of what is known in Pohnpeian custom as KE PWUROHNG OMW MWUR, meaning you reap the fruit of your misdeed. Application of customary law takes precedence over the common law. Pon. Const. Art. 5 §1; 1 TTC 103; 1 FSMC § 203, and I think the act of the plaintiff, under the circumstances, warrants enunciation of the custom herein described.

When one, under Pohnpeian custom, reaps the fruits of his misdeed, he suffers also the consequences. In order to avoid the adverse impact of this ‘pwurohng omw mwur,’ plaintiff should have reposed the vehicle on February 4, 1985, or immediately thereafter, had it repaired, and encouraged the defendant to secure a financial arrangement to pay for the sale price of the vehicle as offered, plus cost of the repair and three days’ rental charge, but not for the one year rental

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1173 3 FSM Intrm 33 (Pon. S.Ct. Tr. 1987)
charge….As reasoned above, I cannot accept plaintiff’s total claim; it is contrary to the Pohnpeian custom as enunciated above and the common law duty which requires plaintiff to mitigate his losses.\textsuperscript{1174}

The \textit{Phillip} court concluded that when the automobile lease agreement provides that the lessee shall pay to the lessor all costs and expenses incurred as a result of loss for damage to the leased vehicle regardless of fault, the lessor has a duty to accept the damaged vehicle and assess any costs of repair to the lessee.\textsuperscript{1175}

**SPECULATIVE DAMAGES**

\textit{Restatement (Second) of Contracts} §352 provides that in order to recover damages, damages must be established with certainty and cannot be speculative.\textsuperscript{1176}

In the Micronesian case, \textit{Phillip v. Marianas Insur. Co}.,\textsuperscript{1177} speculative damages were not permitted because they could not be established with certainty under the “new business” rule.

The Palau Supreme Court and trial court dealt with the issue of speculative damages in \textit{Palau Marine Indus. Corp v. Seid}.\textsuperscript{1178} The Supreme Court remanded the case to the trial court to “either make particularized findings concerning PMIC’s ability to mitigate its damages or enter an appropriate judgment in favor.”\textsuperscript{1179} On remand, plaintiff claimed that defendant Seid failed to provide boats for 40 fishing licenses and was liable

\textsuperscript{1174} Id at 38
\textsuperscript{1175} Id at 36.
\textsuperscript{1176} Restatement (Second) of Contracts, § 352. See also, NECO v. Rdialul, 2 ROP Intrm 211, 220 (1991); Palau Marine Industries Corp. v. Seid, 9 ROP 173, 175 (2002); Palau Marine Industries Corp. v. Seid, - ROP- (February 12, 2004)
\textsuperscript{1177} 12 FSM Intrm 464, 472 (Pon 2004)
\textsuperscript{1178} 9 ROP 173 (2002)
\textsuperscript{1179} Id at 177-8.
for lost profit of $2700 per boat totaling $108,000.\textsuperscript{1180} The trial court found that PMIC was able to cover and secure boats for 68 of the 70 licenses PMIC could have obtained that year.\textsuperscript{1181} The shortfall was two licenses plus lost profit, associated license fees and dockage fees totaling $5400 for those two licenses.\textsuperscript{1182} Plaintiff’s additional damages were speculative and Plaintiff failed to prove any additional damages to a reasonable degree of certainty.\textsuperscript{1183} Since PMIC had kept the $10,000 deposits paid by the defendant, the trial court determined that the appropriate measure of damages would be to offset the damages of $5400 against the $10,000 deposit.\textsuperscript{1184} The trial court found Seid’s liability was covered by the initial deposit.\textsuperscript{1185} The trial court was subsequently affirmed on appeal.\textsuperscript{1186}

\textbf{Open Accounts and Speculation}

Allegations of speculation often are alleged in contracts involving open accounts. Open accounts are not self proving, open to challenges of speculation and inaccuracy, and present a unique proof problem requiring an adequate foundation to demonstrate the accuracy of the account.

For example, in \textit{FSM Telecommunications v. Worswick},\textsuperscript{1187} the defendant had an open account for long distance telephone service, owed the defendant for those long distance phone calls, and continued to make long distance phone calls after she requested

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\textsuperscript{1180} - ROP- (February 12, 2004)(slip opinion, p.1)
\textsuperscript{1181} - ROP- (February 12, 2004)(slip opinion, pp.2-3 )
\textsuperscript{1182} - ROP- (February 12, 2004)(slip opinion, p. 3)
\textsuperscript{1183} - ROP- (February 12, 2004)(slip opinion, pp.1-3)
\textsuperscript{1184} - ROP- (February 12, 2004)(slip opinion, p. 3)
\textsuperscript{1185} - ROP- (February 12, 2004)(slip opinion, p.3)
\textsuperscript{1186} - ROP- (February 12, 2004)(slip opinion, p.6)
\textsuperscript{1187} 9 FSM Intrm 6 (Yap 1999), affirmed 9 FSM Intrm 460 (App. 2000)
\end{flushright}
termination of service. In *Worswick*, both the trial and appellate courts observed that, as a
general rule, open accounts are not self proving and that the creditor may rely on its
running account produced in the normal course of business to establish a prima facia case
for damages.\textsuperscript{1188} However, if there is contrary credible evidence, the normal open
account records produced during the ordinary course of business would be insufficient to
sustain the creditor’s burden of proof and each item must be proven individually.\textsuperscript{1189}
After reviewing each item, the trial court deducted certain amounts that were speculative
and unsupported by the evidence and awarded the Plaintiff $6,117.78.\textsuperscript{1190} The court
denied the plaintiff’s request for attorney’s fees in that they were not permitted either
contractually or statutorily.\textsuperscript{1191}

**Standard Measure of Damages for Breach of Contract: Sale of Goods**

The standard measure of damages in a breach of contract for sale of goods case
would be the difference between the contract price and the market price on the date of
delivery or when knowledge of breach.\textsuperscript{1192}

The Sale of Goods Act of 1986 in Marshall Islands has a similar provision which
provides that where there is an available market for the goods, damages are calculated by
finding the difference between the contract price and the market price at the time or times
when they ought to have been delivered, or if no time was fixed, then at the time of

\textsuperscript{1188} 9 FSM Intrm at 15; 9 FSM Intrm at 464
\textsuperscript{1189} 9 FSM Intrm at 15; 9 FSM Intrm at 464
\textsuperscript{1190} 9 FSM Intrm at 18 (that is a whole lot of Yapese rai!)
\textsuperscript{1191} Id at 18
\textsuperscript{1192} See, for example, *Panuelo v. Pepsi Cola Bottling Co. of Guam*, 5 FSM Intrm 123, 128 (Pon. 1991).
refusal to deliver. \textsuperscript{1193} Specifically, § 51(3) of the Sale of Goods Act of 1986 in the Marshall Islands provides:

Where there is an available market for the goods in question, the measure of damages is prima facie to be ascertained by the difference between the contract price and the market price or current price of the goods at the time or times when they ought to have been delivered, or if no time was fixed, then at the time of the refusal to deliver. \textsuperscript{1194}

The \textit{UCC} also covers numerous remedies, including damages, for the seller\textsuperscript{1195} and the buyer in the event of a breach. \textsuperscript{1196} Computation of damages under the \textit{UCC} is to be determined at time of the breach. Occasionally, a problem arises in calculating damages in the event of anticipatory repudiation when a contract is formed far in advance of date of shipment.

\textbf{BUYER’S REMEDIES FOR BREACH: SALE OF GOODS}

Under the \textit{UCC}, a buyer has a number of rights and remedies when the seller ships non-conforming goods. Under \textit{UCC} 2-711, the buyer has additional remedies for breach. The buyer can seek cover under \textit{UCC} 2-712, seek damages under \textit{UCC} 2-713, or compel specific performance under \textit{UCC} 2-716.

Similarly, in the Marshall Islands, which adheres to the perfect tender rule, the shipment of non-conforming goods also constitutes a breach of contract giving the buyer several options under the Sale of Goods Act of 1986. \textsuperscript{1197} If the seller ships non-

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\textsuperscript{1193} Sale of Goods Act 1986 23 MIRC Cap 1, § 51 \\
\textsuperscript{1194} Sale of Goods Act 1986 Cap 1 § 51(3) \\
\textsuperscript{1195} \textit{UCC} 2-708 \\
\textsuperscript{1196} \textit{UCC} 2-701 to 2-725; Revised \textit{UCC} 2-701 to 2-725. \\
\textsuperscript{1197} Sale of Goods Act 1986, 23 MIRC, Cap 1, § 15. Section 15 states:
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conforming goods and the buyer rightfully rejects, the buyer is not bound to return the goods to the seller and “it is sufficient if he intimates to the seller that he refuses to accept them.”

Under the common law and the original version of UCC 2-711, the perfect tender rule has three potential exceptions: 1) if there is inspection by the buyer; 2) if the defect is not immediately discoverable, the seller can cure; or 3) if goods are materially delayed, the buyer can reject the goods. The buyer’s right to inspection is also recognized as a potential exception to the perfect tender rule in the Marshall Islands under the Sale of Goods Act of 1986.

**Buyer’s Remedies when Non-Conforming Goods Shipped**

**Buyer’s Right to Request Cure by Seller**

When sending non-conforming goods, the seller has an opportunity to cure before the time scheduled for performance. The seller has the right to cure when sending non-conforming or defective goods if buyer rejects and time to perform has not expired. Although not permitted under the current version of UCC 2-508(2), Revised UCC 2-

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Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description. 23 MIRC Cap 1, §15

1198 Sale of Goods Act 1986, 23 MIRC Cap 1, § 37

1199 Sale of Goods Act 1986, 23 MIRC Cap 1, § 35 states:

(1) Where the goods are delivered to the buyer which the buyer has not previously examined, the buyer is not deemed to have accepted them unless and until the buyer has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract. (2) Unless otherwise agreed, when the seller tenders delivery of the goods to the buyer, the seller is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.


1201 UCC 2-508; Revised UCC 2-508.
508(2) indicates that the seller has a potential right to cure even if time has elapsed and the buyer has not provided notice prohibiting right to cure.\textsuperscript{1202} Under the Revised UCC a reasonableness standard will be employed if the time for performance has elapsed and there is an effort to cure. Although the buyer may reject goods for any defect, the seller can cure by giving notice and a new tender.\textsuperscript{1203} Under certain circumstances, the seller may also have the right to cure beyond the original contract time.\textsuperscript{1204} Upon receipt of non-conforming goods, before obtaining cover, and prior to doing anything else in haste, the buyer should verify whether the non-conforming goods were being sent by seller as an accommodation to the buyer and seek adequate assurances from the seller regarding the seller’s intent to cure prior to the time scheduled for performance.\textsuperscript{1205}

**Right to Reject**

Alternatively, under the UCC, the buyer has the right to reject non-conforming or defective goods prior to acceptance of goods. Under the perfect tender rule enunciated in UCC 2-601, the buyer can reject goods if they fail to conform in any respect.\textsuperscript{1206} If the buyer rejects prior to acceptance, the buyer must hold the goods with reasonable care. In

\begin{footnotesize}
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\item \textsuperscript{1202} Revised UCC 2-508(2)
\item \textsuperscript{1203} UCC 2-508; Revised UCC 2-508.
\item \textsuperscript{1204} Revised UCC 2-508
\item \textsuperscript{1205} The buyer’s right to cure is set forth in UCC 2-508; Revised UCC 2-508
\item \textsuperscript{1206} UCC 2-601 provides:
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addition to rejection, the buyer has two other options under *UCC* 2-601: the buyer can chose to accept the non-conforming goods, or the buyer can accept those goods which conform and reject the rest. The buyer may also demand adequate assurances and wait for seller to cure if non-conforming goods are sent before the time scheduled for performance.

**Right to Cover**

The buyer also has the right to cover if seller delivers non-conforming goods or does not deliver. If the buyer is required to obtain cover, the buyer is entitled to the difference between cost paid and the cost contained in the contract plus any incidental or consequential damages. The cover must be a reasonable substitute. The *UCC* and

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1207 *UCC* 2-601; *Revised UCC* 2-601

1208 *UCC* 2-712 states:

1. After a breach within the preceding section, the buyer may “cover” by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller. (2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller’s breach. (3) Failure of the buyer to effect cover within this section does not bar the buyer from any other remedy.

*Revised UCC* 2-712 modifies the first section by delineating specific kinds of conduct by buyer or seller and provides as follows:

1. If the seller wrongfully fails to deliver or repudiates or the buyer rightfully rejects or justifiably revokes acceptance, the buyer may “cover” by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller. (2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller’s breach. (3) Failure of the buyer to effect cover within this section does not bar the buyer from any other remedy.

1209 *UCC* 2-712(2); *Revised UCC* 2-712(2)

1210 *UCC* 2-712; *Revised UCC* 2-712
UNIDROIT Principles indicate that if the party is not reasonably able to cover when a
party breaches that the non-breaching party may be entitled to specific performance.1211

Right to Revoke Acceptance

A buyer may also revoke acceptance of the contract under UCC 2-608.1212 This
option is only available when non-conformity substantially impairs the value to the
buyer. The court will apply an objective test. The revocation of acceptance must be
within a reasonable time and before any substantial change in condition of the goods. If

1211 In pertinent part, UNIDROIT Article 7.2.2 states:

Where a party who owes an obligation other than one to pay money does not perform, the other
party may require performance unless…the party entitled to performance may reasonably obtain
performance from another source.

1212 UCC 2-608 provides:

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity
substantially impairs its value to him if he has accepted it (a) on the reasonable assumption that its
non-conformity would be cured and it has not been seasonably cured; or (b) without discovery of
such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery
before acceptance or by the seller’s assurances. (2) Revocation of acceptance must occur within a
reasonable time after the buyer discovers or should have discovered the ground for it and before
any substantial change in condition of the goods which is not caused by their own defects. It is not
effective until the buyer notifies the seller of it. (3) A buyer who so revokes has the same rights
and duties with regard to the goods involved as if he had rejected them.

Revised UCC 2-608 which adds a provision for reasonable use and makes gender changes states:

The buyer may revoke acceptance of a lot or commercial unit whose non-conformity substantially
impairs its value to the buyer if the buyer has accepted it (a) on the reasonable assumption that its
non-conformity would be cured and it has not been seasonably cured; or (b) without discovery of
such non-conformity if the buyer’s acceptance was reasonably induced either by the difficulty of
discovery before acceptance or by the seller’s assurances. (2) Revocation of acceptance must
occur within a reasonable time after the buyer discovers or should have discovered the ground for
it and before any substantial change in condition of the goods which is not caused by their own
defects. The revocation is not effective until the buyer notifies the seller of it. (3) A buyer that so
revokes has the same rights and duties with regard to the goods involved as if the buyer had
rejected them. (4) If a buyer uses the goods after a rightful rejection or justifiable revocation of
acceptance, the following rules apply: (a) Any use by the buyer which is unreasonable under the
circumstances is wrongful as against the seller and is an acceptance only if ratified by the seller.
(b) Any use of the goods which is reasonable under the circumstances is not wrongful as against
the seller and is not an acceptance, but in an appropriate case the buyer is obligated to the seller for
the value of the use to the buyer.
circumstances require, the buyer may continue to use the non-conforming goods as an accommodation. Continued use will not be construed as acceptance.

**Buyer’s Remedies for Breach**

When breach of a sales contract occurs, the buyer has several remedies. The Marshall Islands Sale of Goods Act of 1986 lists several remedies for breach of contract for the sale of goods: 1) damages for non-delivery, 2) specific performance, 3) remedies for breach of express or implied warranty, and 4) interest and special damages. *UCC 2-711* contains a more extensive list of remedies for the buyer in the event of breach by the seller.\(^{1213}\)

\(^{1213}\) *UCC 2-711* provides:

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid (a) “cover” and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or (b) recover damages for non-delivery as provided in this Article (Section 2-713). (2) Where the seller fails to deliver or repudiates the buyer may also (a) if the goods have been identified recover them as provided in this Article (Section 2-502); or (b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

*Revised UCC 2-711* provides a more detailed checklist of buyer’s remedies than the original version and provides:

(1) A breach of contract by the seller includes the seller’s wrongful failure to deliver or to perform a contractual obligation, making of a nonconforming tender of delivery or performance, and repudiation. (2) If a seller is in breach of contract under subsection (1) the buyer, to the extent provided for by this Act or other law, may: (a) in the case of rightful cancellation, rightful rejection or justifiable revocation of acceptance recover so much of the price as has been paid; (b) deduct damages from any part of the price still due under Section 2-717; (c) cancel; (d) cover and have damages under Section 2-712 as to all goods affected whether or not they have been identified to the contract; (e) recover damages for non-delivery or repudiation under Section 2-713; (f) recover damages for breach with regard to accepted goods or breach with regard to remedial promise under Section 2-714; (g) recover identified goods under Section 2-502; (h)
**Right to Cancel**

The buyer may cancel if the seller fails to make delivery or repudiates or if the buyer rightfully rejects or justifiably revokes acceptance.\(^{1214}\) If the buyer has rightfully cancelled, rejected or revoked and the buyer has paid a portion of the price, the buyer may recover what has been paid.\(^{1215}\) Alternatively, the buyer may deduct damages from any part of the price still due under *UCC* 2-717.\(^{1216}\)

**Cover**

If the seller fails to provide adequate assurances or cure by the date due for performance, the buyer may also cover and obtain damages provided for under *UCC* 2-712.\(^{1217}\)

**Damages**

In cases of cases of non-delivery or repudiation, the buyer is entitled to damages pursuant to the formulas set forth under *UCC* 2-713.\(^{1218}\) The buyer’s damages for breach, obtain specific performance or obtain the goods by replevin or similar remedy under Section 2-716; (i) recover liquidated damages under Section 2-718; (j) in other cases, recover damages in any manner that is reasonable under the circumstances. (3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in the buyer’s possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

\(^{1214}\) *UCC* 2-711(1); *Revised UCC* 2-711(2)(c)  
\(^{1215}\) *Revised UCC* 2-711(2)(a)  
\(^{1216}\) *UCC* 2-717 and *Revised UCC* 2-717 provide:

The buyer on notifying the seller of an intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

\(^{1217}\) *UCC* 2-711(1) (a); *Revised UCC* 2-711(2) (d). See also, *UCC* 2-712 and *Revised UCC* 2-712.  
\(^{1218}\) *UCC* 2-711(1)(b); *Revised UCC* 2-711(2) (e). See also, *UCC* 2-713 and *Revised UCC* 2-713. *UCC* 2-713 which provide:

(1) Subject to the provisions of this *Article* with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with
non-delivery or upon rejection or revocation of acceptance are the difference between the contract price and the market price; the difference between the contract price and cost of replacement goods; and any incidental or consequential damages reasonably foreseeable at the time of contract. This rule governing damages for the sale of goods is consistent with the general rule for contract damages as stated in the English case, Hadley v. Baxendale.

The damages for the buyer as to accepted goods would be the difference between the contract price and the market price or the difference between the value of the goods

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any incidental and consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller’s breach. (3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

Revised UCC 2-713 states:

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), if the seller wrongfully fails to deliver or repudiates or the buyer rightfully rejects or justifiably revokes acceptance: (a) the measure of damages in the case of wrongful failure to deliver by the seller or rightful rejection or justifiable revocation of acceptance by the buyer is the difference between the market price at the time for tender under the contract and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller’s breach. (b) the measure of damages for repudiation by the seller is the difference between the market price at the expiration of a commercially reasonable time after the buyer learned of the repudiation, but no later than the time stated in paragraph (a), and the contract price together with any incidental or consequential damages provided in this Article (Section 2-715), less expenses saved in consequence of the seller’s breach. (2) Market price is determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

Revised UCC 2-713; Revised UCC 2-713 and UCC 2-715; Revised UCC 2-715. UCC 2-715 and Revised UCC 2-715 define incidental and consequential damages as follows:

(1) Incidental damages resulting from the seller’s breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach. (2) Consequential damages resulting from the seller’s breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.

1219 UCC 2-713; Revised UCC 2-713 and UCC 2-715; Revised UCC 2-715. UCC 2-715 and Revised UCC 2-715 define incidental and consequential damages as follows:

1220 9 Exch. 341 (1854)
conferred. For damages for goods that are non-conforming but accepted, notice has to be provided by buyer. The buyer could recover the difference between the value of goods accepted and the value of goods as they have been warranted.

Section 51 of the Marshall Islands Sale of Goods Act of 1986 provides for damages when breach result from non-delivery while Section 53 addresses the buyer’s remedy for breach of warranty and provides that the buyer may: “(a) set up against the seller the breach of warranty in diminution or satisfaction of the price; or (b) maintain an action against the seller for damages for the breach of warranty.” Similar to the Hadley “consequential” damages standard, the measure of damages for breach of warranty as defined by the Marshall Island Sale of Goods Act of 1986 “is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty.” Comparable to the standard employed by the UCC, damages for breach of warranty are calculated under the Marshall Islands Sale of Goods Act of 1986 by determining the “difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.”

**Buyer’s Rights for Breach of Remedial Promise**

If goods have been accepted and the buyer has request the defect or non-conformity be remedied and there is a breach in regard to a remedial promise, the buyer can obtain damages for breach under UCC 2-714.

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1221 UCC 2-714; Revised UCC 2-714
1222 UCC 2-714(1); Revised UCC 2-714(1)
1223 UCC 2-714 (2); Revised UCC 2-714(2)
1224 Sale of Goods Act 1986 23 MIRC Cap 1, § 53(1)
1225 Sale of Goods Act 1986 Cap 1 § 53(2)
1226 Sale of Goods Act 1986 Cap 1 § 53(3)
1227 UCC 2-714; Revised UCC 2-714. UCC 2-714 provides:
Replevin and Specific Performance

The buyer also has the right to revoke after delivery, to replevy identified goods if seller is insolvent or bankrupt, or specific performance. If goods have been identified, they can be recovered by the buyer under UCC 2-502.\footnote{1228} If a substitute or cover cannot be obtained or if the goods are unique or made under special circumstances and the buyer is unable to procure anywhere else, the buyer is also entitled to replevin or specific performance under UCC 2-716.\footnote{1229} UNIDROIT Article 7.2.2 also provides for specific performance unless it would be reasonable to cover or expect performance from another source.\footnote{1230}

\begin{enumerate}
\item Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller’s breach as determined in any manner which is reasonable. (2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount. (3) In a proper case any incidental and consequential damages under the next section may also be recovered.

Revised UCC 2-714 states:

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) the buyer may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller’s breach as determined in any manner which is reasonable. (2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount. (3) In a proper case any incidental and consequential damages under the next section may also be recovered.

\end{enumerate}

\footnote{1228}{UCC 2-711(2) (a); UCC 2-711(2) (g). See also, UCC 2-502: Revised UCC 2-502.}
\footnote{1229}{UCC 2-711(2)(b); Revised UCC 2-711(2)(h). See also, UCC 2-716, Revised UCC 2-716.}
\footnote{1230}{In pertinent part, Article 7.2.2 states: Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance unless…the party entitled to performance may reasonably obtain performance from another source.}
Similarly, the Marshall Islands Sale of Goods Act of 1986 permits the court the option of ordering specific performance of a contract for specific or ascertained goods.\(^{1231}\) Section 52 of the Marshall Islands Sale of Goods Act of 1986 provides:

In any action for breach of contract to deliver specific or ascertained goods the court may, if it thinks fit, on the application of the plaintiff, by its judgment or decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining goods on payment of damages. The judgment or decree may be unconditional, or upon such terms and conditions as to damages, payment of the price, and otherwise as to the court may seem just. The application by the plaintiff may be made at any time before judgment or decree.\(^{1232}\)

**Liquidated Damages**

For a contract involving the sale of goods, the buyer is also entitled to liquidated damages if provided for by contract or under \textit{UCC} 2-718,\(^{1233}\) or damages in any manner that are reasonable under the circumstances and consistent with contract standards.\(^{1234}\)

**Buyer’s Security Interest in Rejected Goods**

Where the goods are in the buyer’s possession, the buyer also has security interest in the goods where there has been rightful rejection or justifiable revocation.\(^{1235}\) The security interest covers any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and the buyer can either hold the goods or resell them as provided in \textit{UCC} 2-706.\(^{1236}\) The buyer may also resell the non-conforming goods particularly in those instances where the seller gives no instructions on disposal of the goods.

\(^{1231}\) Sale of Goods Act 1986, 23 MIRC Cap 1 § 52
\(^{1232}\) Sale of Goods Act 23 MIRC Cap 1, § 52.
\(^{1233}\) Revised \textit{UCC} 2-711(2) (i). See also, \textit{UCC} 2-718; Revised \textit{UCC} 2-718
\(^{1234}\) Revised \textit{UCC} 2-711(2)(j)
\(^{1235}\) \textit{UCC} 2-711(3); Revised \textit{UCC} 2-711(3)
\(^{1236}\) \textit{UCC} 2-711(3); Revised \textit{UCC} 2-711(3). See also, \textit{UCC} 2-706 and Revised \textit{UCC} 2-706.
Buyer’s Remedies: Installment Contracts

In an installment contract, the buyer may reject the installment if the defect substantially impairs that installment.\footnote{1237} An installment contract is a sales contract which permits delivery in separate lots to be accepted separately. The perfect tender rule does not apply to installment contracts and the buyer only has the right to reject the installment which substantially impairs the contract if the defect in that installment cannot be cured. If the entire contract is substantially impaired by defect in a particular installment, it may result in cancellation of entire contract.\footnote{1238} The rules regarding installment contract has also been followed in § 32(2) of the Marshall Islands Sale of Goods Act of 1986 which provides:

Where there is a contract for the sale of goods to be delivered by stated installments, which are to be separately paid for, and the seller makes defective deliveries with respect to one or more installments, or the buyer neglects or refuses to take delivery of or pay for one or more installments, it is a question in each case, depending on the terms of the contract and the circumstances of the case, whether the breach of contract is a repudiation of the whole contract, or whether it is a severable breach giving rise to a claim for compensation, but not to a right to treat the whole contract as repudiated.\footnote{1239}

The issue of materiality of the breach in an installment contract context was also addressed in the Micronesian case, \textit{Panuelo v. Pepsi Cola Bottling Co. of Guam}.\footnote{1240} In \textit{Panuelo}, an oral installment contract existed between the parties in which the defendant was to provide to plaintiff two containers of Pepsi on a monthly basis. The relationship between the parties deteriorated when a shipment arrived late and one of the two containers was unfit for human consumption due to damage. When the next two

\footnotesize{\textsuperscript{1237} UCC 2-612; Revised UCC 2-612 \\
\textsuperscript{1238} UCC 2-612; Revised UCC 2-612 \\
\textsuperscript{1239} Sale of Goods Act 23 MIRC Cap 1, § 32(2) \\
\textsuperscript{1240} 5 FSM Intrm 123 (Pon 1991)}
containers arrived, the plaintiff sent a letter to the defendant requesting a credit for the prior shipment. When the defendant failed to respond, the plaintiff didn’t pick up the two containers and they sat on the dock where they spoiled. The *Panuelo* court observed:

> Sometimes a particular breach may be so material to the purpose of a contract that the injured party is justified in halting performance under the contract….Whether a breach is material is a question of fact depending on several factors, especially whether the breach deprives the injured party of the benefits of the contract.\(^{1241}\)

The *Panuelo* court indicted that whether the breach is material is a question of fact for the trier of fact and is contingent upon a number of factors including whether the breach deprives the injured party of the benefits of the bargain and in reviewing the facts of this case the court found that the breach was not material.\(^{1242}\) Therefore, the court denied Pepsi its requested relief.

It should be noted that a “material” breach may be different than “substantially impairing” the whole contract. Consequently, the courts may provide different treatment and remedies where the breach is material as opposed to those instances where the whole contract has been substantially impaired.

The issue of severability was recently addressed the Republic of Palau in *Palau Marine Indus v. Pac Call Inves. Ltd.*\(^{1243}\) in which the parties entered into a five year agreement where Palau Marine agreed with Pacific Call Investments to deliver fish to Pacific Call in Guam where Pacific Call would then off-load, process and ship the fish to Japan. When Palau Marine failed to deliver any fish, Pacific Call sued. One of the issues addressed by the trial court was severability i.e. whether the contract was a five year

\(^{1241}\) Id at 127-8
\(^{1242}\) Id at 128.
\(^{1243}\) 9 ROP 67 (2002)
contract or whether it was five separate one (1) year contracts. The trial court found that
the contract was a single unitary agreement and could not be split into five separate
annual installments which defendant argued would reduce its liability. Defendant
appealed. The Supreme Court affirmed the trial court and set forth the standard for
determining whether the contract was severable: “Generally, a contract will not be
regarded as severable unless (1) the parties’ performances can be apportioned into
corresponding pairs of partial performances, and (2) the parts of each pair can be treated
as agreed equivalents.” The court continued, “The question whether a contract can be
properly considered severable is considered ‘in light of the language employed by the
parties and the circumstances existing at the time of the contracting.’” In order to
determine severability, the court must focus on the actual contract language. The Palau
Marine court observed: “The question whether a contract can be properly considered
severable is considered ‘in light of the language employed by the parties and the
circumstances exiting at the time of contracting.’” Although there was an annual tonnage
requirement and an annual scale fee, the Palau Marine court concluded: “But section 13
of the July contract plainly states that the agreement is for a term of five years. Given that
this is ‘the language employed by the parties [,]’ and that Appellant made no showing at
trial that a different arrangement was contemplated ‘at the time of contracting [,]’ we are
satisfied that the contract was not intended to be a divisible one and that the trial court’s
interpretation of the contract was correct.”

1244 Id. This position is consistent with Restatement (Second) of Contracts, § 240.
1245 9 ROP 67 (2002)
SELLER’S REMEDIES FOR BREACH: SALE OF GOODS

Having addressed the buyer’s remedies, we turn to remedies available to the seller. The seller has a number of remedies available prior to tendering the goods to buyer if the seller suspects that the buyer will be unable to perform their corresponding duty. Additionally, the seller has numerous remedies available in the event of a breach by the buyer.

Seller’s Remedies Prior to Tender

Right to Demand Adequate Assurance Prior to Tender

If circumstances suggest anticipatory repudiation or the seller is concerned about the buyer’s ability to perform prior to the time of tender, the seller may demand in a writing or record adequate assurances from the buyer.\textsuperscript{1246} Between merchants, the reasonableness of the grounds for insecurity and the adequacy of any reassurance are to be determined according to accepted commercial standards.\textsuperscript{1247} If adequate assurances are not given, the seller may treat the lack of response as an anticipatory repudiation under \textit{UCC} 2-610.

Seller’s Remedies: Buyer’s Insolvency

One significant concern that the seller may have about the buyer’s prospective ability to perform prior to tender involves a situation where the seller discovers that the buyer is insolvent or bankrupt.

If the buyer repudiates the contract or fails to make an installment payment due before delivery or if the seller discovers the buyer is insolvent at any point during the

\textsuperscript{1246} \textit{UCC} 2-609
\textsuperscript{1247} Id.
transaction, **UCC 2-702** provides that the seller can refuse delivery or accept only cash payment for the goods.\(^{1248}\) **UCC 2-702** also indicates that the seller can: 1) withhold delivery,\(^{1249}\) 2) stop delivery in transit,\(^{1250}\) or 3) reclaim goods within a reasonable time that have been received by a buyer on credit.\(^{1251}\)

Section 40 of the Marshall Islands Sale of Goods Act of 1986, spans an unpaid seller’s rights both before, during and after tender and similarly provides several remedies for an unpaid seller.\(^{1252}\) Pursuant to Section 40, an unpaid seller can: 1) lien the goods,\(^{1253}\) 2) retain the goods for the price while in possession of them,\(^{1254}\) 3) resell the

\(^{1248}\)**UCC 2-702** states:

(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705). (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt of the goods but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer’s fraudulent or innocent misrepresentation of solvency or of intent to pay. (3) The seller’s right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good-faith purchaser for value under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

**Revised UCC 2-702** provides:

(1) Where the seller discovers the buyer to be insolvent the seller may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705). (2) Where the seller discovers that the buyer has received goods on credit while insolvent the seller may reclaim the goods upon demand made within a reasonable time after the buyer’s receipt of the goods. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer’s fraudulent or innocent misrepresentation of solvency or of intent to pay. (3) The seller’s right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good-faith purchaser for value under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

\(^{1249}\)**UCC 2-702(1); Revised UCC 2-702(1); See also, Revised UCC 2-703(3)(a)

\(^{1250}\)**UCC 2-702(1); UCC 2-702(1). See also, UCC 2-705 and Revised UCC 2-705. See also, Revised UCC 2-703(3)(b).

\(^{1251}\)**UCC 2-702(2); Revised UCC 2-702(2). See also, Revised UCC 2-703(3)(c)

\(^{1252}\)Unpaid seller is defined in Sale of Goods Act 1986, 23 MIRC Cap 1, §39.

\(^{1253}\)Sale of Goods Act 1986, 23 MIRC Cap 1, § 41

\(^{1254}\)Sale of Goods Act 1986 23 MIRC Cap 1, §49
goods, or, 4) in the case of insolvency, stop delivery of the goods in transit.

Section 40 also indicates that if the title has not passed to the buyer, the unpaid seller has a right to withhold delivery consistent with lien rights and the right to stop property in transit where the property has passed to the buyer.

**Seller’s Remedies: Breach**

The Marshall Islands Sale of Goods Act of 1986 provides additional remedies for the seller after there has been a breach of a contract for the sale of goods. A seller may bring an action for price under Section 49 or may recover damages for non-acceptance pursuant to Section 50.

UCC 2-703 has a more extensive list of seller’s remedies for breach of sales contract than the Marshall Islands Sale of Goods Act. Revised UCC 2-703 also contains a general, nonexclusive definition of breach of contract by the buyer and expands the original version’s list of seller’s remedies for breach.

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1256 Sale of Goods Act 1986 23 MIRC Cap 1, §44 - §46
1257 Sale of Goods Act 1986 23 MIRC Cap 1 §40 (2)
1258 Sale of Goods Act 1986 23 MIRC Cap 1§49
1260 UCC 2-703 states:

Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or whole, then with respect to any goods directly affected and, if the breach is of the whole contract (Section 2-612), then also with respect to the whole undelivered balance, the aggrieved seller may (a) withhold delivery of such goods; (b) stop delivery by any bailee as hereafter provided (Section2-705); (c) proceed under the next section respecting goods still unidentified to the contract; (d) resell and recover damages as hereafter provided (Section 2-706); (e) recover damages for non-acceptance (Section 2-708) or in a proper case the price (Section 2-709); (f) cancel.

1261 Revised UCC 2-703 provides:

(1) A breach of contract by the buyer includes the buyer’s wrongful rejection or wrongful attempt to revoke acceptance of goods, wrongful failure to perform a contractual obligation, failure to
Where there is a breach by buyer, UCC 2-703 and Revised UCC 2-703 lists numerous remedies that are available to the seller upon breach by buyer, including but not limited to:

6) withholding delivery if the goods have not been shipped,
7) stopping delivery of those goods which are in transit or with a bailee.\footnote{1262}

\footnote{1262} UCC 2-703(a); UCC 2-703(b); and Revised UCC 2-703(2) (a) and UCC 2-703(2) (b). See also, UCC 2-705; Revised UCC 2-705. UCC 2-705 provides:

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (Section 2-702) and may stop delivery of carload, truckload, plane load or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods. (2) As against such buyer the seller may stop delivery until (a) receipt of the goods by the buyer; or (b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or (c) such acknowledgement to the buyer by a carrier by reshipment or as warehouseman; or (d) negotiation to the buyer of any negotiable document of title covering the goods. (3) (a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods. (b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages. (c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of the document. (d) A carrier who has issued a non-negotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

Revised UCC 2-705 makes minor changes and states:

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when the seller discovers the buyer to be insolvent (Section 2-702) or when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods. (2) As against such buyer the seller may stop delivery until (a) receipt of the goods by the buyer; or (b) acknowledgment to the buyer by any bailee of the goods, except a carrier, that the bailee holds the goods for the buyer; or (c) such acknowledgement to the buyer by a carrier by reshipment or as warehouse; or (d) negotiation to the buyer of any negotiable document of title covering the goods. (3) (a) To stop delivery the seller must so notify as to enable
8) proceeding under Section 2-704 with respect to goods unidentified to the contract or unfinished,\textsuperscript{1263}
9) reclaiming or recovering the goods,\textsuperscript{1264}
10) requiring payment directly from the buyer if a letter of credit is dishonored or repudiated,\textsuperscript{1265}

the bailee by reasonable diligence to prevent delivery of the goods. (b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages. (c) If a negotiable document of title has been issued for goods, the bailee is not obliged to obey a notification to stop until surrender of the document. (d) A carrier that has issued a non-negotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

\textsuperscript{1263} UCC 2-703 (c); Revised UCC 2-703(2) (c). UCC 2-704; Revised UCC 2-704. UCC 2-704 provides:

(1) An aggrieved seller under the preceding section may (a) identify to the contract conforming goods not already identified if at the time he learned of the breach the goods are in his possession or control; (b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished. (2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

Revised UCC 2-704 which deletes language from section (2) and makes minor gender neutral changes states:

(1) An aggrieved seller under the preceding section may (a) identify to the contract conforming goods not already identified if at the time the seller learned of the breach the goods are in the seller’s possession or control; (b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished. (2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

\textsuperscript{1264} Revised UCC 2-703(2) (d). See, Revised UCC 2-507(2) which states:

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, the seller may reclaim the goods delivered upon a demand made within a reasonable time after the seller discovers or should have discovered that payment was not made.

Revised UCC 2-702(2) provides for instances where goods may be reclaimed if seller is aware of buyer’s insolvency and states:

(2) Where the seller discovers that the buyer has received goods on credit while insolvent the seller may reclaim the goods upon demand made within a reasonable time after the buyer’s receipt of the goods. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer’s fraudulent or innocent misrepresentation of solvency or of intent to pay.

\textsuperscript{1265} Revised UCC 2-703(2) (e). See Revised UCC 2-325(c) which addresses failure to pay by agreed letter of credit and states: “If the letter of credit is dishonored or repudiated, the seller, on seasonable notification, may require payment directly from the buyer.”
11) canceling the contract,

12) reselling the goods and recovering damages,

13) recovering damages where there is non-acceptance or repudiation,

14) obtaining lost profits,

15) recovering price and forcing goods on buyer.

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1266 UCC 2-703(f); Revised UCC 2-703(2)(f).

1267 UCC 2-703(d); Revised UCC 2-703(2)(g); UCC 2-706, Revised UCC 2-706

1268 UCC 2-703(e); Revised UCC 2-703(2)(h); Revised UCC 2-708(1) provides:

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723): (a) the measure of damages for non-acceptance by the buyer is the difference between the contract price and the market price at the time and place for tender together with any incidental or consequential damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer’s breach; and (b) the measure of damages for repudiation by the buyer is the difference between the contract price and the market price at the place for tender at the expiration of a commercially reasonable time after the seller learned of the repudiation, but no later than the time stated in paragraph (a), together with any incidental or consequential damages provided in this Article (Section 2-710), less expenses saved in consequence of the buyer’s breach.

1269 Revised UCC 2-703(i); Revised UCC 2-708(2) provides:

(2) If the measure of damages provided in subsection (1) or in Section 2-706 is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental or consequential damages provided in this Article (Section 2-710).

1270 In the Marshall Islands, the Sale of Goods Act of 1986, § 49 provides:

(1) Where, under a contract of sale, title to the goods has passed to the buyer, and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action for the price of the goods. (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery, and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although title to the goods has not passed and the goods have not been appropriated to the contract.

UCC 2-703(e); Revised UCC 2-703(j); Revised UCC 2-709 provides:

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental or consequential damages under the next section, the price (a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing. (2) Where the seller sues for the price the seller must hold for the buyer any goods which have been identified to the contract and are still in the seller’s control except that if resale becomes possible the seller may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles the buyer to any goods not resold. (3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated
16) compelling specific performance,\textsuperscript{1271}
17) recovering liquidated damages if reasonable and expressly provided for in the contractual agreement,\textsuperscript{1272} or in other cases,
18) recovering damages in any manner that is reasonable\textsuperscript{1273} including incidental or consequential damages.\textsuperscript{1274}

(Section 2-610), a seller that is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

\textsuperscript{1271} \textit{Revised UCC 2-703(k); Revised UCC 2-716} which addresses specific performance by the buyer and seller and the buyer’s right to replevin states:

(1) Specific performance may be decreed where the goods are unique or in other proper circumstance. In a contract other than a consumer contract, specific performance may be decreed if the parties have agreed to that remedy. However, even if the parties agree to specific performance, specific performance may not be decreed if the breaching party’s sole remaining contractual obligation is the payment of money. (2) The decree for specific performance may include such terms and conditions as to payment for price, damages, or other relief as the court may deem just. (3) The buyer has a right to replevin or similar remedy for goods identified to the contract if after reasonable effort the buyer is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. (4) The buyer’s right under subsection (3) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

\textsuperscript{1272} \textit{Revised UCC 2-703(2)(l); Revised UCC 2-718} provides:

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach and, in a consumer contract, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. Section 2-719 determines the enforceability of a term that limits but does not liquidate damages. (2) Where the seller justifiably withholds delivery of goods or stops performance because of the buyer’s breach or insolvency, the buyer is entitled to restitution of any amount by which the sum of the buyer’s payments exceeds the amount to which the seller is entitled by virtue of terms liquidating the seller’s damages in accordance with subsection (1). (3) The buyer’s right to restitution under subsection (2) is subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this Article other than subsection (1), and (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract. (4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer’s breach before reselling goods received in part performance, the resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (Section 2-706).

\textsuperscript{1273} \textit{Revised UCC 2-703(2)(m)}
\textsuperscript{1274} \textit{Revised UCC 2-710} provides:

(1) Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer’s breach, in connection with return or resale of the goods or otherwise resulting from the breach. (2) Consequential damages resulting from the buyer’s breach include any loss resulting from general or particular requirements and needs of which the buyer at the time
19) **Withhold Delivery**

Under both the *UCC* and the Marshall Islands Sale of Goods Act, the seller has the right to withhold delivery of the goods. *UCC* 2-703 provides that the seller can refuse delivery\(^{1275}\) and *UCC* 2-702 provides that delivery can be withheld unless paid cash by an insolvent buyer.\(^ {1276}\) If the buyer fails to make a payment due before delivery or if seller discovers at any time during the transaction that buyer is insolvent both the *UCC*\(^ {1277}\) and the Marshall Islands Sale of Goods Act\(^ {1278}\) permit the seller to stop delivery in transit.

**Damages for Non-Acceptance or Repudiation**

The Marshall Islands Sale of Goods Act\(^ {1279}\) and the *UCC* also permit the seller to recover damages where there is non-acceptance or repudiation.\(^ {1280}\)

If the seller is ready, willing and able to deliver and the buyer does not request or take delivery within a reasonable time, under the Section 38 of the Marshall Islands Sale of Goods Act

\(^{1275}\) *UCC* 2-702(1)
\(^{1276}\) *UCC* 2-702(1)
\(^{1277}\) *UCC* 2-705
\(^{1278}\) Sale of Goods Act 1986 23 MIRC Cap. 1, §44
\(^{1279}\) Sale of Goods Act 1986 23 MIRC Cap 1, §50
\(^{1280}\) *UCC* 2-703(e); Revised *UCC* 2-703(2)(h); Revised *UCC* 2-708(1) provides:

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723): (a) the measure of damages for non-acceptance by the buyer is the difference between the contract price and the market price at the time and place for tender together with any incidental or consequential damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer’s breach; and (b) the measure of damages for repudiation by the buyer is the difference between the contract price and the market price at the place for tender at the expiration of a commercially reasonable time after the seller learned of the repudiation, but no later than the time stated in paragraph (a), together with any incidental or consequential damages provided in this Article (Section 2-710), less expenses saved in consequence of the buyer’s breach.
of Goods Act of 1986, the buyer “is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods; provided, that nothing in this section shall affect the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.”

Section 38 is comparable to UCC 2-710(1) which provides recovery for seller’s incidental damages.

Under the original version of the UCC, if the buyer acts wrongfully and seller terminates a contract but the buyer has made a down payment, the buyer would be entitled to 80% of the deposit and seller would be entitled to keep 20% of value of performance or $500 which ever is less. If buyer wrongfully rejects and seller can prove actual damages, i.e. lost volume seller, the buyer would not get any of the down payment.

**Unpaid Seller’s Lien**

The Marshall Islands Sale of Goods Act of 1986 provides that an unpaid seller may lien the goods if the goods are sold on credit without any stipulations as to the terms of credit, if sold on credit and the terms of the credit have expired, or where the buyer becomes insolvent. If partial delivery has been made and payment has not been received by the buyer, the seller may exercise the lien or retain the remainder unless there has been an agreement to waive the seller’s lien. The seller’s lien in the goods is

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1281 Sale of Goods Act 1986 23 MIRC Cap 1, § 38
1282 UCC 2-718 (2). These specific penalty terms were deleted in Revised UCC 2-718 and replaced by more general terms.
1283 Sale of Goods Act 1986 23 MIRC Cap 1 §41
1284 Sale of Goods Act 1986 23 MIRC Cap 1 §42
terminated if the seller delivers the goods to a carrier or bailee without reserving lien rights, if the buyer obtains possession, or if the lien is waved.\textsuperscript{1285} The \textit{UCC} has comparable provisions where the seller retains rights in the goods delivered on credit or where buyer becomes insolvent.

\textbf{Right to Resell}

The \textit{UCC} and the Marshall Islands Sale of Goods Act permit the seller to resell the goods in the event of a breach by the buyer. Section 48(3) of the Sale of Goods Act states:

Where the goods are of a perishable nature or where the unpaid seller gives notice to the buyer of his intention to resell, and the buyer does not within a reasonable time pay or tender the price, the unpaid seller may resell the goods and recover from the original buyer damages for any loss occasioned by his breach of contract.\textsuperscript{1286}

\textit{UCC} 2-706 similar provides that the seller has the right to resell and recover comparable damages from the buyer.

\textbf{Action for Price and Right to Force Goods on Buyer}

Section 49 of the Marshall Islands Sale of Goods Act of 1986 specifically recognizes seller’s remedies for action for price.\textsuperscript{1287} Section 49 provides:

(1) Where, under a contract of sale, title to the goods has passed to the buyer, and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action for the price of the goods. (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery, and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although title to the goods has not passed and the goods have not been appropriated to the contract.\textsuperscript{1288}

\textsuperscript{1285} Sale of Goods Act 1986 23 MIRC Cap 1 §43
\textsuperscript{1286} Sale of Goods Act 1986 23 MIRC Cap 1§48(3)
\textsuperscript{1287} Sale of Goods Act 1986 23 MIRC Cap 1, §49
\textsuperscript{1288} Sale of Goods Act 1986 23 MIRC Cap 1 § 49
If buyer rejects or wrongfully repudiates, the seller can resell goods at public or private sale or elect not sell them at all and sue for price.\textsuperscript{1289} 

\textit{UCC} 2-709 similarly permits the seller to receive the price if the buyer has accepted the goods or if the seller identified goods in the contract and seller can’t resell after a reasonable effort at a reasonable price.\textsuperscript{1290} The seller’s action for price is equivalent to the “reverse” of buyer’s right to specific performance in that if the seller cannot sell the goods to anyone else the seller can force delivery on the buyer and require the buyer to pay the price. \textit{Revised UCC} 2-703 and \textit{Revised UCC} 2-716 expand the scope of the right to specific performance and convert what used to be an exclusive buyer’s remedy in the original version of \textit{UCC} 2-716 into a remedy available to both buyer and seller.

\textit{Consequential Damages} 

Both the \textit{UCC} and the Sale of Goods Act of 1986 provide that seller is also entitled to consequential damages which are those damages which are naturally resulting or foreseeable at the time of contract.\textsuperscript{1291} 

In the Marshall Islands, Section 50 of the Sale of Goods Act of 1986 states:

(1) Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may maintain an action against him for damages for non-acceptance.
(2) The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer’s breach of contract.
(3) Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current priced at the time or times when the goods ought

\textsuperscript{1289} \textit{UCC} 2-709; \textit{Revised UCC} 2-709(3) 
\textsuperscript{1290} \textit{UCC} 2-709; \textit{Revised UCC} 2-709. 
\textsuperscript{1291} \textit{Revised UCC} 2-710(2)
to have been accepted, or, if no time was fixed for acceptance, then at the time of refusal to accept.\footnote{1292}{Sale of Goods Act 1986 23 MIRC Cap 1, § 50}

\textit{UCC} 2-710 similarly provides in a contract for sale that the seller is entitled to recover foreseeable consequential damages which could not be reasonably prevented by resale or otherwise.\footnote{1293}{\textit{UCC} 2-710(2)}

Consequential damages can be contractually limited as long as the limitation is not unconscionable.\footnote{1294}{\textit{UCC} 2-719; Revised \textit{UCC} 2-719(3)} In a sale of goods, the seller cannot recover consequential damages from a consumer.\footnote{1295}{\textit{UCC} 2-710(3)}

\textbf{Interest, Lost Profit and Incidental Damages}

Where buyer wrongfully refuses delivery, interest and special damages are also available to the seller under Section 54 of the Marshall Islands Sale of Goods Act of 1986.\footnote{1296}{Sale of Goods Act 1986 Cap 1, Section 54}

The seller may also be entitled to damages based on lost profit and incidental damages foreseeable at the time of contract.\footnote{1297}{\textit{UCC} 2-708 (2); Revised \textit{UCC} 2-708(2)} Even a lost volume seller may be able to recover profit the lost volume seller would have made but for the breach.

In \textit{Ngiratkel Etpison Co. (NECO) v. Rdialut},\footnote{1298}{2 ROP Intrm 211 (1991)} the Palau Supreme Court indicated that in order to recover lost profits in a contract for the sale of goods or any other contract, a party must prove lost profits within a reasonable degree of certainty, that the defendant wrongfully caused the lost profits, and that the profits were reasonably

\begin{footnotesize}
\begin{itemize}
\item \footnote{1292}{Sale of Goods Act 1986 23 MIRC Cap 1, § 50}
\item \footnote{1293}{\textit{UCC} 2-710(2)}
\item \footnote{1294}{\textit{UCC} 2-719; Revised \textit{UCC} 2-719(3)}
\item \footnote{1295}{\textit{UCC} 2-710(3)}
\item \footnote{1296}{Sale of Goods Act 1986 Cap 1, Section 54}
\item \footnote{1297}{\textit{UCC} 2-708 (2); Revised \textit{UCC} 2-708(2)}
\item \footnote{1298}{2 ROP Intrm 211 (1991)}
\end{itemize}
\end{footnotesize}
within the contemplation of the parties at the time of contract formation.\footnote{1299} In *Ngiratkel*, Plaintiff was unable to meet this standard and not entitled to claim any lost profits and the trial court decision was reversed.\footnote{1300}

**Seller’s Right to Recover Goods**

Under the *UCC*, the right to recover goods from a buyer is permitted when the buyer becomes insolvent.\footnote{1301} The *UCC* also permits the seller to recover goods shipped to the buyer or goods shipped to the buyer which are stored with a bailee holding the goods for the buyer if the buyer becomes insolvent or upon buyer’s breach.\footnote{1302}

Section 44 of the Marshall Islands Sale of Goods addresses the right of the seller to stop goods in transit. Section 45 defines transit and the implications of a carrier or bailee holding or transporting goods. Like the *UCC*, Section 46 requires the unpaid seller to take possession of the goods or give the bailee or carrier notice of the seller’s claim to the goods. Under the Sale of Goods Act, the bailee or carrier must redeliver the goods to seller at seller’s expense upon receiving proper notice of stoppage.

In order to avoid any risk of loss, a bailee must return the property to the bailor or put the bailor on notice that the property should be removed in order to terminate the bailment and avoid risk of loss for property while in the bailee’s possession. Otherwise, the bailee will be liable for any loss incurred to the property while it is in the bailee’s possession.

\footnote{1299} Id. at 220-21  
\footnote{1300} Id at 222-3  
\footnote{1301} *UCC* 2-702; *Revised UCC* 2-702  
\footnote{1302} *UCC* 2-702; *Revised UCC* 2-702
Bailment and bailee liability for items in the bailee’s possession was generally discussed in a non-goods case in a recent Micronesian trial court decision involving an automobile bailment lease. In *Phillip v. Marianas Ins. Co.*, the court defined “bailment” stating:

Bailment occurs when one person has lawfully acquired possession of another’s personal property; the bailor retains ownership, but the bailee has lawful possession and exclusive control over the property for the duration of the term of the lease.

In *Phillip*, the Marianas Insurance Company excluded bailment leases from coverage provided to the plaintiff Phillip for a fleet of nine vehicles and denied a claim when a lessor of one of those vehicles was involved in a careless driving automobile accident. The trial court found that Plaintiff was not entitled to summary judgment on that breach of contract claim.

The Palau courts dealt with the issue of bailment and bailee liability for property left in the bailee’s possession, an automobile, in a non-goods case in *Ngiraioi v. Shat*, where there was a contract between Plaintiff and Defendant to repair Plaintiff’s truck. Due to the fact that extensive work and additional parts were required, the truck was left in defendant’s possession for two to three years with Plaintiff claiming to return every week to check on its progress. Ultimately, the vehicle was lost, stolen or converted from Defendant’s repair shop and the Plaintiff sued. The Palau trial court noted that a bailee has a continuing obligation to protect the property while it is in the bailee’s possession.

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12 FSM Intrm 301 (Pon 2004)

Id at 305

Id.

I ROP Intrm. 85 (Tr. Div. 1983)
and would be liable for any damage incurred while it was in his possession.\textsuperscript{1307} Citing 8 Am. Jur. 2d, \textit{Bailments}, 294, the \textit{Ngiraloi} court stated: “If he wishes to terminate the bailment, defendant was under an obligation to restore the property to plaintiff, or put the plaintiff on notice to remove the vehicle.”\textsuperscript{1308} The court also observed that the plaintiff also had a duty to protect his property and “cannot merely sit on his rights indefinitely.”\textsuperscript{1309} This failure to mitigate by bailor as a result of the delay in asserting rights to bailed property led to the court’s reduction of Plaintiff bailor’s damages.\textsuperscript{1310}

In another non-goods bailment case addressing bailee liability, \textit{Palik v. PKC Auto Repair Shop},\textsuperscript{1311} the Kosrae court observed that the transfer of property to another for repair is a bailment and that the bailee has an obligation to exercise due care to prevent loss, damage or destruction. If the property is damaged, the bailee is liable for all repairs. The court also noted that when the plaintiff had accepted the defendant’s condition that the jeep could not be returned to its original condition and continued to request that the defendant work on the jeep, the plaintiff had accepted the defendant’s condition regarding workmanship on the jeep and the defendant’s inability to return the jeep to its original condition. Consequently, the court found that the plaintiff was not entitled to recover on his claim for additional work completed later by another.\textsuperscript{1312}

\textsuperscript{1307} Id at 86.
\textsuperscript{1308} Id
\textsuperscript{1309} Id at 87.
\textsuperscript{1310} Id at 87
\textsuperscript{1311} 13 FSM Intrm 93 (Kos. S. Ct. Tr. 2004)
\textsuperscript{1312} Id at 96.
**Seller’s Measure of Damages**

The *UCC* provides that seller’s damages for breach are generally the difference between contract price and market price for non-acceptance, or the difference between the contract price and the market or resale price after a commercially reasonable time for instances involving repudiation plus any other incidental or consequential damages less expenses saved as a result of the breach.\(^{1313}\) *UCC* 2-723 addresses proof of market price and indicates, in pertinent part, that the burden of proof of market price rests upon the party seeking damages and that party must provide notice to the opposing party to prevent unfair surprise.\(^{1314}\)

The Marshall Islands Sale of Goods Act of 1986 contains a similar provision which indicates:

> Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted, or if no time was fixed for acceptance, then at the time of the refusal to accept.\(^{1315}\)

**Sellar and Buyer Remedies for Breach: Sale of Goods**

There are several remedies available to the buyer and seller for breach of a contract for the sale of goods including the right to demand adequate assurance of performance,\(^{1316}\) and to utilize the doctrine of anticipatory repudiation if adequate assurances are not provided.\(^{1317}\)

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\(^{1313}\) *UCC* 2-708; Revised *UCC* 2-708.

\(^{1314}\) *UCC* 2-723(3); Revised *UCC* 2-723(2)


\(^{1316}\) *UCC* 2-609 provides:
**Demand for Adequate Assurances**

If either party has reasonable grounds for insecurity, a party may not act in haste and immediately repudiate on a suspicion of non-performance but must request in writing or in a record adequate assurance of performance.\(^{1318}\) If the contract is between merchants, the reasonableness of grounds for insecurity or the adequacy of assurance is evaluated by commercial standards.\(^{1319}\)

If a party accepts improper delivery or payment and the contract involves future performance, such as an installment contract, the acceptance of improper delivery or

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(1) A contract for sale imposes an obligation on each party that the other’s expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return. (2) Between merchants the reasonable grounds for insecurity and the adequacy of assurance offered shall be determined according to commercial standards. (3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party’s right to demand adequate assurance of future performance. (4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

*Revised UCC* 2-609 which provides that notification may be made in a record instead of a writing and makes gender neutral language changes states:

(1) A contract for sale imposes an obligation on each party that the other’s expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may demand in a record adequate assurance of due performance and until the party receives such assurance may if commercially reasonable suspend any performance for which it has not already received the agreed return. (2) Between merchants the reasonable grounds for insecurity and the adequacy of assurance offered shall be determined according to commercial standards. (3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party’s right to demand adequate assurance of future performance. (4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

\(^{1317}\) *UCC* 2-610; *Revised UCC* 2-610
\(^{1318}\) *UCC* 2-609(1); *Revised UCC* 2-609(1)
\(^{1319}\) *UCC* 2-609(2); *Revised UCC* 2-609(2)
payment does not preclude the party from demanding adequacy assurance as it relates that portion of the contract requiring future performance.\textsuperscript{1320}

The failure to give adequate assurances will be construed as a repudiation if there is a failure to give assurances within a commercially reasonable time but that time frame is not to exceed 30 days.\textsuperscript{1321} The repudiation must be clear and unequivocal.

There may also be retraction of repudiation before performance is due unless the aggrieved party has cancelled, materially changed position, or has otherwise indicated that the repudiation is final.\textsuperscript{1322}

\textbf{Anticipatory Repudiation}

Either party, buyer or seller, may utilize the doctrine of anticipatory repudiation in the absence of adequate assurances from the other.\textsuperscript{1323} In the event of anticipatory

\begin{footnotesize}
\begin{enumerate}
\item \textit{UCC 2-609(3); Revised UCC 2-609(3)}
\item \textit{UCC 2-609(4); Revised UCC 2-609(4)}
\item \textit{UCC 2-611 provides:}
\begin{enumerate}
\item Until the repudiating party’s next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final. (2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this \textit{Article} (Section 2-609). (3) Retraction reinstates the repudiating party’s rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.
\end{enumerate}
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\begin{enumerate}
\item \textit{Revised UCC 2-611 makes slight gender neutral language changes and states:}
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\item Until the repudiating party’s next performance is due that party can retract the repudiation unless the aggrieved party has since the repudiation cancelled or materially changed position or otherwise indicated that the repudiation is final. (2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this \textit{Article} (Section 2-609). (3) Retraction reinstates the repudiating party’s rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.
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\begin{enumerate}
\item \textit{See Hochster v. De La Tour 118 ER 922 (1853) which was a non-goods case and involved a contract for personal services in which there existed circumstances constituting anticipatory repudiation. UCC 2-610 provides:}
\end{enumerate}
\end{footnotesize}
repudiation, the aggrieved party has several options under the *UCC* including waiting for performance by the repudiating party,\(^{1324}\) resorting to any remedy available for breach,\(^ {1325}\) suspending performance, or proceeding to identify goods or salvage unfinished goods.\(^ {1326}\)

**Specific Performance: *UCC* and *CISG* Remedies**

For contracts involving the sale of goods, the equitable concept of specific performance has been statutorily adopted regionally by the *UCC* in Guam, Mariana Islands, and Hawaii and is also an available remedy under the Marshall Islands Sale of Goods Act. Internationally, the remedy of specific performance has been incorporated in

\(^{1324}\) *UCC* 2-610(a); *Revised UCC* 2-610(a)
\(^{1325}\) *UCC* 2-610(b); *Revised UCC* 2-610(b)
\(^{1326}\) *UCC2*-610(c); *Revised UCC* 2-610 (c)
CISG and is applicable to the international sale of goods between merchants in member nations if local law would permit it as an available remedy.

Original UCC 2-716 and the Marshall Island Sale of Goods Act of 1986 limited the remedy of specific performance solely to the buyer because the seller is usually entitled to monetary damages.\(^ {1327}\) The modern trend is to give the remedy of specific performance broader application. Revised UCC 2-716 eliminates any limitation on the remedy by expressing deleting reference to it being only a buyer’s right\(^ {1328}\) and as noted in Revised UCC 2-703 specific performance is now an option for the seller, similar to the seller’s action for price, where the breach of contract involves the sale of unique goods or where justice so requires.\(^ {1329}\)

CISG which governs the international sale of goods between signatory member nations also permits either the buyer or seller to require the breaching party to perform specifically its obligations regardless of whether other alternative remedies, such as damages, are available or adequate. For example if the seller fails to deliver, the buyer may demand specific performance “by the seller of his obligation.”\(^ {1330}\) Further, the seller may demand specific performance if the buyer fails to “pay the price, take delivery, or perform his other obligations.”\(^ {1331}\) CISG Article 46 also permits the buyer to force the seller to deliver replacement goods or “to remedy the lack of conformity by repair.” The difficulty with either the seller or buyer obtaining specific performance under CISG arises under CISG Article 28 which seems to indicate that a party is only entitled to specific

\(^{1327}\) UCC 2-716; Marshall Islands Sale of Goods Act 1986 23 MIRC Cap 1 §52

\(^{1328}\) Revised UCC 2-703(2)(k); Revised UCC 2-716

\(^{1329}\) Revised UCC 2-703(2)(k); Revised UCC 2-716

\(^{1330}\) CISG Article 45(1)(a) and Article 46(1). See also UCC 2-716.

\(^{1331}\) CISG Article 61(1)(a) and Article 62.
performance if the place of enforcement would permit specific enforcement as an available remedy under the situation.\textsuperscript{1332} For example, if the Marshall Islands were to ratify \textit{CISG}, \textit{CISG Article} 28 advises a judge in that jurisdiction that he or she need not order specific performance unless the seller or buyer would be entitled to such a remedy under Section 52 of the Sale of Goods Act of 1986.\textsuperscript{1333} Similarly, a judge in the United States or its territories would not need to order specific performance for breach of an international sale of goods contract between private parties of signatory nations unless it would be an available remedy applicable under the \textit{UCC} 2-716.

\textbf{Claims Against Third Parties for Injury to Goods}

Both parties also have the right to sue 3\textsuperscript{rd} parties for injury to goods.\textsuperscript{1334} The aggrieved party can await performance by the other party within a reasonable time, resort to any remedy available for a breach, or suspend performance.

\textbf{Interest and Special Damages}

The buyer and seller may also be entitled to interest or special damages as a consequence of the breach. For example, Section 54 of the Sale of Goods Act of 1986 in the Marshall Islands states: “Nothing in this Act shall effect the right of the buyer or seller to recover interest or special damages in any case where by law, interest or special

\textsuperscript{1332} \textit{CISG Article} 28 states:

\begin{quote}
If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.
\end{quote}

\textsuperscript{1333} For a good overview, see Walt, Steven, \textit{For Specific Performance under the United Nations Sales Convention}, 26 Texas Int’l L.J. 211 (1991)

\textsuperscript{1334} \textit{UCC} 2-722; Revised \textit{UCC} 2-722
damages may be recoverable, or to recover money paid where the consideration for the
damages has failed.” In contracts other than for the sale of goods, pre-judgment
interest may also be awarded to the prevailing party. The interest awarded cannot be
unreasonable, exorbitant or constitute usury in violation of any local Usurious Interest
Acts. The reasonable and acceptable regional interest rate appears to be in the range
of eight (8) percent in American Samoa to nine (9) percent in Micronesia and Palau. In
the Marshall Islands, interest may not exceed 24% per annum. In order to determine

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1335 Sale of Goods Act, 23 MIRC Cap 1, § 54
1336 See, Ngiratkel Etpison Co. v. Rdialul, 2 ROP Intrm 211, 213-15 (1991) in which pre-judgment at a
statutory rate of 9% was awarded to the prevailing party on a counter-claim in a service for exchange of
goods contract but the trial court decision to compound that interest rate was reversed. Id at 223. In
Micronesia, see Coca-Cola Beverages Co. (Micronesia) v Edmond, 8 FSM Intrm 388 (Kos. 1998) which
was case seeking to enforced a default judgment entered in favor of the plaintiff and against the defendant
in the Superior Court of the Commonwealth of the Northern Mariana Islands (CNMI). The court declined
to enforce the CNMI judgment because of a treble damage provision in the judgment but entered judgment
against defendant based on its de novo determination of the undisputed facts. In doing so, the court then
concluded that the plaintiff was entitled to prejudgment interest for the bad checks the defendant had
written to the plaintiff observing:

Generally, [i]nterest is usually included as an element of damages as a matter of right when a
debtor knows precisely what he is to pay and when he is to pay it. The complaining party has been
denied of funds to which he was entitled by virtue of the contract, the defaulting party knew the
exact amount and terms of the debt, and the goal of compensation requires that the complainant be
compensated for the loss of use of those funds. This compensation is made in the form of interest.
When defendant wrote the insufficient funds checks to the plaintiff, he committed to pay in
unambiguous terms, and on the date indicated, the sum specified in each check. Defendant knew
precisely the amount to which he was obligating himself, and the effective date of that
commitment. Pre-judgment interest is therefore appropriate. Taking into account the $200.00
payment which plaintiff received from defendant on November 7, 1995, plaintiff will submit a
form of judgment to the court which specifies pre-judgment interest, and which computes that
interest on each of the insufficient funds checks from the date of issuance of the checks to the date
of the judgment which issues herewith. Interest will be computed at the statutory, judgment rate of
interest of 9% pursuant to 6 FSMC 1401. Id at 392-3

As an aside the Coca-Cola court observed that the CNMI judgment rate was also 9% which was consistent
with the FSM Interest rate in 6 FSMC 1401. Id at 392. See also Malem v. Kosrae, 9 FSM Intrm 233 (Kos S.
Ct. Tr. 1999) which awarded prejudgment interest in the amount of 9% form the date of completion of
construction at the Malem Elementary School to the date of judgment which was consistent with the usury
1337 See for example, Palau Usurious Interest Act, 11 PNCA §301 et seq.; Micronesia Usury Act, 34 FSMC
§201 et. seq. ; Kosrae State Usury Statute, KSC § 13.518.
reasonableness, the courts frequently compare the interest charge assessed contractually
with the judgment interest rate.\footnote{1338}

**Liquidated Damages**

Both buyer and seller are also entitled to liquidated damages for breach of
contract for the sale of goods if expressly set forth in the contract.\footnote{1339} The damages
must be difficult to ascertain at the time of contract. The liquidated damage clause must
be reasonable in light of the breach and must not be construed as a penalty.

**ATTORNEY FEES**

Attorney fees are not permissible under the common law but may be awarded to
the prevailing party for breach of contract if the terms of the contract expressly provide
for attorney fees\footnote{1340} or if attorney fees are permitted by statute as some consumer
protection statutes provide.\footnote{1341}

In the Marshall Islands case, *Anitok v. Binejal*,\footnote{1342} plaintiff filed suit claiming defendant breached
their contract when a bum-bum (boat) carrying plaintiff’s goods tipped over and the cargo was lost.
Plaintiff also claimed that the defendant should also pay attorney fees. The Supreme Court reversed the
High Court for other reasons but noted that: “Under the ‘common law’ attorney’s fees are not awarded to
the prevailing party in the absence of an agreement between the parties or a statute authorizing the award of
attorney’s fees….” This Court hereby adopts and declares the ‘common law’ American Rule to be the law of

\footnote{1338}{For example, Micronesia’s judgment interest rate is 9% as established by 6 FSMC 1401.}
\footnote{1339}{UCC 2-718(1); Revised UCC 2-718}
\footnote{1340}{In *Adams v. Island Homes*, 12 FSM Intrm 541 (Pon. 2004) the court noted that no express contractual
provision provided for attorney fees but that attorney fees may be provided for under appellate rules or the
rules of civil procedure for vexatious filings. In *Adams v. Island Homes*, 12 FSM Intrm 644 (Pon 2004) the
court reiterated that attorney’s fees must be reasonable and are limited to 15% of the judgment in a
collection case.}
\footnote{1341}{In *Anitok v. Binejal*, 2 MILR 114 (January 6, 1998) the Supreme Court reversed the High Court for
other reasons but indicated: “Under the ‘common law’ attorney’s fees are not awarded to the prevailing
party in the absence of an agreement between the parties or a statute authorizing the award of attorney’s
fees.”}
\footnote{1342}{2 MILR 114 (January 6, 1998)}
the Marshall Islands.” The Anitok case is a significant example of anthropological assimilation in the Marshall Islands as it relates to the “American” rule regarding attorney fees.\textsuperscript{1343}

In Bank of FSM v. Bartolome,\textsuperscript{1344} the court indicated that the court will “scrutinize carefully and strictly construe contractual provisions which relate to the payment of attorney’s fees.”\textsuperscript{1345} The court did not find that the language of the loan agreement permitted the bank to collect attorney fees incurred by the bank in collection actions against debtors and indicated that to the extent that the court would permit an award of attorney fees to creditors in the future, “it will be necessary for each creditor to establish that the attorney’s fees to be charged are reasonable in relation to the amount of the debt as well as to the services rendered.”\textsuperscript{1346}

MEASURE OF DAMAGES: OTHER ACTIONS

Commercial or Residential Lease

Damages for breach of commercial or residential lease would be unpaid rent from the time lessee stops paying rent until the time lessor terminates the lease pursuant to the terms of the lease agreement.\textsuperscript{1347}

\textsuperscript{1343} For this proposition the court relied on two American sources: Huecker v. Milburn, 538 F2d 1241,1245 (CA6 1976) and 6 Moore’s Fed. Prac. Section 54.77
\textsuperscript{1344} 4 FSM Intrm 182 (Pon. 1990)
\textsuperscript{1345} Id at 185-6
\textsuperscript{1346} Id at 186. See also, Bank of Hawaii v. Jack, 4 FSM Intrm 416 (Pon. 1990) which adopted the Bartolome criteria in a consumer loan case involving the Bank of Hawaii. The Jack court reiterated that only reasonable fees in relation to the amount of the debt and nature of service will be awarded. Contractual terms providing for attorney fees will only be given effect to the extent that expenses and losses are actually incurred, as supported by detailed documentation showing the date, the work performed and the amount of time spent on each service. Id at 219-20. If the attorney fees are unreasonable, the Jack court indicated that for public policy reasons involving consumer loans it is within the equitable power of the court to reduce or deny attorney fees even if a contractual provision provides for such fees. Id at 220. The court then placed a cap not to exceed 15 % on outstanding principal and interest on recovery of attorney fees under the pretext that such a rule would give “certainty and predictability to creditors and debtors alike.” Id at 221. See also, Mobil Oil Micronesia v. Benjamin, 10 FSM Intrm 100,103 (Kos. 2001) which also calculated the reasonable of attorney’s fees under the 15% Bartolome-Jack formula.
\textsuperscript{1347} See, Ueda v Stephen, 9 FSM Intrm 195, 196 (Chk. St. Tr. Ct. 1999)
**Sale of Land**

Damages for breach of contract for the sale of land are either the contract price or the fair market value at time of the breach.

**Employment Contracts**

Damages for breach of employment contract depend on the party breaching. If the breach is by the employer, the damages would be for the full contract price. If the breach is by the employee, the damages would be the cost to replace the employee.

If an employment contract permits the employee the opportunity to cure to avoid termination, the Palau trial court in *Owens v. House of Delegates*\(^1\) required the employer to inform the employee of the default and permit an opportunity to cure before termination.\(^2\) On appeal,\(^3\) the Plaintiff tried to argue that the requirements of the Palau Public Service System supplemented her rights under the employment contract. The Supreme Court held that the House of Delegates was statutorily exempt from the Public Service System, that the contract defines the rights and duties of the parties, and that the contract was paramount to and supercedes any rules or regulations adopted as guidelines for the House of Delegates.\(^4\) The Supreme Court agreed with the trial court that the contract required notice and to give the employee an opportunity to cure but that

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\(^1\) 1 ROP Intrm 320 (Tr. Div. 1986)
\(^2\) Id at 324-25.
\(^4\) Id at 513K
defendant voluntarily waived any rights to cure after having been notified by representatives of the House of Delegates of the deficiencies in her work.\textsuperscript{1352}

Damages for breach of employment contract may also differ if the breach by the employee is intentional or unintentional. The modern approach allows the employee to offset monies due from the work done to date if the breach by the employee is intentional. The employee can take a comparable or substantially similarly job. The employee need not take a lesser job, but if the employee takes a lesser job, the amount received by the employee will be offset against recovery of damages for the breach of employment contract.

In \textit{Isamu Towai v. ROP},\textsuperscript{1353} plaintiff sued for a living quarter’s allowance which had been previously provided by contract while he was a Trust Territory employee. In January 1981, jurisdiction over Trust Territory employees passed to the Palau National Government and plaintiff executed a new agreement with Palau in which he was paid higher wages as a result of his new higher job classification. His new contract with the Republic of Palau was silent, however, on a living quarter’s allowance but plaintiff cited to a personnel action form (PAF) as a basis for relief. The Supreme Court observed that the personnel action form did not establish independent rights in addition to the employment contract and, since the new contract was silent on a living quarter’s allowance, his requested relief was denied.\textsuperscript{1354}

\textsuperscript{1352} Id at 513L  
\textsuperscript{1353} 1 ROP Intrm 658 (1989)  
\textsuperscript{1354} Id at 662-3
In *Kingon v. ROP*, the plaintiff was hired as a member of the Vice-President of Palau’s staff. The personnel action form (PAF) he signed indicated that he was to be hired for a term not to exceed one year and could be terminated at will. He signed a subsequent employment contract indicating a term of employment for one year from May 9, 1986 to May 8, 1987. The plaintiff’s employment contract was declared to be void because it was contrary to Palau statute which requires that any contract obligating public funds requires certification that public funds are available to fund the contract. Since it was not certified according to statute, the contract was void ab initio. The *Kingon* court took a different approach than *Towai, supra*, in regard to the PAF. In *Kingon*, the trial court utilized the PAF to cure or clarify contract deficiencies. The Palau Supreme Court held that for the trial court to do so was incorrect. Since the employment contract was void ab initio and the PAF, the only enforceable agreement he signed, indicated that he could be terminated at will, the plaintiff was appropriately discharged at will and no damages were owed.

In *Sualog v. Kebekol*, the defendant hired workers from the Philippines to work in commercial fishing in Palau. When the defendant breached the contract, Plaintiffs sued and the trial court awarded the employees back wages and airfare to the

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1356 Id at 72-3
1357 40 PNC § 401
1358 This statutory requirement of contract certification applies to all contracts with the Republic of Palau not just employment contracts. See, *Gibbons and Andrew v. ROP*, 1 ROP Intrm 634, 640-45(1989) (a taxpayer challenge to a contract between the Republic of Palau and Gorones International Construction Company to build and manage the Aimeliik Power plant); *Orion Telecommunications Ltd. v. PNCC*, 1 ROP Intrm 633A, B-C (Civ. Tr. 1989) (involving a joint venture with Palau National Communications Corp. (PNCC) to operate and manage a local and international communications system for the Republic of Palau.)
1359 2 ROP Intrm at 75
1360 Id at 75-77.
1361 1 ROP Intrm 16 (Tr. Div. 1982)
Philippines as a result of the defendant’s breach pursuant to the express terms of the contract.\textsuperscript{1362}

In the Micronesia case, \textit{McGillivray v. Bank of FSM},\textsuperscript{1363} the plaintiff sued the defendant for wrongful termination in both tort and contract. The defendant bank moved for summary judgment indicting that the plaintiff’s damages were limited by the terms of his employment contract. In denying defendant’s motion for summary judgment, the trial court observed that where the plaintiff makes a claim in tort as well as a damage claim based on contract, the employment contract clause limiting contract damages may be inapplicable.\textsuperscript{1364}

\textbf{Construction Contracts}

In a construction contract, owner’s damages for breach by the contractor are generally the cost of completion or substitute performance. Occasionally, the diminished value rule is applied where the measure of damages under the cost of completion rule would result in economic waste.

If the breach is by the builder, the owner is entitled also to cost of completion or substituted performance plus reasonable compensation for delay. The owner’s damages may also include interest and rent. Damages for the owner for breach by the contractor also differ depending on whether the contractor breaches before construction starts, causes delay or late performance, or commits a breach during construction.

\textsuperscript{1362} Id at 19-20
\textsuperscript{1363} 6 FSM Intrm 404 (Pon 1994)
\textsuperscript{1364} Id at 409
The builder’s contract damages for breach by the owner are generally the contract price less any amounts paid by the owner. However, this general formula and the builder’s damages for breach by owner may vary, however, depending on whether breach is before construction started, during construction, or after construction completed. The contract price less any amounts paid by the owner formula enables the builder to recover profits plus cost expended. If the owner breaches after completion of construction, the contractor is entitled to the full contract price less any payments made plus interest.

**Construction Damages: Doctrine of Substantial Completion**

Under the doctrine of substantial performance, the builder technically breaches by failing to complete the contract but the owner is not discharged from the duty to pay despite the breach. Instead, the owner is required to pay the contractor the contract price, less cost incurred by the owner for substituted performance to complete the work.

The leading case in the Republic of Palau addressing the doctrine of substantial completion or performance is *Nakatani v. Nishizono*. In *Nakatani*, the Governor of Airai State entered into a contract with Nishizono for construction of an airport terminal which was supposed to be completed by December 31, 1984. Defendant Nishizono entered into a standard form Japanese Building contract with plaintiff Nakatani in which Nakatani was to be paid Y500 million plus an additional Y100 million for transportation cost from Japan to Palau. The job was supposed to be completed by December 1984 and when the job was still not completed by July 1985, plaintiff subcontractor was

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1365 2 ROP Intrm 7 (1990)
1366 Id at 12-13
1367 Id. at 12-13
terminated by defendant and Guam contractor H.D. Lee was hired to complete the work on the terminal at a cost of US $198,000. The trial court concluded that plaintiff has substantially complied and awarded plaintiff the contract price of Y416,628,596 less $198,000 that had to be paid by defendant to complete the work. Defendant Nishizono appealed. Relying upon American precedent and *Corbin on Contracts*, the *Nakatani* court observed that the doctrine of substantial performance is an equitable doctrine permitting a contractor who has substantially completed a contract to sue on the contract rather than having to rely on quantum meruit which may not adequately compensate contractor for the work performed. Under the doctrine of substantial completion, a contractor is not permitted to recover full consideration as set forth in the contract and any recovery would be off set by the cost of completion or remedying defects. Substantial completion or performance is not a complete discharge of duty but it does constitute a condition precedent to the owner’s duty to pay. If the builder was unable to prove substantial performance, quantum meruit would only compensate the builder for labor and materials expended for the owner and would not include any profit. The burden of proving performance or substantial completion of the contract rests with the contractor and the burden of showing defects or lack of completion rests with the owner. The *Nakatani* court stated that under the doctrine of substantial

\[1368\] Id at 13
\[1369\] Id at 10-11
\[1370\] A.L. Corbin, 3A *Corbin on Contracts*, §§ 702,704,710 (1960)
\[1371\] 2 ROP Intrm at 13-15
\[1372\] Id at 14
\[1373\] Id at 14
\[1374\] Id at 13-15
\[1375\] Id at 15
performance, a contractor is entitled to recover the contract price less deductions for cost of completion or any defects.\(^{1376}\) Substantial completion is a question of fact for the trier of fact and is contingent upon an evaluation of the facts and circumstances in light of the contract language.\(^{1377}\) Based upon the evidence presented to the trial court, the Palau Supreme Court concluded that this “sow’s ear” did not meet the legal requirements of the doctrine of substantial performance.\(^{1378}\) The cases was remanded to the trial court to determine Plaintiff’s quantum meruit claim for labor and material expended on the air terminal that it alleged were not included in the first award.\(^{1379}\)

In Micronesia, the issue of construction damages and the concept of substantial completion were addressed in *Malem v. Kosrae*.\(^{1380}\) The *Malem* case involved the construction of catch basins at the Malem Elementary School in Kosrae. The court found that the defendant breached its contract with plaintiff by failing to pay Plaintiff contractor for the work which had been performed. The court found that the plaintiff, who had completed the work, was entitled to recover $1566 which was the difference between the contract amount and the amount the defendant had already paid on the contract.\(^{1381}\) The court also found that prejudgment interest was also recoverable in those instances where plaintiff would be entitled to recover a liquidated sum of money.\(^{1382}\) The issue was whether the interest rate sought was usurious. If the interest rate sought is excessive, it

1376 Id at 13-15
1377 Id at 15-16
1378 Id at 17
1379 Id at 18,21
1380 9 FSM Intrm 233, 236 (Kos. S. Ct. Tr. 1999)
1381 Id at 236
1382 Id
must be reduced to a reasonable amount.\textsuperscript{1383} The court concluded that where there is no statutory rate for prejudgment interest and where there is no contract provision or limitation on prejudgment interest, the court can employ its discretion to determine the prejudgment interest rate.\textsuperscript{1384} In this case, the court used the Kosrae State Usury Statute\textsuperscript{1385} and post judgment interest rate to determine that 9\% was a reasonable prejudgment interest rate.\textsuperscript{1386}

The Kosrae State trial court recently dealt with the issue of substantial completion in \textit{O’Byrne v. George}.\textsuperscript{1387} In \textit{O’Byrne}, the plaintiff orally contracted with the defendant to build a house for $15,500. Of the $15,500, $10,000 was attributable to construction material and $5,500 was allocated to labor. The plaintiff paid $10,000 for the materials and $1800 towards labor. When the defendant requested more money for materials, the plaintiff refused to pay and the defendant halted construction after substantially completing the house leaving only doors, windows, and material for room partitions and the ceiling to be completed. The plaintiff hired a second contractor to complete the work who charged plaintiff $6240.64 which included both material and labor. Both parties claimed the other party breached the contract. In order for a breach of contract to halt performance of a construction contract, the breach must be material. Whether a breach is material depends on several factors particularly where the breach deprives an injured party of the contract benefits.\textsuperscript{1388} The trial court found that plaintiff breached and owed

\begin{itemize}
\item \textsuperscript{1383} Id. at 237
\item \textsuperscript{1384} Id
\item \textsuperscript{1385} Kosrae State Code, § 13.518
\item \textsuperscript{1386} 9 FSM Intrm at 237
\item \textsuperscript{1387} 9 FSM Intrm 62 (Kos S. Ct. Tr. 1999)
\item \textsuperscript{1388} Id at 65 citing \textit{Panuelo v Pepsi Bottling}, 5 FSM Intrm 123, 128 (Pon 1991)
\end{itemize}
the defendant at least $1800 for labor because defendant contractor had substantially performed.\footnote{9 FSM Intrm at 65} Further, the court found that the cost of construction materials was a material term of the contract; that plaintiff did not breach by refusing to pay more than $10,000 for construction materials; and that defendant breached by failing to purchase construction materials with the $10,000 plaintiff had paid for those materials.\footnote{Id at 65} Defendant’s breach required plaintiff to hire a second contractor to complete the work paying $6240.64 which were the plaintiff’s consequential damages for additional labor and materials attributable to the breach.\footnote{Id at 64} The trial court correctly noted that where the defendant contractor substantially completed performance in constructing plaintiff’s house that the defendant contractor was entitled to the second of three installments for labor in the amount of $1800 and that plaintiff’s failure to pay was a breach of contract.\footnote{Id} This was an error, however, by the court which should have awarded the remaining $3600 to the defendant contractor who substantially completed the work and then offset those damages by the owner’s damages due to the contractor’s breach. Instead of offsetting the damages due to the mutual breach\footnote{Id} or awarding damages to the owner for the amount paid to the contractor, plus the amount paid to complete the work then deducting from the contract price, the trial court deviated from accepted contract law.

\footnote{9 FSM Intrm at 65}{Heller Elec. Co. v. William Klingensmith, Inc. 670 F2d 1227 (DC Cir. 1982)} where both parties were in breach due to delay and the trial indicated that neither could recover damages due to mutual breach. The Court of Appeals reversed indicating that damages should be off-set.
damage principles finding that neither party was entitled to recover anything from the other due to their mutual breach and remarkably dismissed all claims.\textsuperscript{1394}

**EQUITABLE REMEDIES FOR BREACH OF CONTRACT: SPECIFIC PERFORMANCE, PROHIBITORY INJUNCTION, RESTITUTION, RECISSION, AND UNJUST ENRICHMENT**

In addition to those remedies provided by statute and in law, there are a number of remedies available in equity such as specific performance, injunctive relief, restitution, recission, and unjust enrichment.

**Prohibitory Injunction**

*Restatement (Second) of Contracts* §356 recognizes that specific performance or injunctive relief may be appropriate where damages are inadequate. *Restatement (Second) of Contracts* § 360 lists several factors which can be utilized to determine whether damages are an adequate remedy which, in turn, would then preclude injunctive relief or specific performance.

The right to injunctive relief was recognized by the Supreme Court of the Marshall Islands in *Gushi Bros. v. Kios*\textsuperscript{1395} where certain leaseholders sued seeking injunctive relief to stop a builder from constructing a dwelling on land that they had leased. In affirming the decision of the High Court which granted prohibitory injunctive relief, the Marshall Islands Supreme Court utilized customary law and traditional rights to assess the validity of a lease, the bill of sale regarding certain property rights and an

\textsuperscript{1394} 9 FSM at 65-66.
\textsuperscript{1395} 2 MILR (Rev) 120 (August 26, 1998)
addendum involved.\textsuperscript{1396} As noted in \textit{Gushi Bros.}, Marshall Islands customary law and traditional rights require notice to all bwij members, if possible, and that the Iroijlaplap, Iroijedrik where necessary Alap and Senior Dri Jerbal of such land must approve any alienation or disposition of clan property. Failure to comply with traditional law requirements would result in granting injunctive relief. Similar traditional and customary rules apply in other island nations in the region and are important to understand if businesses intend to acquire or lease property for commercial purposes. Otherwise, what would facially appear to be a valid contract to acquire or lease could be declared null and void under traditional or customary law.

\textbf{Specific Performance}

The equitable right to specific performance is distinguishable from the statutory right of specific performance limited to breach of a contract for the sale of goods which has been legislatively created in those jurisdictions that have adopted the \textit{UCC 2-716}.\textsuperscript{1397}

\begin{itemize}
\item (1) Specific performance may be decreed where the goods are unique or in other proper circumstances. (2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just. (3) The buyer has a right of replevin or similar remedy for goods identified in the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family, or household purposes, the buyer’s right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.
\end{itemize}

\textit{Revised UCC 2-716} precludes parties in a consumer contract from agreeing to specific performance and excludes specific performance where the breaching party’s sole obligation is payment of money. \textit{Revised UCC 2-716} also removes reference to “goods for personal, family or household purposes” and states:
An alternative recognized by the Restatement (Second) of Contracts\(^{1398}\) to damages for breach of contracts which do not involve the sale of goods in those jurisdictions that have not adopted the UCC or its equivalent would be a suit in equity to compel specific performance of the contract or a prohibitory injunction. Specific performance is a generally recognized remedy where the breaching party owes an obligation to perform other than the payment of money.\(^{1399}\)

The equitable right of specific performance in a non-goods case was addressed in Palau in Jiangsu State Farms & Agribusiness Corp. v. Ho.\(^{1400}\) The Palau trial court was asked to resolve a dispute over shares in a corporation to be formed in Palau to manufacture garments. The dispute was between Pukou, a wholly owned subsidiary of

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(1) Specific performance may be decreed where the goods are unique or in other proper circumstances. In a contract other than a consumer contract, specific performance may be decreed if the parties have agreed to that remedy. However, even if the parties agree to specific performance, specific performance may not be decreed if the breaching party's sole remaining contractual obligation is the payment of money. (2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just. (3) The buyer has a right of replevin or similar remedy for goods identified in the contract if after reasonable effort the buyer is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. (4) The buyer's right under subsection (3) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

\(^{1398}\) Restatement (Second) of Contracts §359

\(^{1399}\) In pertinent part, UNIDROIT Article 7.2.2 states:

Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance unless...the party entitled to performance may reasonably obtain performance from another source.

\(^{1400}\) 7 ROP Intrm 267 (Tr. Div. 1998). In addition to the issue of specific performance, Jiangsu decision also addresses the concept of contractual choice of law. If the contract does not specifically indicate which country’s law is applicable in governing disputes, the law of the country which has the most significant relationship to the transaction and the parties will apply. Factors which are to be utilized in making this determination include place of contracting, where the contract was negotiated, the place of performance, the location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation and place of business of the participants. Id at 272
plaintiff, Jiangsu, a corporation organized under the laws of the People’s Republic of China, and the defendants. Pukou owned 49 percent of Nanjing Orientex, a corporation in the business of manufacturing garments in China. The defendants were Waisei, a Palauan corporation, a number of individual Palauan citizens, and Frank Ho, a U.S. citizen who was the owner of a Hong Kong corporation, World Fame Trading. The corporation, World Fame Trading, owned the remaining 51% of Nanjing Orientex.

The dispute in Jiangsu was over whether money advanced by Pukou was a loan or a capital contribution in exchange for shares in the new Palauan garment manufacturing corporation. The Jiangsu court observed that specific performance is generally not available if an award of damages would adequately compensate an injured party. Because specific performance is an equitable remedy and not a “right,” the Jiangsu court indicated that such a remedy will be granted or denied within the discretion of the court based upon consideration of the facts and circumstances of the case because no absolute entitlement to specific performance exists. Applying these general principles to the facts of the case, the court concluded that specific performance was not warranted.

The Palau Supreme Court also addressed equitable specific performance in a land dispute case in ROP v Toribiong. In this case, the State of Airai and the Airai State Public Land Authority (ASPLA) intervened in the lawsuit between a private land owner and the Republic of Palau and sought specific performance compelling the Republic of Palau to transfer an airport to the State of Airai and the ASPLA. The trial court ordered

1401 Id at 272. See Restatement (Second) of Contracts, § 359.
1402 7 ROP at 273. See Restatement (Second) of Contracts, § 357.
1403 7 ROP at 273-4
1404 2 ROP Intrm 43 (1990)
specific performance but the Supreme Court reversed finding that there was no express promise to transfer the land and secondarily to do so would be illegal and unenforceable. Specifically, the Palau Supreme Court observed:

A final possibility might be that ROP was agreeing, regardless of the actual state of the law, to act as though the law required transfer. This would be a promise either to change the law or to disregard it. As to the former, the language cannot possibly be construed as a promise to attempt to change the law. As to the latter, a promise by ROP officials to disobey or ignore the law would be illegal and unenforceable.\textsuperscript{1405}

The Supreme Court concluded it was an error for the trial court to order ROP to transfer the airport land to ASPLA.\textsuperscript{1406}

The equitable right to specific performance was also recognized in Micronesia as a viable alternative to damages in \textit{Ponape Construction v Pohnpei}.\textsuperscript{1407} In \textit{Ponape}, the State breached a contract with two contractors that it had engaged to perform emergency repairs to the Dekehtik causeway. One of the contractors had completed nearly 100\% of its work and damages were estimated by the contractor to be $222,400 and the State

\textsuperscript{1405} Id at 49-50
\textsuperscript{1406} Id at 50.
\textsuperscript{1407} 6 FSM Intrm 114 (Pon 1993), aff’d 7 FSM Intrm 613 (App. 1996). It should be noted that on appeal the FSM Supreme Court reluctantly affirmed this portion of the decision. Id at 622-3. It is apparent that the FSM Supreme Court was concerned that the trial court failed “to consider reliance damages or the other limitations on the ability of the court to grant specific performance” and asked the parties to brief the issue on appeal. The FSM Supreme Court indicated that if one of the parties had been compensated for its reliance expenditures it would have been put into as good of a position as it had been if it had not entered into a contract. Id at 623. Additionally, the FSM Supreme Court expressed concern that the trial court did not appropriately address the requirement that definiteness of the terms of the contract and difficulty of enforcement which must also be considered before awarding specific performance. Id. Because the State was given notice of these concerns on appeals but failed to address the concerns of the appellate court, the FSM Supreme Court affirmed the award of extraordinary relief but made it clear that they “were compelled to rule this way.” Id at 623.
valued that contractor’s work at approximately $300,000.\textsuperscript{1408} Where monetary damages were adequate, the *Ponape* court awarded the one contractor damages in the amount of $222,400.\textsuperscript{1409} The *Ponape* court observed that specific performance may an appropriate equitable remedy only when money damages are inadequate compensation to the plaintiff or when damages cannot be computed or a substitute purchased.\textsuperscript{1410} The other contractor was entitled to specific performance because in this particular case it had been terminated by the State before it could complete a large portion of the work and the method of compensation could not be accurately calculated. Part of the compensation package included commercial dredging rights of coral as part of the compensation. Since the contractor had not sufficiently dredged when wrongfully terminated by the State to establish a referral basis for the price of commercial coral, compensatory damages could not be accurately calculated and specific performance was an appropriate alternative.\textsuperscript{1411} Consequently, the State was ordered to permit the contractor to complete the repair work that it had originally agreed to perform and to extend the commercial dredging rights of the contractor immediately through December 31, 1994 plus the number of days attributable to the wrongful termination of the contract by the State.\textsuperscript{1412}

\textsuperscript{1408} Id at 125-6
\textsuperscript{1409} Id at 126
\textsuperscript{1410} Id.
\textsuperscript{1411} Id
\textsuperscript{1412} Id. One of the issues raised earlier in this decision by the State was that the agreement was vague and unenforceable because it did not have a date of completion. The court found that it was implied that the completion date of the emergency project ran concurrent with an Army Corp of Engineers permit that expired on 12/31/94. Id at 123.
Rescission and Restitution

Another alternative to awarding contract damages for breach of contract are rescission and restitution.\footnote{\textit{UCC} 2-718(2) states:}

Rescission allows the parties to rescind the agreement and to return to the status quo prior to contract formation. \textit{Restatement (Second) of Contracts} §370 provides that a party is entitled to restitution only to the extent that the party has conferred a benefit on another party by way of part performance or reliance. Each party is entitled to restitution for their efforts expended or any benefit conferred.\footnote{Restatement (Second) of Contracts \textsection{370}; UCC 2-718(2); Revised UCC 2-718(2)} \textit{Restatement (Second) of Contracts} §371 sets forth the standard method of calculating restitution interest. \textit{Restatement (Second) of Contracts} § 373 delineates when restitution is appropriate when the other party is in breach and \textit{Restatement (Second) of Contracts} § 374 specifies when the breaching party is entitled to restitution.

Restitution may also be appropriate if a contract is voidable under the Statute of Frauds.\footnote{Restatement (Second) of Contracts \textsection{375}} If a contract is voided due to lack of capacity, mistake, misrepresentation, duress, undue influence or abuse of fiduciary relationship, restitution may also be an appropriate remedy.\footnote{Restatement (Second) of Contracts \textsection{376}} Likewise, restitution is an appropriate remedy in cases involving

\begin{itemize}
  \item ...
impracticability, frustration of purpose, non-occurrence of a condition, or where there is disclaimer by a beneficiary.  

In *Phillip v. Aldis*, the Pohnpei Supreme Court determined that an effort to assign an account payable constituted a recission of an earlier agreement. Defendant had originally leased a vehicle from plaintiff. It was damaged. When defendant tried to return it the plaintiff, the plaintiff told him to repair it and return it or, alternatively, purchase the vehicle. The defendant agreed to purchase contingent upon obtaining financing which was not approved. When the defendant informed plaintiff that he was not approved, the plaintiff and defendant went to defendant’s employer and tried to assign the account stated to the defendant’s employer who refused. The court held that the “general rule is that parties to a contract may rescind it by making a new contract that is inconsistent with the original contract.”

**Unjust Enrichment and an Anthropology**

The doctrine of unjust enrichment is another equitable alternative to damages. The doctrine of unjust enrichment precludes one party from unjustly enriching itself at the expense of another.

One of the earliest cases in Micronesia in which a state court applied the doctrine of unjust enrichment and awarded restitution is the Kosrae case, *Jim v. Alik*. The court observed that where no contract exists, restitution is an equitable remedy which returns

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1417 Restatement (Second) of Contracts §377
1418 3 FSM Intrm 33 (Pon. S. Ct. Tr. 1987)
1419 Id at 37.
1420 Id at 37.
1421 4 FSM Intrm198 (Kosrae S. Ct. Tr. 1989).
the benefits already received by a party to the party who gave them. The Kosrae court noted: “Sometimes the remedy is phrased in terms of preventing ‘unjust enrichment.’”

Despite the Kosrae decision in *Jim v. Alik* in 1989, the theory of unjust enrichment was rejected in 1994 in the Pohnpei decision, *Etscheit v. Adams*. In *Adams*, defendants argued that to prevent unjust enrichment to the others that one son, Carlos, should be compensated for the time, money and effort he expended to re-claim land be either receiving a larger portion of land or additional compensation. From an anthropological perspective, the *Adams* trial court indicated cultural reluctance to adopt the concept of unjust enrichment in Pohnpei. The *Adams* court stated:

> The doctrine of unjust enrichment is widely recognized in the United Stated, but the defendants neither cite any FSM cases adopting the doctrine nor provide any compelling reason why this court would want to adopt that doctrine. Assuming this court wanted to adopt the doctrine, this is not the appropriate case for doing so.

The *Adams* court indicated that the doctrine usually applies to situations where one takes part performance under a contract that is void due to impossibility illegality, mistake, fraud, or some other comparable reason. In those situations, the doctrine requires that the person return what has been received or pay the other person even though there is no enforceable contract. Because there was no contract, enforceable

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1422 Id at 201.
1423 6 FSM Intrm 365 (Pon 1994) reversed on other grounds 6 FSM Intrm 580 (App. 1994)
1424 6 FSM Intrm at 392
1425 Id
1426 Id
or not, between Carlos and his relatives the court found the doctrine of unjust enrichment was inapplicable.\textsuperscript{1427}

The court also acknowledged that the doctrine of unjust enrichment has been expanded and applied to cases of “implied contract” but indicated that there was no evidence that Plaintiffs ever requested that Carlos undertake any efforts on their behalf or implied or suggested in any way that they would compensate him.\textsuperscript{1428}

Lastly, the \textit{Adams} court noted that that the doctrine of unjust enrichment is premised upon the concept that “one person should not be permitted unjustly to enrich himself at the expense of another.”\textsuperscript{1429} The court concluded that the doctrine of unjust enrichment was factually inapplicable because there was no evidence that Carlos expended any additional efforts on the plaintiffs’ behalf beyond what he had to do to preserve or protect his own personal interests in the land.\textsuperscript{1430} Consequently, the trial court granted summary judgment dismissing defendants’ claim of unjust enrichment.\textsuperscript{1431}

The theory of unjust enrichment was anthropologically assimilated four years later and was applied in Micronesia for the first time in 1998 in \textit{Mauricio v. Phoenix of Micronesia} where defendant had misappropriated plaintiff’s image using it on items it sold for profit.

\begin{flushright}
\textsuperscript{1427} Id \\
\textsuperscript{1428} Id \\
\textsuperscript{1429} Id (footnote omitted) \\
\textsuperscript{1430} Id \\
\textsuperscript{1431} Id \\
\textsuperscript{1432} 8 FSM 248, 262 (Pon. 1998). No party raised the unjust enrichment issue on appeal and the appellate case primarily addressed the tort issue of invasion of privacy. See \textit{Phoenix of Micronesia v. Mauricio}, 9 FSM 155 (App 1999)
\end{flushright}
Unjust enrichment was recently addressed by the FSM trial court in *Fonoton Municipality v. Ponape Island Trans. Co. (PITC)* in a case where plaintiff through Chuuk State ordered 27 outboard motors from the defendant PLR which in turn placed an order with PITC. Defendants delivered only 14 of those ordered. The *Fonoton* court listed the elements of unjust enrichment:

The generally accepted elements of a cause of action for unjust enrichment are that: 1) the plaintiff conferred a benefit on the defendant, who has knowledge of the benefit, 2) the defendant accepted and retained the conferred benefit, and 3) under the circumstances it would be inequitable for the defendant to retain the benefit without paying for it.

From a socio-cultural anthropological perspective, the *Fonoton* case is significant in that it demonstrates the extent of cultural assimilation of the Western common law concept of unjust enrichment within a ten year period. The *Fonoton* decision reflects one of the points that Llewellyn made in *Cheyenne Way* which was that for any foreign legal system to be successful it must be culturally integrated.

In *Fonoton v. PITC*, defendant PITC had cited *Etscheit v. Adams* claiming that the doctrine of unjust enrichment, although widely recognized in the United States, had not been expressly adopted in the FSM and, in the absence of any compelling reason to adopt this doctrine, should not be applied in this case. In response to this argument, the *Fonoton* court rejected defendant’s argument citing its earlier decision in *Mauricio v.*

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1433 12 FSM Intrm 337 (Pon. 2004)
1434 Id at 345
1435 Llewellyn, *The Cheyenne Way*, supra at 239.
1436 6 FSM Intrm 365, 392 (Pon 1994)
1437 12 FSM Intrm at 345-6
Phoenix of Micronesia\textsuperscript{1438} in which the doctrine was applied and noted that it was decided in 1998 four years after Etscheit v. Adams.\textsuperscript{1439}

In Fonoton, Justice Andon Amaraich observed that:

Unjust enrichment is an equitable remedy, and generally requires that the party who accepted and retained a benefit pay that benefit back to the party who conferred it. A court exercising equity jurisdiction has plenary power to fashion an order in such a manner as to recognize and maintain the equities of the parties involved. The relief granted in equity is dictated by the equitable requirements of the situation at hand and must be adapted to the facts and circumstances of each particular case. More simply stated, the underlying concept is the prevention of injustice, when a legal remedy may not be available to a party because of a technicality.

While the doctrine of unjust enrichment has not explicitly been discussed or adopted, the Court finds that the law of Pohnpei State, and Micronesian custom and tradition, dictate that a party who has benefited unjustly from another should be made to repay that benefit under certain circumstances. See FSM Const. Art. XI, §11.\textsuperscript{1440}

Anthropologically, the Fonoton decision reflects how within such a short period of time, a ten year period, Micronesia has gone from reluctantly acknowledging and rejecting a “widely recognized” doctrine in the United States with no FSM cases or compelling reason to adopt the doctrine in Etscheit to ten years later finding the law of Pohnpei State and Micronesian custom and tradition consistent with this equitable concept under the FSM Constitution.

In granting relief under the theory of unjust enrichment in Fonoton, Justice Amaraich distinguishes the facts in Fonoton from Etscheit v. Adams where there was no benefit conferred with an expectation of receiving anything in return consequently

\textsuperscript{1438} 8 FSM Intrm 248, 262 (Pon 1998)
\textsuperscript{1439} 6 FSM Intrm 365, 392 (Pon 1994)
\textsuperscript{1440} 12 FSM Intrm at 346
assessing liability under a theory of unjust enrichment upon the defendants in their respective capacities.\footnote{1441}

Having assessed liability, the \textit{Fonoton} court addressed a second significant contract concept. While assessing liability or allocating risk among and between defendants, the \textit{Fonoton} court also dealt with the concept of express contractual indemnification. Citing \textit{Joy Enterprises v. Pohnpei Utilities},\footnote{1442} the \textit{Fonoton} court observed that FSM courts “had recognized claims for indemnity based on contractual provisions between two parties” but “in the absence of a contractual provision the court would not create a common law indemnity claim.”\footnote{1443} This reluctance by the court to

\vspace{1.0em}

\footnote{1441}{Id at 346-7}
\footnote{1442}{8 FSM Intrm 306 (Pon 1998). The Joy case was a tort case in which the plaintiff sued Joy for electrical shock suffered while working on the Joy Hotel. In the absence of an express contractual provision, Joy sued PUC in a third party claim seeking indemnity. The \textit{Joy} court observed:}

This Court has recognized claims for indemnity based on contractual provisions between two parties. \textit{Bank of FSM v. Bartolome}, 4 FSM Intrm 182, 185 (Pon 1990); \textit{Semens v. Continental Airlines}, 2 FSM Intrm 131, 136-7 (Pon 1985). However, even when the Court has recognized claims for contractual indemnity, the Court has required ‘precise clarity in the language of the [indemnification] clause.’ \textit{Bartolome}, 4 FSM Intrm at 185. Here the undisputed facts demonstrate that there was no contractual relationship between Joy and PUC, let alone any precise or clear agreement by PUC to indemnity Joy…. The Court is not prepared to create a common law indemnity claim, and Joy has demonstrated no other legal basis for its indemnity claim against PUC. (Citation omitted) Id at 311.

\footnote{1443}{12 FSM Intrm at 347; 8 FSM Intrm at 311. For an additional cases in which express contractual indemnification has been recognized in Micronesia see: \textit{FSM v. Ting Hong Oceanic Enterprises}, 8 FSM Intrm 79, 88-9 (Pon. 1997) in which the defendant was charged with violating the Foreign Fishing Agreement it had signed with the Micronesia Maritime Authority when one of its ships failed to maintain a daily catch log. The FSM sought civil and criminal fines for breaching the agreement. The defendant had a contract with the mainland Chinese owners of the vessel in which the owner, Ning-Bo, agreed to comply with all laws and regulations and to pay any consequences of any violations. The court found that the cooperation agreement provided Ting Hong with a contractual right of indemnity against Ning-Bo allocating risk among the defendants but did not bar the government’s imposition of penalties for fishing violations on Ting Hong. Id at 88-9; and \textit{Asher v Kosrae} 8 FSM Intrm 443 (Kos. S. Ct. Tr. 1998) which was a tort case in which Judge Alikas addressed express contractual indemnification and successor corporate liability. In \textit{Asher}, an 8 year old had injured his eye when he ran into an electrical guy wire installed by the State of Kosrae. Before the incident at issue, the State of Kosrae had transferred all assets and liability to Kosrae Utility Agency (KUA). The court found the State negligent for the injury sustained by the plaintiff and the State sought express contractual indemnification from KUA. Id at 451. The KUA
adopt common law indemnity in the FSM which is accepted in other Western cultures is anthropologically significant and may reflect another anthropological trend.\textsuperscript{1444} Because of the Fonoton court’s reluctance to adopt a common law indemnity, the trial court denied PITC’s claim for indemnity from co-defendant Billy Jonas.\textsuperscript{1445}

In addition to Micronesian national courts, the doctrine of unjust enrichment is also being employed in Micronesian state courts. For example, the Kosrae courts applied the concept of unjust enrichment in \textit{Esau v. Malem Mun. Gov’t.}\textsuperscript{1446} In \textit{Esau}, plaintiff, who entered into a contract to provide his land to defendant for a dump, sued the defendant to recover expenses when defendant did not complete performance by filling the dump, and spreading and compacting the fill within what plaintiff considered to be a reasonable time. Because plaintiff did not give the defendant a reasonable time to perform under the contract, the plaintiff was precluded from suing for breach for money claimed that its general manager did not have authority to sign the transfer agreement and that its board of directors never ratified the agreement. The court rejected that argument indicating an officer’s authority to contract for a corporation may be actual or apparent and may result for the officer’s conduct or corporate acquiescence particularly if the corporation accepts the benefits of the contract. Id at 452. Further, a corporation may impliedly ratify an alleged unauthorized act or contract by receiving and retaining the benefits of the contract and ratification need not be a formal vote or resolution of the corporation. Id at 452-3. In order to avoid liability, a corporation needs to act promptly to rescind or revoke an alleged unauthorized transaction. Id at 453. A corporation may not accept benefits of a contract and then seek to escape liability claiming that the transaction was not authorized. Id at 452-3. Consequently, where the agreement’s indemnification provision is clear and KUA agreed to accept liability for causes of action and other claims, the KUA is liable to indemnity the State of Kosrae for tort damages attributable to State’s negligence. Id at 453.

\textsuperscript{1444} The FSM court distinguishes indemnification from contribution in \textit{Senda v Semes}, 8 FSM Intrm 484, 505 (Pon 1998) and is not as reluctant to permit contribution among tortfeasors in tort cases. The \textit{Senda} court observed that, in the case of indemnity, a defendant would be liable for the whole damage arising out of the contract, while in contribution the defendant is assessed a portion of liability based upon equitable factors measured by equality of burden and not upon a contractual relationship. Id at 505. Anthropologically, one of the significant factors of the \textit{Senda} case is its discussion regarding Pohnpeian culture and defendants claim that Pohnpeian culture prohibits relatives from suing one another and particularly prevents the contribution sought in this case. The \textit{Senda} court denied this claim indicating that the defendants failed to present sufficient evidence to support the claim that custom and tradition prohibit contribution among tortfeasors. Id at 497-9.

\textsuperscript{1445} 12 FSM Intrm at 347

\textsuperscript{1446} 12 FSM Intrm 433 (Kos. Ct. Tr. 2004)
damages he paid to have the work completed. Further, there were no equitable remedies available to plaintiff. In *Esau*, Chief Justice George of the Kosrae Supreme Court succinctly summarized Micronesian law regarding equitable alternatives to traditional contract remedies observing:

There is no other basis upon which Plaintiff may recover the White Sands fee from the Defendant. The doctrine of unjust enrichment only applies where there is no unenforceable contract. *Etscheit v. Adams*, 6 FSM Intrm 365 (Pon 1994). The doctrine of restitution may not be applied where there is a contract. *Jim v. Alik*, 4 FSM Intrm 199 (Kos. S. Ct. Tr. 1989). The doctrines of implied contract and quantum meruit do not apply where there is an enforceable contract. *E.M Chen & Assoc. v. Pohnpei Port Auth.*, 9 FSM Intrm 551 (Pon 2000). The doctrines of unjust enrichment, restitution, implied contract and quantum meruit are not applicable here, as the MOU [memorandum of understanding] is an enforceable contract between the parties.

**Statute of Limitations**

**In General: Breach of Contract Claims**

A claim for damages resulting from breach of contract must be brought within the applicable statute of limitations. These periods vary from jurisdiction to jurisdiction and are established by statute.

Equity recognizes an equivalent concept to the statute of limitations known as laches in which equitable claims must be brought. A comparable concept to laches is a statute of repose.

For example, in the Marshall Islands, the statute governing limitation of contract actions is the Civil Procedure Act.\(^\text{1447}\) The Marshall Islands follows the general rule for that all contract claims including breach of contract for the sale of goods must be brought

\(^{1447}\) Civil Procedure Act, 29 MIRC 1
within six (6) years. \(^{1448}\) Similarly, contract claims must generally be brought within 6 years in Micronesia. \(^{1449}\)

The Marshall Islands still recognizes contract under seal and provides that if the contract is under seal, a ten (10) year statute of limitations applies. \(^{1450}\) The statute of limitation period runs from the date upon which the action arose. \(^{1451}\)

**Disability**

Disability, such as infancy or unsound mind, can toll the statute of limitations. In the Marshall Islands, disability tolls the statute of limitations for a period of six (6) years from the point in time the disability is lifted. \(^{1452}\)

In addition to disability, the statute of limitations may be tolled for a number of reasons including fraudulent concealment as recognized in a recent Micronesian case. In *Youngstrom v. NIH Corporation*, \(^{1453}\) defendant tried to assert a statute of limitations defense relative to a construction project completed in 1993. The defendant argued that the six years expired in 1999. The plaintiff contended that the defendant fraudulently concealed defects in the work by filling hollow blocks with cardboard and capping them with concrete and, as a result, the statute was tolled until they became aware of the deficiency. The FSM trial court found that the statute of limitations was governed by

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\(^{1448}\) Civil Procedure Act, 29 MIRC 1, § 20.
\(^{1449}\) 6 FSMC §305. Chuuk still employs the Trust Territory Code, 6 TTC §305. See also, Kosrae State Code §6.2506 Pohnpei State Code Pon. S.L. No. 3L-99-95 §7-7; and Yap 31 Yap SC 104(a) (for contract actions against the state government) otherwise 6 TTC §305.
\(^{1450}\) Civil Procedure Act, 29 MIRC 1, § 20
\(^{1451}\) Civil Procedure Act, 29 MIRC 1, § 27
\(^{1452}\) Civil Procedure Act, 29 MIRC 1, § 21
\(^{1453}\) 12 FSM Intrm 75 (Pon. 2003)
In this construction case, Pohnpei State has a six (6) year limitation for contract claims. Generally, the 6 years begins to run from the date of completion or acceptance but the six year period can be tolled by fraudulent concealment. In the event that there is fraudulent concealment, the six year period begins when the plaintiff knew or should have been aware of the alleged defect in construction. Because the issue of when plaintiff became aware or should have been aware of the defect was essentially a fact question to be resolved, the trial court denied defendant’s motion for summary judgment. Please note that although fraudulent concealment may toll a statute of limitations it generally does not toll a statute of repose.

**UCC: Warranty Claims**

Under the *UCC*, warranty claims must be brought in four (4) years. The parties can agree to reduce the statute of limitations for a contract for the sale of goods to one (1) year but not less than one (1) year.

**UCC: Contract Claims**

Under the *UCC*, the statute of limitations for an action for breach of contract for sale of goods is four years from the date that the action accrued. *UCC* 2-725 provides that the parties may negotiate the length of the statute of limitations and reduce it to no

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1454 Id at 77
1455 Pon. S. L. No 3L-99-95, §7-7 (July 20, 1995)
1456 12 FSM Intrm at 77
1457 Id at 77-8
1458 Id at 78
1459 Revised UCC 2-725; Revised UCC 2-725
less than one year and may not extend it.\textsuperscript{1460} The action accrues when the buyer receives the goods and not when the defect is discovered.

**Exceptions**

The statute of limitations may differ depending on the type of claim. For example, for those jurisdictions which have not adopted the \textit{UCC}, the statute of limitations may be different than the \textit{UCC}'s four (4) years. Many jurisdictions provide a six year statute of limitations for breach of contract claims.

If the sale of goods is on an open account, the statute of limitations is six years as noted in the Micronesian case, \textit{Mid-Pacific Liquor v. Edmond}.\textsuperscript{1461} In \textit{Mid-Pacific}, the plaintiff provided defendant with $15,661.99 in product and defendant made a partial payment of $962.76.\textsuperscript{1462} An open account is defined as “an account based upon running or concurrent dealings between the parties which have not been closed settled, or stated, and which is kept unclosed with the expectation of further transactions.”\textsuperscript{1463} In \textit{Mid-Pacific}, the defendant claimed that the plaintiff’s claims were precluded by the six year statute of limitations.\textsuperscript{1464} The court rejected this argument relying upon 6 FSMC 807\textsuperscript{1465} indicating that where partial payment has been made or the cause of action is for an open account, the cause of action accrues at the time the last item proved in the account and

\begin{footnotesize}
\begin{enumerate}
\item \textit{UCC} 2-725(1)
\item 9 FSM Intrm 75 (Kos 1999)
\item Id at 77
\item Id at 78
\item Id at 77
\item 6 FSMC 807 provides “[i]n an action brought to recover the balance due upon a mutual and open account, or upon a cause of action on which partial payments have been made, the cause of action shall be considered to have accrued at the time of the last item proved in the account.”
\end{enumerate}
\end{footnotesize}
that pursuant to 6 FSMC 805\textsuperscript{1466} the statute of limitations is six years from the accrual date.\textsuperscript{1467} The Mid-Pacific court concluded that the matter had been brought within the applicable statute of limitations.\textsuperscript{1468} Plaintiff also sought attorney fees and pre-judgment interest which may be awarded if expressly made a part of the contract. The court rejected the request for attorney fees and pre-judgment interest by way of motion for summary judgment. The court indicated that a question of fact existed as to whether a paragraph providing for attorney fees and interest on the bottom left portion of each standard form invoice was a material part of the open account agreement between the parties because it was never signed or initialed by the defendant.\textsuperscript{1469}

The statute of limitations for breach of contract claims against the government may also differ from the standard six year period for contract claims. For example, in \textit{E.M Chen & Assoc v. Pohnpei Port Authority},\textsuperscript{1470} the plaintiff provided a master plan for the Pohnpei airport to defendant and was to be paid $75,000 within one year of receipt and acceptance. When the defendant did not, plaintiff sued. The \textit{Chen} court noted that the claim accrued when the payment was due but that breach of contract claims have a two year statute of limitations under the Pohnpei Governmental Liability Act.\textsuperscript{1471} Because plaintiff failed to timely file, its claim for damages was precluded even though there was no question that the defendant had not complied.\textsuperscript{1472}

\textsuperscript{1466}6 FSMC 805 states: “[a]ll actions other than those covered in the preceding sections of this chapter shall be commenced within 6 years after the cause of action accrues.”
\textsuperscript{1467}9 FSM Intrm at 78
\textsuperscript{1468}Id at 78
\textsuperscript{1469}Id at 79
\textsuperscript{1470}9 FSM Intrm 551 (Pon 2000)
\textsuperscript{1472}9 FSM Intrm at 557
**Statute of Repose**

In certain contract actions like construction contracts, an action may be barred by a statute of repose which begins running upon use, occupancy or acceptance by the owner. A significant difference between a statute of limitations and a statute of repose is that a statute of limitations may be tolled by infancy, disability, fraudulent concealment and related concepts whereas a statute of repose cannot be tolled.

**Doctrine of Laches**

The doctrine of laches applies in equity to preclude stale claims. One must bring suit in equity in a timely manner and may not rest on their laurels. Even though the statute of limitations may permit a contract claim to be brought in law within a specified period of time, an equitable action may be precluded related equitable claims if they are not brought in a timely manner which may be shorter in equity than in law. In that instance, equitable remedies may be barred but the duty to perform is not technically discharged.

The Marshall Islands Supreme Court has recognized the doctrine of laches in *Langijota v. Alex* and in *Likinbod and Alik v. Kejlat*.

Laches is also a defense recognized in Micronesia. As noted in *Mid Pacific Liquor v. Edmond*, the doctrine of laches involves two criteria: “1) inexcusable delay

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1473 1 MILR Rev. 216, 222 (December 3, 1990). The Marshall Islands Supreme Court indicated that the facts and circumstances of each case will determine whether laches bars an action and the decision to apply laches is discretionary with the trial judge. In order to apply laches, however, the court must find lack of diligence by the party against whom the defense is asserted and prejudice to the party asserting the defense. Id at 222.

1474 2 MILR 65, 66 (April 21, 1995). The Marshall Islands Supreme court indicates that the doctrine of laches is well established in the common law and that there are no constitutional or statutory impediments in applying the doctrine of laches even in land title cases. Id at 66.
or lack of diligence by the plaintiff in bringing suit, and 2) injury to the defendant from
the plaintiff’s delay.” 1476 Further, in order to avail oneself of the doctrine of laches one
must have clean hands and “must have acted properly concerning the subject matter of
the litigation.”1477 In *Mid Pacific*, the court found that the defendant could not assert
laches in that he lacked clean hands due to the fact that he had the benefit of the goods
which he received from the plaintiff without paying plaintiff for them.1478

**Traditional Law: Statute of Limitations and Laches**

An interesting feature of customary or traditional law in Palau provides that under
traditional law close familial relationships toll the application a statute of limitations or
the doctrine of laches.

In *Aguon v. Aguon*,1479 the trial court in Palau observed that plaintiffs’ claims
“were not precluded by either the equitable doctrine of laches nor the 20 year limitation
on land claims in 14 PNC Section 402(a)(2) because of the family relationship between
Plaintiffs and Francisco.”1480 The *Aguon* case involved a dispute among relatives over
land originally owned by three (3) brothers.
TORT AND QUASI-CONTRACT ALTERNATIVES

Other alternative forms of relief arising out of contractual situations to damages for breach of contract or equitable actions would be tort actions, i.e. negligence, fraud, misrepresentation, professional liability, strict product liability claims, tortious breach of contract or tortious interference with contractual relations, or an action in equity or quasi-contract.

Tortious Interference with Contractual Relations

The Supreme Court of the Marshall Islands initially recognized the existence of both quasi-contract and tort alternatives, such as tortious interference with contractual relations, to traditional contract claims in Guaschino v. Reimers and Reimers and has more recently addressed these alternative theories to contractual liability in Anitok v.

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1481 2 MILR 49 (March 8, 1995). Guaschino attempted to obtain a written contract from Ramsey Reimers regarding the design and construction of Ramsey Reimer’s residence. The draft agreement sat on Ramsey Reimers’ desk for six years and was never signed. The Supreme Court of the Marshall Islands referred to the arrangement between Guaschino and Ramsey Reimer as “an oral construction undertaking with no meeting of the minds as to the details of Guaschino’s responsibilities by virtue of it.” The Supreme Court of the Marshall Islands observed that oral contracts can be valid but there must be a meeting of the minds. Despite the absence of a complete meeting of the minds, the Guaschino court enforced the “agreement” between Ramsey Reimer and Guaschino and observed that the draft agreement prepared by Guaschino but never signed by Reimers set forth in some detail the work that Guaschino undertook to do; referred to Guaschino as the “designer and project manager for the project;” and corroborated Reimers’ understanding of the oral agreement. In response to breach of contract and professional liability allegations regarding the design and construction of Robert and Ramsey Reimers’ homes, Guaschino also argued that there was no valid contract for the construction of Robert Reimers’ house because that particular agreement with Guaschino had been signed by Ramsey Reimers and not Robert Reimers. The Supreme Court refuted this assertion because Guaschino acted on it and had substantially completed the house before being terminated. The court affirmed the damage award for both Reimers’ due to Guaschino’s breach of contract and tortious conduct except the Supreme Court did not believe the award of punitive damages was appropriate in a breach of contract case that did not involve egregious tortious conduct.
Tortious interference with contractual relations is also recognized as a viable alternative to traditional contract claims in the Republic of Palau. For example, in *Wolff v. Sugiyama*, Wolff alleged in a third party complaint that Sugiyama intentionally...

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1482 2 MILR 114 (January 6, 1998) in which the plaintiff sued defendant in both tort and contract when goods Plaintiff purchased were lost at sea when the bum-bum they were being transported in by the defendant capsized.

1483 2 MILR 211 (December 24, 2002) in which AMI sued Dornier over the sale of two aircraft in which AMI alleged fraud, misrepresentation, tortious interference of contractual relationship with another, unjust enrichment, conversion or duress. In this case, the lower court record indicated that the High Court did something quite unusual in that it awarded a default judgment of $1.6 to AMI for money paid to Dornier under a theory of breach of contract when that theory was not pled by the plaintiff. AMI also argued that under Section 162 of the Marshall Islands’ Civil Procedure Act they should be entitled to treble punitive damages of $4.8 million for fraud because it was one of the theories they pled and a default judgment is a judgment on the merits. The High Court awarded a total of $2.1 million to AMI which included the $1.8 that AMI paid to Dornier and an additional $300,000 for losses incurred for tortious interference with contractual relations regarding the collateral sale of a SAAB 2000. The High Court did not award punitive damages and the Supreme Court rejected AMI’s argument on appeal indicating that there was nothing in the lower court transcript of the default judgment hearing which indicated that the High Court found fraud or misrepresentation. The Supreme Court observed that the $2.1 million award could have been supported by a number of well pled theories that actually had been pled in the Plaintiff’s complaint such as unjust enrichment, conversion, or duress. In the absence of a finding of fraud or misrepresentation on the record, punitive damages would not be appropriate. Id at 222.

1484 In *Pacific International, Inc v. United States of America*, 2 MILR 244 (May 10, 2004), the United States awarded contractor Wallace O’Connor to perform various construction projects on the U.S. Army base located on the Kwajalein Atoll. O’Connor entered into a subcontract with Pacific International. Pacific International requested that some of its employees be permitted to reside on the base. When the base commander refused, Pacific International sued the United States Government and Army. The Supreme Court of the Marshall Island held that the operation of military bases is a purely government function and sovereign in nature citing *United States of America v. Public Service Alliance of Canada*, (1992) 2 S.C. R. 50, 91 D.L.R. (4th) 449, 1992 Carswell Nat 1005 (with respect to a military base in Canada leased by the United States, the Supreme Court of Canada stated, “I can think of no activity of a foreign state that is more inherently sovereign than the operation of such a base. As such, the United States government must be granted the unfettered authority to manage and control employment activity at the base.”); *Holland v. Lampen-Wolfe* (2000) 3 All E.R. 833,[2001] I.L. Pr. 49, 2000 WL 976034 (HL) ([t]he maintenance of the base itself was plainly a sovereign activity. As Hoffman L.J. (Now Lord Hoffman) said in *Littrell v. United States* (No.2), this looks about as imperial an activity as could be imagined”); and *Cafeteria Workers v. McElroy* 367 U.S. 886, 896(1961)(“the governmental function…here was…to manage the internal operation of an important federal military establishment. In that proprietary military capacity, the Federal Government, as has been pointed out, has traditionally exercised unfettered control.”) Consequently, the Supreme Court held that the United States government and the United States Army were immune from suit and that alleged, in part, tortious interference with contract, and tortious interference with prospective contractual and business relations and economic advantage.

1485 5 ROP Intrm 105 (1995)
interfered between Wolff and Jane Arugay for the provision of domestic services. Because Arugay left Wolff’s employment without his consent, he claimed Sugiyama interfered with a contract he had with Arugay to provide domestic services. Sugiyama moved for summary judgment which the trial court granted and the appellate court affirmed. The Wolff decision is significant for three reasons. First, it reiterates that Palau courts are statutorily required by the rule of decision statute to follow the American Law Institute’s Restatement of Laws. Second, it defines a claim for tortious interference. Third, it sets forth the seven (7) elements for a claim of tortious interference with contractual relations:

First, there must be a valid, enforceable contract between the claimant and a third-party….Second, defendant must have knowledge of the existence of the contract…. Third, the third-party must actually breach the contract with the claimant…. Fourth, defendant’s action must have been the proximate cause of the third-party’s breach of contract….Fifth, at the time of defendant’s action, defendant must have intended his or her action to induce the third-party to breach the contract….Sixth, defendant’s actions must have been improper…. Seventh, claimant must have suffered a pecuniary loss as a result of the breach by the third-party.  

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1486 Id at 110-111  
1487 Id at 110. See also, Kamiishi v. Han Pa Constr. Co. 4 ROP Intrm 37, 40 (1993) and A.J.J. Enter. V. Renguul, 3 ROP Interm 29, 31 (1991)  
1488 5 ROP at 110. Citing Restatement of the Law (Second) of Torts, § 766, the Wolff court observed:  

One who intentionally and improperly interferes with the performance of a contract (except a contract to marry) between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract. Id at 110.  

1489 In determining whether the defendant’s actions are improper, the Wolff court adopted Restatement (Second) of Torts, § 767, which requires consideration of: the nature of the actor’s conduct, the actor’s motive, the interests of the other with which the actor’s conduct interferes, the interests sought to be advanced by the actor, the social interests in protecting the freedom of action of the actor and the contractual interests of the other, the proximity or remoteness of the actor’s conduct to the alleged interference, and the relations between the parties. Id at 111, fn.2  
1490 Id at 111. (Citations omitted)
Applying these criteria to the facts of the case, the Wolff court determined that the trial
court properly granted Sugiyama’s motion for summary judgment.\textsuperscript{1491}

Tortious interference with contractual relations is also a recognized cause of
action in Micronesia. In \textit{Federated Shipping v. Ponape Transfer and Storage},\textsuperscript{1492} the
court indicated that relief may be granted under the law of Pohnpei\textsuperscript{1493} for a claim of
tortious interference with contractual relations when an individual’s economic advantages
obtained through dealing with others are knowingly jeopardized due to malicious or petty
reasons or by the improper or unjustified conduct of a third party. Applying the facts of
the case to the law, the court concluded that defendant’s allegedly offensive actions were
taken during good faith efforts to protect a legally cognizable interest and did not
constitute tortious interference under Pohnpei law.\textsuperscript{1494}

In \textit{Kihara v. Nanpei},\textsuperscript{1495} the FSM trial court granted a motion for summary
judgment rejecting a defense that payment by plaintiff to defendant of $50,000 pursuant
to a bond of debt was tortious interference with a pre-existing economic relationship that
defendant had with a third party.\textsuperscript{1496} The trial court was affirmed on appeal.\textsuperscript{1497}

\textsuperscript{1491} Id at 112-3
\textsuperscript{1492} 4 FSM Intrm 3 (Pon. 1989)
\textsuperscript{1493} The \textit{Federated Shipping} court indicated that since general contract law falls within the powers of the
state, state law will be utilized to resolve contract disputes. 4 FSM Intrm at 9. In \textit{Edwards v Pohnpei}, 3FSM
Intrm 350 (Pon 1988) the court previously indicated that consistent with practice in the United States that
state law, rather than national law, controls in the resolution of tort and contract issues. Id. at 360, fn. 22.
See also, Pohnpei v. M/V Miyo Maru No. 11, 8 FSM Intrm 281,295 (Pon 1998) which was a tort case in
which the State of Pohnpei alleged that the defendant negligently grounded a fishing vessel damaging
submerged lands and reefs and spilling oil into Pohnpeian waters where the court observed: “State law
controls in the resolution of contract and tort issues…. ‘When the Supreme Court, in the exercise of its
jurisdiction, decides a matter of state law, its goal should be to apply the law the same way the highest state
court would.’” Id at 295. (Citation omitted.) Compare, \textit{Bank of Hawaii v. Jack}, 4 FSM Intrm 216 (Pon
1990) in which the court acknowledged that generally in cases requiring the interpretation or construction
of contracts, the national courts apply state law, but in this case involving a personal bank loan from a
foreign bank through interstate commerce, the court formulated and applied rules of national law. Id at 220.
\textsuperscript{1494} 4 FSM Intrm at 15
\textsuperscript{1495} 5 FSM Intrm 342 (Pon. 1992)
\textsuperscript{1496} Id at 345
Quasi or Implied Contract

The concept of quasi-contract or implied contract as a basis for legal obligation has roots in the civil and Roman law traditions. Quasi-contract is different from an express contract between the parties which is either oral or written or an implied in fact contract based upon the conduct of the parties. Quasi contract is implied in law and is really a legal fiction crafted by the courts to prevent injustice and unjust enrichment.

Lord Mansfield was one of the early English jurists who defined the concept within the common law tradition. In *Moses v. MacFerlan*, Lord Mansfield best summarized this concept in contract law stating:

If the defendant be under an obligation from the ties of natural justice to refund, the implies a debt and gives this action founded in equity of the plaintiff’s case, as it were, upon a contract (‘quasi ex contractu,’ as the Roman law expresses it.)…This kind of equitable action, to recover back money, which ought not in justice to be kept, is very beneficial, and therefore much encouraged…[I]t lies for money paid by mistake; or upon a consideration which happens to fail; or for money got through imposition, (express or implied;) or extortion; or oppression; or an undue advantage taken of the plaintiff’s situation, contrary to laws made for the protection of persons under those circumstances. In one word, the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money.

The elements of quasi contract generally require that:

20) one party confer a benefit (services, real or personal property, etc…) on the other;
21) that the person conferring the benefit has a reasonable expectation of being compensated;
22) the person conferring the benefit was not an “officious intermeddler” or volunteer; and

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1498 97 ER 676 (1760)
1499 Id at 678, 680-1
23) if the person receiving the benefit is permitted to retain the benefit conferred without compensating the person who conferred it, the person receiving the benefit would be unjustly enriched.

The Supreme Court of the Republic of Palau recognized implied or “quasi contract” as an alternative theory of liability in *Loitang v. Jesus*.\(^{1500}\) The *Loitang* decision involved a dispute over a Micronesian War Claims award for damage to trees and crops during World War II to Ngercheu Island in the State of Peleliu. Rubasch Fritz obtained the War Claims settlement on behalf of the Edaruchei clan. Fritz was then jointly sued by Uchelmekediu Ngireblekuu and an individual named Ngirchomtilou seeking a share of the War Claims award. This second suit was settled and the parties agreed to split the War Claims award in half (half for Fritz, half for Ngireblekuu) for distribution to their respective lineages and families since each family has lost crops and trees on the island during World War II. Ngireblekuu further split his half among his family and lineage. The settlement between Fritz and Ngireblekuu only covered that money that had been paid out at the time of the oral agreement on deposit in the Bank of Hawaii. After this initial agreement, several additional War Claims payments were made and these payments were divided in half just like the initial division. A final payment was made in 1989 which was divided like all the rest but Ichiro Loitang who had assumed the title of Uchelmekediu refused to divide his share among the lineage leading to this dispute. The plaintiffs sued Loitang for their share of the payment made to the Uchelmekediu and the trial court found for the plaintiffs holding that the money should

\(^{1500}\) 5 ROP Intrm 216 (1996)
be split between the families.\textsuperscript{1501} Loitang appealed. The Palau Supreme Court affirmed. The Supreme Court observed: “Although there is no evidence of an express agreement or contract to split the monies recovered as a result of the lawsuit between the two families, the existence of such an agreement and its terms can be inferred from the circumstances leading up to this action.”\textsuperscript{1502} The \textit{Loitang} court stated: “A promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct.”\textsuperscript{1503} The \textit{Loitang} court continued: “A contract implied in fact is ‘inferred from the facts and circumstances of the case.’”\textsuperscript{1504} Relying upon the \textit{Restatement (Second) of Contracts}, the \textit{Loitang} court stated: “[w]here an agreement involves repeated occasions for performance by either party…any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of the agreement.”\textsuperscript{1505} Applying the law to the facts of the case, the Palau Supreme court affirmed the trial court decision to split the War Claims award consistent with prior conduct and the implied in fact contract existing between the parties.\textsuperscript{1506}

In \textit{Weilbacher v Kosrae},\textsuperscript{1507} the Kosrae State trial court recognized an implied admiralty contract for passage in the absence of a written document in a case involving

\begin{footnotes}
\item[1501] Id at 217
\item[1502] Id at 218.
\item[1503] Id. In support of this proposition, the Palau Supreme Court cited \textit{Restatement (Second) of Contracts}, § 4; accord \textit{Kamiishi v. Han Pa Construction Co}, 4 ROP Intrm 37, 40 (1993)(manifestation of mutual assent to terms of contract may be in form of words or acts.)
\item[1504] 5 ROP Intrm at 218 citing 17A Am Jur 2d \textit{Contracts}, § 12 (1991) and \textit{Baltimore & Ohio R.R. v. United States}, 43 S. Ct. 425, 426 (1923) (“An agreement implied in fact [is] founded upon a meeting of the minds, which although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in the light of surrounding circumstances, their tacit understanding.”)
\item[1505] 5 ROP Intrm at 218 citing \textit{Restatement (Second) of Contracts}, § 202 (4)
\item[1506] 5 ROP Intrm at 218-9.
\item[1507] 3 FSM 320 (Kos S. Ct. Tr. 1988)
\end{footnotes}
tort liability for an injury that occurred in navigable waters under FSM federal admiralty jurisdiction.\textsuperscript{1508}

In \textit{Ponape Transfer & Storage Inc. v. Wade},\textsuperscript{1509} the court recognized an implied term of a contract by utilizing course of dealing and surrounding circumstances to determine the intention of the parties which is the predominant consideration in deciding whether a vague or missing term is implied at common law.\textsuperscript{1510} The \textit{Ponape} court concluded that prior course of dealing and surrounding circumstances reflected the parties’ intent that pay for unused vacation time would constitute an implied term of the employment contract.\textsuperscript{1511} On the other hand, there was no factual support for defendant’s implied contract claim for shipping and transportation costs back to the point of hire in the course of dealing or surrounding circumstances between the parties.\textsuperscript{1512}

The FSM trial court also recognized an implied contract in conjunction with an express contract that had been terminated in \textit{FSM Telecomm. Corp. v. Worswick}.\textsuperscript{1513} In \textit{Worswick}, the defendant had an open account with plaintiff and cancelled her long distance telephone service but continued to use it while waiting for the plaintiff to disconnect the service. Applying a theory of implied contract, the court indicated that the defendant was precluded from arguing that she should not have to pay the plaintiff when she continued to use the long distance service despite the absence of an actual contract.

\begin{footnotes}
\textsuperscript{1508} Id at 323
\textsuperscript{1509} 5 FSM 354 (Pon. 1992) (Court implied a term that compensation was to be paid to employees for unused holiday time minus taxes.)
\textsuperscript{1510} Id at 356
\textsuperscript{1511} Id at 356
\textsuperscript{1512} Id at 357
\textsuperscript{1513} 9 FSM Intrm 6 (Yap 1999) affirmed 9 FSM Intrm 460 (App. 2000)
\end{footnotes}
after its termination by the defendant.\textsuperscript{1514} Consequently, the trial court awarded plaintiff $6117.78.

An action in quasi-contract would also allow recovery for any benefit conferred or detriment incurred. In a quasi-contract situation, one party must confer a benefit by rendering services or expanding properties of another with a reasonable expectation of being compensated. The benefit must be conferred at the express or implied request of the other person and unjust enrichment would result if defendant was allowed to retain benefit without compensating Plaintiff.

The existence of an express written contract precludes one from asserting a quasi or implied contract claim. In \textit{E. M Chen & Assoc. v. Pohnpei Port Authority},\textsuperscript{1515} the plaintiff had an agreement with defendant to provide a master plan for the Pohnpei airport and defendant was supposed to pay $75,000 within one year of receipt and acceptance. The contract claim was precluded by the statute of limitations. Because there was an express written contract and the contract claim was precluded by operation of law, a quasi or implied contract claim was precluded.

**Relationship between Quasi Contract and Anthropology**

Anthropologically, the \textit{Chen} case is significant in that the Micronesian court observes cultural reluctance to this particular theory of alternative contract recovery. Citing cases spanning twelve (12) years from 1988 until 2000, the \textit{Chen} court observes:

\begin{flushright}
\textsuperscript{9} FSM at 17  
\textsuperscript{1515} 9 FSM Intrm 551 (Pon 2000)
\end{flushright}
Cases in the FSM have addressed claims based on the theory of quantum meruit; however, no cases granting relief under quantum meruit, or even recognizing that quantum meruit is a basis for recovery in the FSM, were found.\footnote{Id at 558 citing \textit{Sohl v. FSM}, 4 FSM Intrm 186 (Pon 1990); \textit{Truk v. Maeda Constr. Co (II)} 3 FSM Intrm 487 (Chk 1988)}

The \textit{Chen} court defined the elements for quantum meruit:

Quantum meruit is an ‘equitable doctrine, based upon the concept that no one who benefits by the labor and materials of another should be unjustly enriched thereby.’ \textit{Black’s Law Dictionary} 1119 (5\textsuperscript{th} ed. 1979). The essential elements of recovery under quantum meruit include: (1) valuable services rendered or materials furnished; (2) to a person sought to be charged; (3) which services or materials were used and enjoyed by the person sought to be charged; and (4) under such circumstances as reasonably notified the person sought to be charged that the person performing the services expected payment. Id.\footnote{Id}

The \textit{Chen} court held that as a matter of law “that in the presence of an express written contract, like the one at issue here which clearly sets forth the obligations of the parties, a party is precluded from bringing a claim under quantum meruit.”\footnote{Id} The court also indicated that the statute of limitations on an implied or quasi contract claim runs from the time a claim would accrue like any other claim and that claims against the Pohnpei State are governed by a two year statute of limitations.\footnote{Pohnpei Government Liability Act of 1991, Pon S.L. No. 2L-192-91} Because plaintiff filed their claim of implied or quasi contract beyond the two year limitation period, the claim was time barred.\footnote{9 FSM Intrm at 558. The \textit{Chen} court also precluded plaintiff’s express contract claim and an estoppel claim in that all claims against the State must have been filed within the two year time frame pursuant to Pon. S.L. No 2L-192-91 even though there was no dispute that defendant had not paid in accord with the terms of the contract. Id at 557-9.}
**Tortious Breach of Covenant of Good Faith and Fair Dealing**

In *Phillip v. Marianas Insur. Co.*,\(^1\) the Micronesian courts recently recognized a tort claim for breach of implied covenant of good faith and fair dealing which “rests on the premise that whenever the cooperation of a party is necessary for the performance of a contractual promise, there is a condition implied that the cooperation will be given.”\(^2\) This tort claim was limited to cases involving insurance contracts “where the insurer possess greater sophistication, can be expected to assist local insureds in understanding the relevant legal terminology, and has a specialized role in processing claims.”\(^3\)

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**Strict Product Liability**

If the plaintiff opts to sue a third party in tort for strict product liability, no privity of contract is required as it is in contract claims. However, if one elects to sue in tort for strict liability, one must waive any contract claim such as breach of implied warranty. This concept is described as an election of remedies.

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\(^1\) 12 FSM Intrm 301 (Pon 2004)  
\(^2\) Id at 307  
\(^3\) Id.
PART VIII: RIGHTS AND DUTIES OF THIRD PARTIES AND
THIRD PARTY BENEFICIARY CONTRACTS

THIRD PARTY BENEFICIARIES

A third party beneficiary is an individual or entity who is not a party to a contract but who is specifically identified in the contract and who will receive some benefit from the contract.

Under the common law, there are two categories of beneficiary: creditor or donee beneficiaries. A creditor beneficiary is a person or entity to whom a debt is owed by the promisee. A donee beneficiary involves a situation in which the promisee intends to gratuitously benefit the third party.

The Restatement (Second) of Contracts §302 suggests the elimination of these two common law categories and suggests that they be replaced with two new categories: intended beneficiaries and incidental beneficiaries. Under the Restatement (Second) of Contracts, only an intended beneficiary has contract rights.

As a general rule, the rights of a third party beneficiary will vest when the beneficiary manifests assent to the promise in a manner requested by the parties, brings suit to enforce the promise, or materially changes position in substantial reliance upon the promise. An intended third party can sue either the promisor or promisee on the contract.
Under the *Restatement (Second) of Contracts*, an incidental beneficiary has no enforceable contract rights and cannot sue to enforce the contract. An incidental beneficiary is entitled to no benefits and has no rights under the contract.\(^{1524}\)

A person is an intended beneficiary if the agreement between the parties intended that the benefits of the contract be conferred directly on the third person. Intended beneficiaries include creditor and donee beneficiaries. Under the *Restatement (Second) of Contracts*, the third party’s rights vest if the third party files suit, knows of and detrimentally relies on the promise, or if there is an acknowledgement.

Under the common law, a donee beneficiary’s rights immediately vest at the time the contract is made. A creditor beneficiary’s rights vest when suit is brought to enforce or if the creditor has knowledge and detrimentally relies on the promise. Because of the donee’s vulnerability, donee beneficiaries are afforded greater protection and have earlier vesting rights under the common law than creditor beneficiaries who can sue to enforce. Once contractual rights vest in the third party, the original parties cannot revoke.

Common law vesting rules can be expressly modified contractually if there is a clause reserving the right to divest and change at anytime. In the absence of such a clause, the court will follow the common law vesting rules.

Most jurisdictions still retain the creditor-donee distinction even though the *Restatement (Second) of Contracts* recommends doing away with the distinctions between creditor and donee beneficiaries.

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\(^{1524}\) Restatement (Second) of Contracts, §302
An early example of a court recognizing third party creditor beneficiary status is *Lawrence v. Fox*. In *Lawrence*, Holly owed plaintiff Lawrence $300. Defendant Fox asked Holly for a $300 loan. Holly indicated that he owed the $300 to plaintiff Lawrence but loaned $300 to defendant Fox. In consideration of the one day loan, defendant Fox agreed to pay the $300 to plaintiff Lawrence the next day. When Fox did not pay, Lawrence sued.

 Defendant Fox moved to dismiss Plaintiff Lawrence’s claim indicating, among other things, that Lawrence lacked privity and that there was no consideration. In essence, Fox claimed that if anyone had the ability to enforce the agreement it would have been Holly, not Lawrence.

 The court rejected these arguments indicating that the loan from Holly to Fox for a day, albeit brief, was still valuable and sufficient consideration and “that where one person makes a promise to another for the benefit of a third person, that third person may maintain an action upon it” in the absence of privity. The lower court judgment of $344.66 which included interest was affirmed.

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1525 20 N.Y. 268 (Ct. of App 1859)
Diagram: Third Party Beneficiary Relationship

Third party beneficiaries have not fared as well in other common law countries. Although unsuccessfully raised in Lawrence, lack of privity and consideration are frequent obstacles utilized to preclude enforcement of third party contracts in other jurisdictions. One of the earliest English cases addressing the concept of third party beneficiary status is Tweddle v Atkinson. In Tweddle, William Guy and John Tweddle promised to pay a sum of money to William Tweddle who was going to and did marry Guy’s daughter. Obviously, the intended beneficiary of this agreement was William Tweddle. The money was intended to provide for the couple after their marriage. Unfortunately, Guy died before paying anything to William Tweddle and William

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1526 121 ER 762 (1861)
Tweddle sued the Guy estate to enforce the promise. The claim was dismissed in that there was no consideration for the underlying agreement and William Tweddle was not a privity to the contract and had no enforceable rights. John Tweddle, who was in privity, could have sued Guy or Guy’s estate to enforce the contract if valid. Even applying third party beneficiary concepts recognized today intended to circumvent the privity requirement and relieve the harshness of this ruling, Tweddle would not have succeeded due to the fact that the original agreement was unenforceable in that it lacked consideration.

The earliest third party beneficiary case in Micronesia is *Mailo v. Penta Ocean Inc* 1527 which arose out of the dredging of certain submerged tideland in conjunction with the Weno Commercial Dock improvement project. In *Mailo*, plaintiff Mailo sued Chuuk and Penta claiming that Penta dredged submerged tideland without his permission when making improvements to the facilities and approaches to the Weno Commercial dock. 1528 Chuuk agreed to settle the claim with Mailo on July 28, 1995. The settlement agreement began: “IT IS AGREED: 1. The Government (and the Contractor) shall compensate the reef owner in the following manner….“ Chuuk agreed to pay Mailo $30,000 within 90 days with a monthly penalty charge thereafter if still unpaid and to provide Mailo with 1500 cubic yards of coral sand. The activity covered by the agreement was the dredging a “privately owned adjacent reef” and by agreeing to its terms, Mailo agreed to “waive [ ] all claims that he may have [had] arising from the dredging of said reef.” The agreement concluded: “4. This Agreement constitutes the

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1527 8 FSM Intrm 139 (Chk 1997)
1528 Id at 141.
entire compensation settlement to the Reef Owner and all obligations shall be binding
upon and benefits shall inure to the Parties’ heirs, assigns, representatives, or successors.’
Penta moved for summary judgment claiming that they were a third party beneficiary of
the Mailo-Chuuk settlement agreement. Mailo claimed he could still sue Penta because
they were not a party to the settlement agreement. The trial court granted summary
judgment for Penta. The *Mailo* court observed:

A third person may, in his own right and name, enforce a promise made for his
benefit even though he is a stranger both to the contract and to the consideration. This concept, originally an exception to the rule that no claim can be sued upon
conttractually unless it is a contract between the parties to the suit, has become so
general and far-reaching in its consequences as to have ceased to be an exception,
but is recognized as an affirmative rule, generally known as the third-party
beneficiary doctrine.\(^\text{1529}\)

In determining whether a party is an intended third party, the *Mailo* court noted
that “the determining factor as to the rights of a third-party beneficiary is the intention of
the parties who actually made the contract.”\(^\text{1530}\) The *Mailo* court stated:

The question whether a contract was intended for the benefit of a third person is
generally regarded as one of construction of the contract. The intention of the
parties in this respect is determined by the terms of the contract as a whole,
construed in the light of the circumstances under which it was made and with the
apparent purpose that the parties are trying to accomplish.\(^\text{1531}\)

As for the requirement that the third party be described or identified in the
contract, the *Mailo* court observed: “When the third-party beneficiary is ‘so described as
to be ascertainable, it is not necessary that he…be named in the contract in order to’

\(^{1529}\) Id at 141. Citing 17A Am Jur 2d *Contracts* § 435, at 458 (1991)(footnotes omitted)
\(^{1530}\) Id at 141. Citing 17A Am Jur 2d *Contracts* §440, at 463 (1991)
\(^{1531}\) Id at 141. Citing 17A Am Jur 2d *Contracts* §441 at 464 (1991)
\(^{1532}\) Id at 141-2. Citing 17A Am Jur 2d *Contracts* § 454 at
The Mailo court indicated that the words “the Contractor” sufficiently identified Penta as the intended third party beneficiary of the settlement agreement and that the agreement was intended to be the “entire compensation agreement” with Mailo.\footnote{1533} The Mailo court also observed that the language of the agreement clearly intended that Penta benefit from Mailo’s promise to waive any and all claims to further compensation.\footnote{1534} Consequently, Penta could directly enforce against the promisor, Mailo, his promise to waive any further claims to compensation outside the scope of the agreement.\footnote{1535} The fact that the money had not been paid by Chuuk does not constitute a defense to the third party claim where the agreement already provided a remedy for any late payment.\footnote{1536}

The Micronesian courts addressed the distinction between “intended” and “incidental” beneficiaries in \textit{FSM Dev. Bank v. Mudong}\footnote{1537} which arose out of a $37,000 loan from FSM Development Bank to the Mudongs for a taxi service they intended to operate. The loan to the Mudongs was secured by mortgages in real property and chattel. The Mudongs in turn entered into a promissory note and agreement with Benskin Etse in which the Mudongs assigned their entire financial obligation with the plaintiff bank to Etse. When the bank was not paid, it sued the Mudongs seeking to foreclose on the mortgages. The Mudongs claimed that Etse was responsible and sought contribution suing Etse for breach of their agreement and the promissory note. Etse responded that the agreement with Mudongs was unenforceable because it did not set forth the exact amount he would have had to pay to make the debt to the plaintiff bank current and that he should...
be excused from a bad investment. Etse also claimed that the plaintiff bank did not provide him technical assistance for an economic development project enabling him to pay and that the agreement is unenforceable because it is unconscionable. Etse filed a cross-claim against the bank claiming it violated the general Micronesian enabling bank statute with an unconscionable contract and the bank breached it duty by approving or entering into such an unconscionable contract.

The bank responded that it would be the third party beneficiary of any agreement entered into between the Mudongs and Etse. The Mudong court rejected the bank’s argument indicating that only intended third party beneficiaries may recover and that incidental beneficiaries may not.\(^\text{1538}\) The court remarkably found the bank to be an “incidental” beneficiary of the promissory note between the Mudongs and Etse and assignment of Mudongs entire financial obligation to plaintiff.\(^\text{1539}\) Since the Mudongs and Etse entered into the agreement to benefit themselves and not the plaintiff their purpose was not to give the benefit of the bargain to the bank.\(^\text{1540}\) Consequently, the bank could not enforce the promises contained in the assignment and promissory note since it was not an intended beneficiary.\(^\text{1541}\) Its motion for summary judgment against Etse asserting third party beneficiary status was denied.\(^\text{1542}\) The bank’s motion for summary judgment against Mudongs was granted in that the Mudongs could not assign their

\(^{1538}\) Id at 75. For this proposition the Mudong court cited Mailo v Penta Ocean, 8 FSM Intrm 139,141 (Chk 1997)
\(^{1539}\) 10 FSM Intrm at 75
\(^{1540}\) Id at 75
\(^{1541}\) Id at 75-6
\(^{1542}\) Id at 76
liability to Etse without assent of the creditor.\textsuperscript{1543} The court rejected Etse’s argument that the agreement was vague noting that the payments could be easily calculated in order to make the loan current.\textsuperscript{1544} The court also noted that losing money and a bad investment are also not grounds for avoiding responsibility under a legally binding agreement to make the bank payments and granted Mudongs’ motion for summary judgment against Etse seeking contribution from Etse.\textsuperscript{1545}

Although the court took a narrow view of third party beneficiary status in \textit{Mudong}, a recent Micronesian case broadly applied third party beneficiary status to suppliers in a claim by suppliers against a bank financing a construction project in \textit{Adams v. Island Homes Constr. Inc.}\textsuperscript{1546} In \textit{Adams}, the FSM bank had entered into a $241,122 loan with the developers, Paulus and Lorenza Perman, in regard to the Panasang apartment project in which the bank assumed the duty to pay suppliers on a draw down basis in the loan agreement. The Permans entered into a construction agreement with Islands Homes. Island Homes then entered into a number of agreements with suppliers, including Adams, regarding this particular project. During construction, Island Homes negotiated an assignment with suppliers regarding any proceeds it would receive from the bank assigning those proceeds to the suppliers to pay outstanding liability. The suppliers sued and trial court held that they were entitled to recovery from FSM Bank under the terms of the loan as third party beneficiaries.

\textsuperscript{1543} Id at 74  
\textsuperscript{1544} Id at 76  
\textsuperscript{1545} Id at 78  
\textsuperscript{1546} 12 FSM Intrm 234 (2003)
The *Adams* court observed that a third person may enforce a contract for his own benefit where he is a stranger to the contract if the contract shows the parties intended to benefit the third person.\textsuperscript{1547} The question of the parties’ intent is to be ascertained from the contract and this intent is to be determined by examining the contract terms as a whole, construed in light of the circumstances of the contract’s making and the parties’ purpose.\textsuperscript{1548} When a third party third-party beneficiary can be ascertained from the contract, the third party need not be named.\textsuperscript{1549}

The *Adams* court distinguished the construction loan from the construction contract and indicated that while the loan conferred third party status on suppliers due to the language employed,\textsuperscript{1550} the construction contract was more ambiguous and did not contain comparable language and, consequently, the suppliers did not have a valid third party claim against the developers.\textsuperscript{1551}

Palau addressed the issue of third party beneficiary status in *Kerradel v. Micronesian Dev. Corp.*\textsuperscript{1552} In *Kerradel*, the court found that plaintiff employee was a third party beneficiary of the defendant foreign corporation’s contract with the Palau Economic Development Board and the court found that plaintiff clearly fell within the class which Public Laws 6-65 and 7-7-3 intended to benefit when enacted.\textsuperscript{1553}

\textsuperscript{1547} Id at 239. The *Adams* court cited *Mailo v. Penta Ocean, Inc.*, 8 FSM Intrm 139, 141 (Chk. 1997) in support of this proposition.

\textsuperscript{1548} 12 FSM Intrm at 239; *Mailo, supra* at 141

\textsuperscript{1549} 12 FSM Intrm at 239; *Mailo, supra* at 141


\textsuperscript{1551} 12 FSM Intrm at 240.

\textsuperscript{1552} 1 ROP Intrm.118 (Tr. Div 1984),

\textsuperscript{1553} Id at 119
Consequently, plaintiff was entitled to indemnification for loss of wages when the defendant employer violated Palau’s overtime wage law. As a result of a strike, the defendant had entered into an agreement in July 1978 that provided that overtime would be paid if employees worked in excess of 96 hours bi-weekly when Palau statute required overtime pay to be paid for work in excess of 80 hours bi-weekly. The defendant argued that a payment of $87.20 it made to the plaintiff was an accord and satisfaction. The trial court rejected this argument noting that defendant was operating illegally in violation of Public Laws 6-65 and 7-7-3 and the payment was an effort to avoid statutory overtime requirements. Because payment was an illegal effort to avoid the law, defendant’s efforts were contrary to public policy and could not be considered valid accord and satisfaction of a disputed matter. The court, however, permitted the payment of $87.20 as an offsets to damages due to the plaintiff. The court observed: “The measure of damages in such third party beneficiary employment contract cases is ‘what the employee would have earned had he been compensated at the proper scale less that which he in fact received as compensation’.”

The concept of creditor beneficiary was briefly addressed in the Palau case, Nakatani v. Nishizono which was a case arising out the construction of an airport terminal in Airai, Palau. The Nakatani court noted: “A transaction of guaranty involves at least three parties: a promisor (here argued to be Airai State), a creditor (the person to

\footnotesize{\begin{itemize}
  \item Id at 121
  \item Id
  \item Id
  \item Id
  \item Id
  \item Id at 119. The court cited Clark Summary of American Law, 160, p.229; Williston on Contracts, Revised Ed. (Hornbook Series) 1358-1361.
  \item 2 ROP Intrm 7 (1990)
\end{itemize}}
whom the promise is made; here alleged to be defendant Nishizono), and a debtor (here Nakatani)….The usual guarantee situation arises when the promisor makes a promise to the creditor either as to the solvency of the debtor or as to payment of the debt.” 1560 The trial court and Supreme Court found that such a relationship did not exist because the Airai State was both owner and alleged guarantor and there would only be two parties in what was supposed to be a three party relationship. 1561 Further, it would make no logical sense for Airai State to guarantee an obligation or benefit it already owed to itself. 1562

**Relationship Between Customary Law and Third Party Beneficiary Status**

Customary or traditional law in the Northern Pacific region may determine whether one is a third party in privity entitled to pursue a claim. 1563

The concept of third parties entitled to contractual relief is broader under traditional and customary law in the northern Pacific region than the concept of third party as defined under the traditional common law. Since lack of privity may be asserted as a defense to a contract claim, there are numerous cases in which status based cultural

\[ \text{1560} \text{ Id at 19-20.} \]
\[ \text{1561} \text{ Id at 20-21} \]
\[ \text{1562} \text{ Id} \]
\[ \text{1563} \text{ The Marshall Islands Supreme Court mention a possible privity defense in dicta in } \text{Gushi Bros. v Kios, 2 MILR 120 (August 26, 1998) but since the parties stipulated to privity, it was not an issue on appeal. Gushi Brothers had initially asserted that Jimmy Kios had no standing under customary law because he held no alap or dri jerbal title to assert any claim to the property at issue. Nonetheless, the Supreme Court observed under application of traditional or customary law:} \]

The trial court found that Jimmy Kios was a privy of Letan Jello, but that Article Kios was not. Appellants have not contested the court’s decision on the privity issue, except to the extent that they argue that Article Kios was in privity with Letan Jello. It is unclear why the appellants would chose to maintain that Article Kios is a privy of Letan Jello; the effect of such an admission is to make Article Kios bound by the 1989 stipulated dismissal. Nonetheless, appellants have taken such a position and appellee agrees with it. Because there is no longer a dispute between the parties on this issue, we will treat Article Kios as a privy of Jello.

2 MILR at 124.
relationships have permitted traditional leaders to file claims in court similar to third party beneficiaries. This broad concept of third party rights and third party beneficiary claims based on customary or traditional status is anthropologically significant.

As mentioned but not raised by the parties in the Marshall Islands case, *Gushi Bros. v. Kios*,\(^{1564}\) the concept of third party beneficiary potentially includes status based relationships in addition to those contractually based relationships which would commonly recognized by law.

In *Marcus v. Truk Trading Co.*,\(^{1565}\) an afokur to a land owning lineage who was not a member of the lineage itself but a patrilineal descendant was permitted to represent the lineage in a lawsuit regarding a lease. In reviewing Micronesian case law, the *Marcus* decision appears to be the furthest extent that such a status based relationship has been permitted. In *Marcus*, the clan settled on appeal and sold the property to the defendants. In *Edgar v. Truk Trading*,\(^{1566}\) clan representatives then sued as 3rd Party beneficiaries because they claimed they had not been paid in accordance with the settlement agreement. Generally, a senior male or senior female member would be the lead litigant as was the case in *Nahnken of Nett v. United States*.\(^{1567}\) Alternatively, suits have been brought in the clan’s name itself as in the case, *Wito Clan v. United Church of Christ*.\(^{1568}\)

In Palau, status allowed the son of a party who was member of the lineage but who was not in privity of contract to seek enforcement of group rights on behalf of the

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\(^{1564}\) 2 MILR 120,124 (1998)
\(^{1565}\) 11 FSM Intrm 152, 158-9 (Chk 2002)
\(^{1566}\) 13 FSM Intrm 112 (Chk. 2005)
\(^{1567}\) 7 FSM Intrm 581 (App. 1996)
\(^{1568}\) 6 FSM Intrm 129 (App. 1993)
lineage in an action to quiet title in *Arbedul v. Iderbei Lineage*. In *Arbedul*, the defendant purchased 675 square meters of property for $1500 in April 1992 from the Iderbei Lineage, with Rose Kebekol acting as trustee. Kebekol signed a warranty deed in exchange for the $1500 but in February 1993 met with the defendant asking him to rescind the earlier deed in exchange for return of his $1500. In February 1993, the defendant signed a document indicating the land was to be returned and acknowledged receipt of the $1500 which he then deposited. When Arbedul disavowed the February 1993 agreement and filed the April 1992 deed in November 1994, George Kebekol, a son of Rose Kebekol, filed suit to quiet title in the Lineage and to set aside the April 1992 deed. Defendant Arbedul claimed that any oral agreement he had with Rose Kebekol to rescind did not meet the Statute of Frauds which presumed that the February 1993 agreement to rescind the warranty deed was not valid because it was merely a receipt for money and not an exchange of money in return for the property. The court rejected this argument finding the February 1993 agreement met the statute of frauds requirements, that there was a valid contract in which an offer to rescind was extended, and that it was supported by the exchange of valuable consideration of $1500. To the extent there was any ambiguity in the contract, the court permitted examination of extrinsic evidence to clarify any ambiguity. In *Arbedul*, the Palau Supreme Court agreed with the trial court’s determination that credible extrinsic evidence also suggested

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1569 7 ROP Intrm 53 (1998)
1570 Id at 54-5
1571 Id at 55. The court cited Kamiishi v Han Pa Constr. Co. 4 ROP Intrm 37.40-41(1993) which discussed the elements of contract formation, the interrelationship between offer, acceptance and mutual assent, and that a person’s secret intent is irrelevant.
1572 For this proposition, the Palau Supreme Court relied upon Etpison v. Rdialul, 2 ROP Intrm 211, 217 (1991).
that defendant appellant understood the agreement and its purpose contrary to his assertions in this case.\footnote{7 ROP Intrm at 55, fn.4}

In another example, status permitted a tribal chief of the Eluil clan, Francisco Gibbons, and senior members of a clan, Ngirumerang Trolii and Irachel Adelbai, who were not parties to the contract to contest the validity of a sale and deeds involving certain lots transferred by Daniel Ngirchokebai to the Western Caroline Trading Company in \textit{Ngirumerang Trolii v. the Eluil Clan by its Chief Rengiil Ra Eluil Francisco Gibbons}.\footnote{7 ROP Intrm at 55, fn.4} In \textit{Ngirumerang Trolii}, the trial court declared the transfer and sale by Daniel Ngirchokebai to Western Caroline Trading Company void under customary law and invalidated the deeds. The Palau Supreme Court agreed with the trial court that the sale was void under customary law and was only asked to resolve the dispute between Gibbons and the intervenors, Ngirumerang Trolii and Irachel Adelbai, as to whether Gibbons was actually a strong senior member of the Eluil clan, as it related to other issues raised in the case.

A more recent Palau case, however, challenges the legitimacy of such third party customary and status based traditional law claims. \textit{Ngeremlengui State Council of Chiefs v Ngeremlengui Gov’t},\footnote{8 ROP Intrm 178 (2000)} is a Palau Supreme Court case in which there is a conflict between status based rights recognized under traditional or customary law and the substantive contract law within the context of a dispute regarding the Statute of Frauds. It

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is also an excellent example of what Henry Maine described in *Ancient Law* as a society moving “from Status to Contract.”¹⁵⁷⁶

In *Ngeremlengui*, the Governor entered into an agreement (MOA) and joint venture (JVA) in the mid 1990’s with Palau Organic Farms regarding the use of 400 hectares of public land. In 1998, the Council of Chiefs sued claiming that the agreement and joint venture were invalid because they were executed without the involvement of the Ngeremlengui State Public Lands Authority (NSPLA) and without the knowledge, consultation or consent of the Council of Chiefs.¹⁵⁷⁷ While the case was pending, the state legislature passed a bill directing the NSPLA to ratify the agreement and joint venture. The dispute centered over differences between the English language and Palauan version of the Palau Constitution. The Chiefs claimed that the English version of Ngeremlengui Constitution, Article VIII, Section 3(b) requires the Council of Chiefs “to provide advice and consent on bills dealing with traditional matters or subjects dealing with the use of land and territorial waters for state projects, before approval by the Governor.” The Chiefs asserted that this interpretation of the Constitution is anthropologically consistent with Palauan traditional or customary law which requires that senior strong or ochell members of the clan approve any transfer, sale or lease of any clan property.¹⁵⁷⁸ The court observed that the Palauan language version of Section 3(b), however, does not contain the Palauan equivalent of the word “consent” but utilizes the

¹⁵⁷⁷ The Ngeremlengui State Council of Chiefs is a branch of the Ngeremlengui government and consists of the four Uong, the highest ranking chiefs in Ngeremlengui, and the four hamlet chiefs. Id at 178, fn1
¹⁵⁷⁸ See, for example, *Ngiraloi v. Faustino*, 6 ROP Intrm 259 (1997); *Obak v. Ikelau Bandarii*, 7 ROP Intrm 254 (Tr. Div. 1998); and *Ngirumerang v. Francisco Gibbons*, - ROP – (October 17, 2003) which all discuss the customary law tradition of ochell approval.
Palauan word equivalent to “thought about” or “take into consideration.” The court also noted that the State Constitution provides that where there is a conflict between English and Palauan versions of the Constitution, the Palauan version prevails. In this instance, the Court using Palauan language rejected purported Palauan traditional or customary law as a useful interpretive device in assessing the meaning of the constitution and concluded that the constitution did not require what the Chiefs claimed to be the traditional law. The court concluded that “the Palauan version of section 3(b) indicates that the framers of the state constitution intended the Council not to have a right of consent over the disposition of public lands.”

The *Ngeremlengui* decision raises a second significant anthropological issue particularly pertinent to status based third party claims. Although they were not a party to the agreement and lacked privity, the Council of Chiefs was asserting group rights in a third party capacity based on status which is acceptable under customary or traditional law but contrary to the common law of contract which requires that one be an intended beneficiary or in privity of contract. The *Ngeremlengui* court adopted the Anglo-American rule of law as opposed to purported customary law observing:

The Council contends that the MOA and JVA are invalid because they violate the statute of frauds in that they purport to lease land to the Palau Organic Farms without requiring the execution of a written lease. The statute of frauds can only be asserted as a defense to enforcement of contract by a party who is sought to be charged thereon and his privies….Not a party to the agreements, the Council lacks standing to assert the Statute of Frauds as a ground for invalidating the MOA and the JVA.\textsuperscript{1579}

\textsuperscript{1579} 8 ROP Intrm at 182 (Citations omitted)
Consequently, the appellate court reversed the trial court’s grant of summary judgment for the defendants because the legislature did not have authority to ratify the MOA and JVA and affirmed the trial court’s denial of the Council of Chief’s motion for summary judgment because the Governor was not required to get the Chiefs consent.\textsuperscript{1580}

**Third Party Remedies**

A creditor beneficiary can sue promisee on existing obligations between them. The creditor beneficiary can sue either the promisor or promisee but can obtain only one satisfaction. The donee beneficiary has no rights against the promisee but may have rights against the promisor.

Either promisee or creditor beneficiary may sue promisor in law and in equity for specific performance if promisor fails to perform to third parties. This is particularly true in a creditor beneficiary situation.

In addition to rights, third parties have corresponding duties. *UCC* 2-722 addresses who can sue third parties for injury to goods.\textsuperscript{1581} It provides in a contract for sale either the party who has title, a security interest, or an insurable interest may sue a third party for injury to goods. If the goods have been destroyed or converted, the party who bore or assumed the risk of loss at the time of their destruction may also sue the third party responsible for the loss.\textsuperscript{1582} If the party plaintiff is suing but did not bear risk of loss at the time, the party plaintiff acts as a fiduciary for the other the other party in the

\textsuperscript{1580} Id.  
\textsuperscript{1581} UCC 2-722; Revised UCC 2-722.  
\textsuperscript{1582} UCC 2-722(a); Revised UCC 2-722(a)
absence of an agreement between the parties as to the disposition of any recovery for the loss.\footnote{1583}

**DEFENSES TO THIRD PARTY CLAIMS**

**Standard Contract Defenses**

In response to a third party beneficiary’s claim, the promisor may raise any of the standard contract defenses (lack of mutuality, failure of consideration, statute of frauds, ambiguity, etc…) that the promisor would have against the promisee. The promisor can not use a defense that the promisee would have against the third party unless the promisor expressly agreed to pay to the third party only what is legally owed to the third party by the promisee. If the promise is only to pay whatever promisee actually owes to beneficiary, the promisor may then use whatever defenses that promisee may also have against beneficiary. Restatement (Second) of Contracts §309 discusses defenses against the beneficiary. It provides:

24) A promise creates no duty to a beneficiary unless a contract is formed between the promisor and the promisee; and if a contract is voidable or unenforceable at the time of its formation the right of any beneficiary is subject to the infirmity.

25) If a contract ceases to be binding in whole or in part because of impracticability, public policy, non-occurrence of a condition, or present or prospective failure of performance, the right of any beneficiary is to that extent discharged or modified.

26) Except as stated in Subsections(1) and (2) and in §311 or as provided by the contract, the right of any beneficiary against the promisor is not subject to the promisor’s claims or defenses against the promisee or to the promisee’s claims or defenses against the beneficiary.

27) A beneficiary’s right against the promisor is subject to any claim or defense arising from his own conduct or agreement.\footnote{1584}

\footnote{1583 UCC 2-722(b); Revised UCC 2-722(b)} \footnote{1584 Restatement (Second) of Contracts §309}
Restatement (Second) of Contracts §311 addresses the issue of variation of duty to the beneficiary and indicates that the promisor and promisee retain power to discharge or modify the duty by subsequent agreement prior to notification to the third party or prior to any third party reliance.

**Lack of Privity**

Under the common law of contract, one of the principle defenses asserted to third party claims is lack of privity of contract.\(^{1585}\) Lack of privity is not a defense to third party tort or warranty claims.

**Not Intended Beneficiary**

Another defense to a third party contract claim is that the third party is not an intended beneficiary as defined by Restatement (Second) of Contracts §302 under the express terms of the contract. If the party is an intended third party beneficiary, the promisor may assert any standard contract defenses that promisor would have against promisee in defense of the claim.

\(^{1585}\) The Marshall Islands Supreme Court mentions a possible privity defense in dicta in Gushi Bros. v Kios, 1 MILR 420 (August 26, 1998) but since the parties stipulated to privity, it was not an issue on appeal. Nonetheless, the Supreme Court observed under application of traditional or customary law:

The trial court found that Jimmy Kios was a privy of Letan Jello, but that Article Kios was not. Appellants have not contested the court’s decision on the privity issue, except to the extent that they argue that Article Kios was in privity with Letan Jello. It is unclear why the appellants would chose to maintain that Article Kios is a privy of Letan Jello; the effect of such an admission is to make Article Kios bound by the 1989 stipulated dismissal. Nonetheless, appellants have taken such a position and appellee agrees with it. Because there is no longer a dispute between the parties on this issue, we will treat Article Kios as a privy of Jello.
Third Party Claims: Government Contracts and Sovereign Immunity

Restatement (Second) of Contracts §313 addresses government contracts and third party beneficiary status indicating that members of the general public are not generally third party beneficiaries of contracts with government agencies.\(^{1586}\)

Another defense which occasionally arises in response to third party contract claims or contract based tort claims is the doctrine of sovereign immunity when the designated owner in the contract is a governmental entity. For example, in the construction industry, subcontractor contract claims are occasionally brought on a “pass through” basis by the general contractor against the owner. If the owner happens to be a governmental entity, the governmental entity may assert governmental immunity in addition to lack of privity as a defense. In those instances in which third party subcontractors assert tortious based contract claims in those instances in which privity would not be a defense, the owner governmental agency may still assert immunity as a defense to the tort claim.\(^{1587}\)

\(^{1586}\) Restatement (Second) of Contracts §313. Compare to Kerradel v. Micronesian Dev. Corp, 1 ROP Intrm. 118 (Tr. Div. 1984) which indicated that the plaintiff was a third party beneficiary of defendant’s contract with a governmental entity.

\(^{1587}\) In Pacific International, Inc v. United States of America, 2 MILR 244 (May 10 2004), a subcontractor, Pacific International, for Wallace O’Connor, the prime contractor, sued the owner, the United States Army and United States government when the base commander refused to allow the subcontractor permission to house employees on the military installation during the course of construction. The subcontractor sued claiming among other theories tortious interference with contract and tortious interference with prospective contractual and business relations and economic advantage. The Supreme Court of the Marshall Island held that the operation of military bases is a purely government function and sovereign in nature citing United States of America v. Public Service Alliance of Canada, (1992) 2 S.C. R. 50, 91 D.L.R. (4th) 449, 1992 Carswell Nat 1005 (with respect to a military base in Canada leased by the United States, the Supreme Court of Canada stated, “I can think of no activity of a foreign state that is more inherently sovereign than the operation of such a base. As such, the United States government must be granted the unfettered authority to manage and control employment activity at the base.); Holland v. Lampen-Wolfe (2000) 3 All E.R. 833,[2001] I.L. Pr. 49, 2000 WL 976034 (HL) ([t]he maintenance of the base itself was plainly a sovereign activity. As Hoffman L.J. (Now Lord Hoffman) said in Littrell v. United States (No.2), this looks about as imperial an activity as could be imagined”); and Cafeteria Workers v. McElroy 367 U.S. 886,
**Lack of Authority**

An additional defense that the promisor may have against the promisee to a third party contract claim includes the inability or lack of authority to assign rights or to delegate duties.

**Assignment of Rights and Delegation of Duties**

**Assignment of Rights**

*Restatement (Second) of Contracts* §317 addresses assignment of a right. An assignment requires that an owner of a right manifest to an assignee or someone representing the assignee an intent to effectuate a present transfer of the right. Generally, all contract rights can be assigned to another party. A writing is generally not required for an effective assignment but an assignment in writing is preferable particularly if the assignment involves a matter within the Statute of Frauds.

*UCC Article 9* which has been adopted in the Northern Mariana Islands, Hawaii, Guam, and a rudimentary version adopted in the FSM would govern the assignment of a right to payment on an “account”1588 regardless of whether the assignment of that account is an unconditional transfer or simply is intended to create a security interest. In

896(1961)(“the governmental function…here was…to manage the internal operation of an important federal military establishment. In that proprietary military capacity, the Federal Government, as has been pointed out, has traditionally exercised unfettered control.”) Consequently, the Supreme Court held that the United States government and the United States Army were immune from suit and that alleged, in part, tortious interference with contract, and tortious interference with prospective contractual and business relations and economic advantage

1588 *UCC 9-106 defines and account as “any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance.”*
lieu of *UCC Article 9*, American Samoa has adopted the *Uniform Negotiable Instruments Law*.\(^{1589}\)

*UCC Article 9* does not apply to the assignment of rights other than the rights to payment. *Article 9* also exempts wage assignments, assignments of accounts in connection with the sale of a business from which they arose, assignment of rights under a contract coupled with the delegation of an assignor’s duties to the assignee, rights to receive rents from a lease of real property, and the assignment of a single account to an assignee in satisfaction or partial satisfaction of a pre-existing indebtedness. In these instances, the common law applies to any disputes that may arise.

In order for there to be an effective assignment, there needs to be an adequate description of the right assigned. Further there needs to be present, not future, words of assignment. The difficulty with an assignment of future rights is that it is an assignment of a right that has not yet come into being and will arise under a contract which has yet to be made. One does not have to utilize the words “assign” and can use any present words of assignment. An assignment may also be partial.

Unless required by statute, an assignment may be oral. However, if the assignment is governed by *UCC Article 9* a writing is required unless the assignee is in possession of the token chose or collateral involved in the assignment. In the absence of such a writing, the assignment subject to *UCC Article 9* or one that is required by statute to be in writing would be unenforceable.

\(^{1589}\) ASCA 27.2503
The general effect of an assignment is that it establishes privity of contract between the obligor and the assignee as long as the assignor was a real party in interest. An assignment simultaneously extinguishes privity of contract between the obligor and assignor with the exception that the power to compel performance is retained.

**Gratuitous Assignment**

Assignments are generally categorized as gratuitous assignments and assignments for consideration.

Gratuitous assignments are effective, but revocable, and there is no need for consideration in order to make a gratuitous assignment effective. A gratuitous assignment can be revoked: 1) if the assignor gives notice to the obligor or assignee that assignment is being revoked, 2) by the death or bankruptcy of the assignor, 3) if the assignor accepts performance from the obligor, or 4) the subsequent or reassignment by assignor of the same right. Otherwise, assignments that do not involve consideration are revocable.

Since a “right” cannot be tangibly delivered, there are exceptions to the rule of revocability for gratuitous assignments: 1) if performance by the obligor is completed and an assignee has received payment, 2) if a token chose has been delivered, 3) where there has been delivery an assignment of a simple chose in writing or by a symbolic writing, or 4) where there has been promissory estoppel. Additionally, if an assignee can show detrimental reliance on gratuitous assignment, the right to revoke is limited.

**Assignment for Consideration**

The presence of consideration, however, makes the assignment of a right non-gratuitous and makes the assignment irrevocable. As a result, the methods of revocation for gratuitous assignments are inapplicable to an assignment for consideration because
the assignment of the right for consideration extinguishes all rights of the assignor and must be honored by obligor. If there is a valid assignment for consideration, the obligor deals with the assignor at their own peril and the obligor is generally compelled to deal directly with the assignee.
The concept of assignment of rights has been adopted and is frequently applied in the Northern Pacific region.

An example of an assignment of lease rights can be found in the Micronesian case, Wolphagen v. Ramp. Wolphagen entered into a property lease with Hagerstroms who then assigned the lease to Ramp. As permitted by the terms of the lease, Hagerstroms built two residential homes on the land and Ramp lived in one of the houses. When they became uninhabitable due to termites, Ramp moved out and attempted to convert the two homes into a bar. Wolphagen objected to the change in the nature of the property from residential to commercial use as a bar. Ramp ceased work, vacated the property and Wolphagen took possession. After the lease expired, Wolphagen sued Ramp for damages to the property and Ramp counterclaimed for wrongful eviction. The lease provided that the Hagerstroms had the right to build such structures on the property as they saw fit with the buildings to become the lessor’s property upon termination of the

Diagram: Assignment of Rights/Delegation of Duties

Obligor K Obligee /or Delegator

Assignee and/or Delegatee

8 FSM Intrm 241 (Pon 1998); affirmed 9 FSM Intrm 191 (App 1999)
lease. The Hagerstroms built two residential structures as they saw fit defining the nature of the structures and property. The court concluded that once built, the residential structures became the owner’s upon termination of the lease pursuant to the terms of the lease and the owner was entitled to find himself the owner of residential dwellings, not a bar. The court found that the owner was within his rights to prevent the change in character of the property from residential to commercial use as a bar.

Assignment of lease rights was also addressed in the Commonwealth of the Northern Mariana Islands in Eurotex Inc. v. Muna. In Muna, the lessee was assigned all the rights of a lease contract which an option to lease the remainder of the parcel. On appeal, the Muna court held that the lessee was entitled to summary judgment and specific performance on the option. The lessee had presented the signed lease. Additionally, the lessee presented proof that it had paid rent for the leased property and the option property as consideration for the option. The lessee also presented proof that the lessor had accepted the consideration and proof that it had taken possession of the option property and built improvements on it. The court held that the lessor was unable to controvert the evidence presented by the lessee and only presented conclusory unsupported factual allegations in response. The court concluded that the lessee was entitled to specific performance because it had complied with the terms of the option agreement. The lessor contended that the verbal acceptance of the option was barred by the Statute of Frauds. However, the court concluded that the lessee’s verbal acceptance

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1591 Id at 195
1592 Id
1593 Id
1594 Id.
was sufficient to exercise the option where the original lease was in writing and did not establish the manner of acceptance for the option and where the parties had agreed on a rent figure for the property covered by the option.

Assignments of Rights: Limitations

As reflected in the Wolphagen case, there may be limitations on assigning contract rights. Restatement (Second) of Contracts §317(2) lists limitations on the assignment of a contract right. Contract rights are not assignable if the assignment would substantially affect the obligor’s rights and duties such as in an output or requirement contract.\footnote{Restatement (Second) of Contracts §317(2)} Limitations on assignment will also occur when the rights assigned substantially alter the other party’s risk or burden. An assignment may also be precluded if it materially impairs the other party’s opportunity for obtaining a return performance or if it is contrary to public policy or illegal.\footnote{Restatement (Second) of Contracts §317(2)(a) and (2)(b)} An assignment may not be assigned if expressly precluded by the terms of the contract.\footnote{Restatement (Second) of Contracts §317(2) (c). Restatement (Second) of Contracts §322 defines what constitutes a valid contractual prohibition of assignment.}

Rights of a personal nature such as in personal service contracts also cannot be assigned.

Assignments of rights prohibited by law such as wage assignments are also impermissible under both the common law and the UCC.

Future rights that will arise under a contract which has yet to be made also may not be assigned. One must be careful to distinguish an assignment of future rights which
is not assignable from a contract with existing rights in which benefits are to be conferred in the future. A contract with existing rights and future benefits may be assigned.

Under *Restatement (Second) of Contracts* §322 and the common law, it is possible to insert a clause in the contract expressly prohibiting any assignment of rights. Under the common law, these provisions are generally construed as being valid under general principles of freedom of contract. However, under common law, these provisions may also be construed to be a restraint of alienation which is a competing concept under the common law.

An assignor cannot complain that the assigned right cannot be assigned. If the obligor expressly or implicitly permits an assignment, the obligor waives any objection.

From a practical perspective, non-assignment clauses are generally considered to be ineffective because they are not drafted with clarity and usually buried in the contract and are inconspicuous. Under the common law, the assignment may still be valid despite the anti-assignment clause and would simply be treated as a breach of the promise not to assign and not necessarily a material “breach of contract”. Irrevocability of an assignment clauses only go to the right to assign and do not affect the power to assign. The obligor may sue the assignor for breach of contract if an assignment is made contrary to the non-assignment clause but generally the damages, if any, would be nominal rendering the anti-assignment provision practically meaningless. The only way that these clauses restricting assignment will be effective under the common law is if the assignee has notice of the provision and the restriction clearly contains the wording “assignment is void” or “contract is void” upon assignment.
The UCC prohibits such restrictive clauses as it relates to assignments in the sale of goods. UCC Article 9 prohibits anti-assignment clauses which relate to the assignment of an account. Furthermore, UCC Article 2 permits the assignor to assign a right arising out of the due performance of assignor’s entire obligation. If such a restrictive clause is included in a contract for the sale of goods, the obligor is required to deal with the assignee and the provision will be considered ineffective.

**Assignment: Defenses and Remedies**

Defenses against an assignee are set forth in *Restatement (Second) of Contracts* §336 which provides:

28) By an assignment the assignee acquires a right against the obligor only to the extent that the obligor is under a duty to the assignor; and if the right of the assignor would have been voidable by the obligor or unenforceable against him if no assignment had been made, the right of the assignee is subject to the infirmity.

29) The right of an assignee is subject to any defense or claim of the obligor which accrues before the obligor receives notification of the assignment, but not to defenses or claims which accrue thereafter except as stated in this Section or as provided by statute.

30) Where the right of an assignor is subject to discharge or modification in whole or part by impossibility, illegality, non-occurrence of a condition, or present or prospective failure of performance by an obligee, the right of the assignee is to that extent subject to discharge or modification even after the obligor receives notification of the assignment.

31) An assignee’s right against the obligor is subject to any defense or claim arising from his conduct or to which he was subject as a party or prior assignee because he had notice.¹⁵⁹⁹

The obligor may assert any defense against the assignee which the obligor has against the assignor, including any defense which may arise in that interval after the assignment has been made to the assignee but before the obligor receives notice of the

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¹⁵⁹⁹ *Restatement (Second) of Contracts* §336
assignment. The assignee stands in the shoes of the assignor. In order to cut off defenses, the assignor must give notice to the obligor of the assignment to the assignee.

Standard contract defenses apply to voiding an assignment. For example, an assignment may be voided due to infancy, insanity, fraud, duress or other comparable defense.

One of the leading assignment cases in the Marshall Islands raising the defense of a future assignment and notice is Defender of the Fund v. The Rongelap Atoll Local Distribution Authority (LDA). In this case, the Rongelap LDA assigned a present right to future payments to be made to the Rongelap LDA under the Compact of Free Association to American Security Bank. A special tribunal of the Marshall Islands Nuclear Claims Tribunal held that the assignment was void because the Rongelap LDA failed to comply with the notice requirements of the Nuclear Claims Tribunal Act of 1987. In order to circumvent the fact that they failed to comply with the notice requirements, the Rongelap LDA tried to argue the assignment was valid and that the consummation of the assignment was outside the notice period even though some disbursements had been made within the 75 day period after giving public notice. In deferring to and declining to entertain the appeal from the decision of the Nuclear Claims Tribunal, the Marshall Islands Supreme Court rejected the LDA’s argument stating:

This argument is devoid of merit. It is the equivalent of claiming that a mortgage is not effective until steps to foreclose it are taken. Neither is the argument supported by authorities cited by Appellant. The assignment was not a contract to transfer proceeds to be received in the future it was a current assignment of those proceeds. The language employed was ‘hereby assigns…to Bank all of its

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1600 1 MILR (Rev.) 289 (November 20, 1992)
1601 Id at 293
right…to the Distributable Portion of all quarterly payments which are now or may hereafter become due…” (Op. Br., Exhibit 3, p.5). The statute and Regulation make no distinction between outright assignments and assignments as security; or, for that matter, between legal assignments and equitable assignments. The contract may have been executory until loan proceeds were disbursed, but upon that event, the right of the bank to satisfaction from future Section 177 payments became vested.

The rights and liabilities of the parties vary according to their status. An assignee can sue an obligor since the obligor is a real party in interest. The obligor can only utilize those defenses or file those counterclaims inherent in the contract or same transaction such as lack of consideration, etc… existing before obligor has received notice of assignment from assignor.

If an obligor’s counterclaim is inherent in the contract, the obligor can raise a defense known as recoupment which permits the obligor to subtract any damages attributable to a breach from the assignee.

If the obligor’s counterclaim arises from a different transaction, the counterclaim may be raised against the assignor only if the counterclaim accrues before the obligor receives notice of the assignment. The obligor would be entitled to a set off and cannot be used against the assignee. The obligor would be entitled to subtraction of damages.

The obligor can’t assert defenses which arise after obligor has received notice of assignment. There may be an estoppel argument asserted if the obligor would reasonably rely.

Defenses of assignor are not available to assignee. Further, the obligor can’t exercise assignor’s defenses.

\[^{1602}\text{Id at 293-4.}\]
Modification of the contract has no effect on rights of assignee. This position is consistent with \textit{UCC} 2-209 which permits modification of the contract. Under \textit{UCC Article} 9, the assignor and the obligor have a limited right even after notice of the assignment is given to the assignor to limit the rights of the assignee if the assigned right to payment has not been accrued through performance. In this limited instance, the contract may be modified or a substitute contract may be formulated in good faith.

For wrongfully exercising power to revoke an irrevocable assignment or if obligor is successful in asserting defense to contract, an assignee can seek enforcement of the obligation by the assignor. Assignor is not liable to assignee for non-performance obligation.

There are also remedies available if the obligor is incapable of performance. The rights and duties of sub-assignees are also limited to those rights and duties conferred by the sub-assignor.

\textbf{Successive Assignment of Rights: Rules of Priority}

Revocation may also occur by the subsequent assignment of same right by assignor to another. Under the common law, an assignment for consideration takes precedent over a gratuitous assignment. There are three competing rules under the common law to determine priority. The prevailing view as expressed in the \textit{Restatement (Second) of Contracts} provides that prior in time is prior in right unless a subsequent good faith assignee pays consideration and either obtains payment from the obligor; recovers judgment from obligor, or enters into a substituted contract with obligor, or receives delivery of an written document or instrument that incorporates the debt. The English rule is that the first assignee to notify the obligor prevails provided that the
assignee has taken the assignment for value, has reduced to possession, and had taken the assignment without prior notice of any prior assignment. The New York rule provides that the first assigned in time is first in right.

Generally, if the subsequent assignee has actually reduced the matter to possession and does not have notice of the previous assignment of the contract, the second assignee would prevail. Where there are subsequent assignments, the first innocent assignee to reduce to possession prevails.

If there have been successive assignments of the same rights and if the assignment is a revocable gratuitous assignment, successive assignment of the right constitutes a revocation of the first assignment. If the successive assignment is an irrevocable assignment for consideration, the first assignment in time usually prevails over any subsequent assignment. However, there are exceptions to the first in time rule as to irrevocable assignments if the subsequent assignee paid value without notice of first assignment. Further, a subsequent assignee who obtains the first judgment against obligor has priority. Likewise, a subsequent assignee gets first payment of claim from obligor has priority. The subsequent assignee that receives delivery of token chose will also have priority over the first assignee. The subsequent assignee can also proceed against first assignee on estoppel theory. As an aside, the first assignee can use estoppel against the subsequent assignee as well if there has been detrimental reliance. The subsequent assignee who is party to a novation releasing assignor will also have a superior claim over a prior assignee.

*UCC Article 9* governs the attachment and perfection of security interests in accounts. The CNMI, Hawaii and Guam have adopted the *UCC Article 9* provisions
regarding perfection of security interests in accounts. The Marshall Islands Sale of Goods Act also provides for a security interest in goods but unfortunately there is no place currently to file such security interest. The Commercial Code of American Samoa also contains similar provisions. Attachment occurs when there is an agreement to attach, when value is given, and there is identification of the account. Under UCC Article 9, the assignment of an account must also be in writing in order for an assignee’s rights to attach. Once the rights of an assignee attach, the assignee’s rights are superior to those of the assignor.

The version of Article 9 adopted by the FSM is rudimentary and, like the Marshall Islands, there are no provisions for recording a security interests in an account. Consequently, all secured interests in accounts are “secret liens” and thus unenforceable against third parties.1603

Perfection relates to the rights an assignee has against a third party or subsequent assignee. Pursuant to UCC Article 9, perfection generally occurs when the assignor takes possession. Because one cannot possess an “account,” a filing of a notice of assignment or a financing statement with a public record or clerk’s office is the normal method of perfecting an assignment of an account. If the assignment is an insignificant portion of the assignor’s accounts, filing is not necessary and perfection occurs upon attachment. Marshall Islands High Court Chief Judge Carl Ingram indicated at a recent conference that in the absence of a public record office for filing people have attempted to file

1603 See In re Engichy, 11 FSM Intrm. 520, 530 (Chk 2003); UNK Wholesale, Inc. v. Robinson, 11 FSM Intrm 361, 365 (Chk 2003); Bank of Hawaii v. Kolonia Consumer Coop. Ass’n 7 FSM Intrm 659, 664 (Pon. 1996); In re Island Hardware, 3 FSM Intrm 332, 340 (Pon. 1988); Bank of Guam v. Island Hardware, Inc. 2 FSM Intrm. 281, 279 (Pon. 1986).
unsuccessfully with the court clerk in an attempt to perfect under the Sale of Goods Act.\footnote{1604}

A subsequent secured or lien creditor or a subsequent bona fide assignee paying consideration and without notice of the prior assignment have priority over an assignee who has failed to perfect under \textit{UCC} 9-301.

In a related issue, \textit{UCC} 9-205 acknowledges the validity of a floating lien on shifting stock of goods or accounts. \textit{UCC} 9-205 is inconsistent with the common law and \textit{Benedict v. Ratner} \footnote{1605} which declared a floating lien void due to the failure of the creditor to monitor the debtor and the purported fraud which would result upon the debtor’s other creditors. An additional problem under the common law was that these floating liens were considered assignment of future rights not yet in existence. Under \textit{UCC} 9-205, a creditor who files a financing statement identifying the assigned rights in a floating lien with a public record office will be considered as having filed as though the assignment was an assignment of present rights.

\textit{Assignment: Express and Implied Warranties}

There are several implied warranties which exist relative to assignments. The first is an implied warranty to not defeat or impair the value of the assigned right. The second is an implied warranty that right is not subject to defenses or limitations. The third implied warranty is that any document delivered is authentic and is what it is alleged to be. Implied warranties are valid only between the assignor and the assignee and do not apply to any sub-assignee.

\footnote{1604}{Pacific Islands Legal Institute, Majuro, RMI, February 7-11, 2005.}
\footnote{1605}{268 U.S. 353 (1925)
The parties are contractually free to agree to any express warranties as they so desire. Similarly, the parties are contractually free to disclaim any express or implied warranties.

**Delegation of Duties**

**General Rule**

As a general rule, all duties may be delegated. Delegation is the creation of power in another to perform delegator’s contractual duty to a third person. Delegation does not excuse the delegator from performance by delegating the duty to perform.

The obligee can’t compel performance until there has been an assumption by the delegate. Assumption of a duty occurs where delegate promises to perform the duty delegated to the third party and the promise is supported by consideration or its equivalent. This relationship creates a third party beneficiary situation and the obligee can compel performance or sue the delegate for non-performance.

In order for there to be an effective delegation of duties, there needs to be a present intent to make a delegation. There are no special formalities. A delegation of duties can be oral or written. If the duty delegated is within the Statute of Frauds, however, it must be in writing or a record in order to be enforceable.

When there is a delegation of duties, the obligee must accept performance from delegate of all duties that may be delegated. A general rule of construction would interpret the delegation of duties with a corresponding assignment of contract rights. This position is consistent with *UCC* 2-210 which provides that in a contract for sale of goods an assignment of rights carries with it an implied assumption of duties.
**Limitations on Ability to Delegate**

There are certain exceptions to the general rule that all duties can be delegated. Those limitations would involve: 1) duties that involve personal judgment or skill, 2) where the original party has a special reputation, 3) if there is a “special trust” in the delegator, 4) if there would be a change in the expectancy interest of the parties especially in requirement or output contract situations, or 5) if there is an express contractual restriction on delegation of duties. The principle test is whether the contract specifically requires performance by the original delegator or if the original delegator’s personal supervision of the performance is required. If the duty is non-delegable, an attempted delegation is ineffective and constitutes a material breach of contract. *UCC Article 2* is consistent with the common law in that an express prohibition of an assignment of the contract also prohibits the delegation of duties. In the absence of such a provision, however, *UCC Article 2* indicates that a general assignment assigns the rights, delegates the duties, and creates an assumption of those duties.

**Novation**

Novation is distinguishable from other third party situations. A novation is a substitution of one party in the contract for another who is not a party to the original contract. It requires assent of all parties and completely releases the substituted party. There are several situations in which a novation arises.
The Supreme Court of the Marshall Islands addressed the issue of novation in *Northup Boat Repair v. Holly Elaine* 1606 which involved in rem and in personam actions brought by crewmen, artisans, suppliers and mortgagees against four commercial fishing vessels, their owners and other individual and corporate defendants. In their appeal to the Marshall Islands Supreme Court, the supplier appellants claimed that the actions of the parties and execution of supplements to the first mortgages constituted a novation completely extinguishing liens of the first mortgage which in turn would give their claims priority.

In affirming the in rem decision of the High Court, the Marshall Islands Supreme Court distinguished between a modification or an amendment to an original agreement and a novation which would extinguish all liens. The Marshall Islands Supreme Court observed: “A substitution of the primary obligor does not invalidate or necessarily subordinate the priority of the lien on the security, nor has anything been pointed to or found in the Ship Mortgage Act 46 USCA 911 et. seq., as it then existed) which would dictate that result.” 1607

Utilizing a basic rule of contract interpretation by looking to the language of a supplemental agreement to determine intent, the Marshall Island Supreme Court indicated that the language clearly expressed intent to make the new loan an additional charge on the first lien, and was not a novation terminating the rights of the original

1606 1 MILR (Rev) 176 (October 2, 1989).
1607 Id. At 179
Consequently, the suppliers’ liens were subordinate to the liens of the first mortgage.\textsuperscript{1609}

The issue of assignment and novation regarding a bank loan was addressed in *FSM Dev. Bank v. Mudong*\textsuperscript{1610} In *Mudong*, the bank loaned $37,000 to the Mudongs to purchase two 15 seat Mazda vans and start a taxi company. The loans were secured by two mortgages in real property and a chattel mortgage on the vans. The defendant Mudongs assigned their entire financial obligation to the plaintiff bank to Benskin Etse in an agreement and promissory note. When Etse did not pay the bank sued Mudongs. Mudongs sued Etse seeking contribution and claiming that they were relieved of liability as a result of the assignment. The bank sought summary judgment against Mudongs seeking to foreclose on the mortgages and offset proceeds form the sale against the outstanding balance of $30,676. In granting summary judgment, the *Mudong* court noted:

It is a well established rule that a party to a contract cannot relieve himself of the obligations which a contract imposed upon him merely by assigning the contract to a third person. 6 Am. Jur. 2d Assignments § 110 (1963). Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.\textsuperscript{1611}

As to the issue of novation, the *Mudong* court required clear assent by the creditor to substitution of a new obligor observing:

Liabilities arising from a contract are not assignable without the consent of the creditor, an the mere assumption of the debt by a third party is not sufficient to establish a novation of the original contract unless there is a clear assent by the

\textsuperscript{1608} Id. At 179  
\textsuperscript{1609} Id. At 179  
\textsuperscript{1610} 10 FSM Intrm 67 (Pon. 2001)  
\textsuperscript{1611} Id at 74. The court also relied upon Restatement (Second) of Contracts §318(3) (1981)
creditor to the substitution of a new obligor…. When a person is liable for a
business’ debts because he is the sole proprietor of a business, the sale of the
business to another who has agreed to assume the business’ liabilities will not
relieve him of liability if the creditor has not agreed to the assignment.1612

Applying the facts of the case to the law, the Mudong court did not find any
evidence that the bank permitted the Mudongs to be free of their obligations under the
note even though the Mudong-Etse agreement was witnessed by a bank representative, it
was signed in the bank’s office, and appears to be drafted by the plaintiff bank.1613

Consent by the bank to permit the assignment does not equal an agreement by the bank to
relieve the Mudongs’ liability under the note. As an aside, the Mudong court categorized
this as an assignment to Etse by Mudongs of their financial obligations to the bank, it
could also be analyzed from the perspective of a delegation of duty to pay. Further, mere
voluntary assumption of the debt by another does not constitute a novation unless there is
clear assent by the creditor. Consequently, the Mudong court granted the bank’s motion
for summary judgment on its claim against the Mudongs.1614

The issue of whether a settlement agreement of a prior claim was a novation was
addressed in Marshall Islands Development Bank (MIDB) v. Alik and Alik,1615 by the
Marshall Islands Supreme Court. In MIDB v. Alik, supra, the Marshall Islands Supreme
Court addressed the issue of whether the settlement of a prior claim was only a partial
settlement of a motion for injunctive relief or whether it amounted to a novation and a
resolution of all issues in the prior dispute. The court indicated that in order to determine

1612 10 FSM Intrm at 74. For these propositions, the Mudong court cited an earlier decision in Black Micro
Corp. v. Santos, 7 FSM Intrm 311, 314-15 (Pon. 1995)
1613 10 FSM Intrm at 74.
1614 Id at 74.
1615 I MILR (Rev.) 193 (December 12, 1989)
whether the prior resolution was a settlement or novation would depend on the intent of the parties. Because the High Court had not previously developed a sufficient record on this and other issues such as was the settlement a resolution of the motion for an injunction or the entire suit, the Marshall Islands Supreme Court remanded the case in part to determine what the intent of the parties was as to the prior claim.  

Citing *Black’s Law Dictionary* as authority, novation was succinctly defined by the FSM trial court in *Black Micro Corp v. Santos* as:

Substitution of a new contract, debt, or obligation for an existing one, between the same or different parties. The substitution by mutual agreement of one debtor for another or of one creditor for another, whereby the old debt is extinguished. The requests for novation are a previous valid obligation, an agreement of all the parties to a new contract, the extinguishment of the old obligation, and the validity of a new one.

The *Black Micro* case was a collection matter in which the plaintiff, Black Micro, provided construction materials and equipment to the defendant who refused to pay. As a defense, the defendant claimed that he transferred any interest or obligations of the defendant business to another and that he was not personally liable for the debt. Citing general principle of contract law which requires consent of the creditor to a novation, the court rejected the defendant’s argument and imposed liability for the debt on the defendant.

1616 Id at 198-9  
1617 *Black’s Law Dictionary*, 959-60 (5th ed. 1979)  
1618 7 FSM Intrm 311 (Pon 1995)  
1619 Id at 316, fn 3.  
1620 Id at 315. A similar argument was advanced and rejected in *Mobil Oil Micronesia v. Benjamin*, 10 FSM Intrm 100 (Kos. 2001) where defendant Benjamin argued that his assignment of his interest in a Mobil station with all liabilities to Thurston Siba excused him from obligations under a judgment and payment order assessing principal, interest and attorney’s fees. Id at 103. The *Mobil* court noted that it may give him recourse against Siba but does not excuse his obligation to Mobil. Id.
Novation and Anthropology

The *Black Micro* case is also significant from an anthological perspective in that it is another example of legal cultural assimilation. The FSM trial court notes that “This Court finds that the U.S. common law rule regarding the assignment of debts is appropriate for application in the FSM and in this case.”\textsuperscript{1621}

\textsuperscript{1621} 7 FSM Intrm at 315
PART IX: CONCLUSION

As a result of the research of this text, two important developments were noted: 1) the American Law Institute’s Restatement of Law have been elevated from simply persuasive authority to a statutory rule of decision in some Pacific island nations, and 2) the anthropological implications of local custom and traditional rights on substantive contract and sales law have resulted in a unique regional amalgam of substantive law.

Contract and sales law in the Northern Pacific region has yet to develop its own identity and is in a state of anthropological transition as these societies move from status based relationships to relationships based on contract. Anthropologically the region is a mix of assimilation and conflict which has created this unique blend of substantive contract and sales law.

As Llewellyn and Hoebel have observed:

The success of any legal system depends upon its acceptance by the people to whom it applies. Insofar as the system is an integrated part of the web of social norms developed within a society’s culture (with due exception for imposition by some organized minority force) it will be accepted as a parcel of habit-conduct patterns in the social heritage of the people. As noted by Donovan and Anderson, the “[l]aw, in order to achieve its goal of justice and social order, requires the theoretical grounding and empirical conclusions of anthropology.”

Contractual based relationships are interpreted and enforced by foreign, externally imposed international standards applied for the most part by foreign born or foreign

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1622 Llewellyn and Hoebel, The Cheyenne Way, supra at 239.
1623 Donovan and Anderson, Anthropology & Law, supra at 2.
trained judges applying international standards of contract and sales law such as the *Restatement (Second) of Contracts* and the Anglo-American common law tradition of contract and sales law.

For the most part, it appears from judicial decisions that these foreign standards are consistent with or have begun to successfully integrate into the web of social norms developed within the Northern Pacific culture and are blending into the social heritage of the people.

The Northern Pacific region appears to be trending toward cultural assimilation of Anglo-American concepts of contract and sales law. Hawaii, Guam and the Commonwealth of the Northern Mariana Islands have to the greatest extent anthropologically assimilated Anglo-American concepts of contract and sales law and have supplanted the common law of contracts with the adoption of the Uniform Commercial Code governing contracts for the sale of goods. American Samoa, the southern most and only territory of the United States below the equator, has an abbreviated commercial code, applies case law from the United States in contract and sales disputes but also clings to vestiges of local traditional rights or customary law. Because the United States is a signatory to the UN Sales Convention, international contractual disputes between commercial entities in these American state and territories and commercial entities in other UN member nations are governed under the terms of the UN Sales Convention if the commercial entities are in member nations who are also signatories. Although the Marshall Islands has statutorily omitted the American Law Institute’s *Restatement (Second) of Contracts* as the rule of decision, Palau and Micronesia are required to utilize the Restatement pursuant to their rule of decision
statutes. Micronesia has adopted Article 9 of the *UCC* but has reserved Article 2 in the Uniform Commercial Code. Consequently, contractual disputes in Micronesia particularly those involving the the sale of goods are governed by the Restatement and the common law. Contractual disputes in the Marshall Islands would be governed by the common law and the English Sale of Goods Act which was adopted by the Marshall Islands in 1986.

Traditional rights or custom and tradition as noted in the text remain a significant factor in assessing issues arising in contract formation, interpretation, enforcement and breach in the Marshall Islands, Micronesia, Palau and in the American territories and protectorates. In many cases, judges of the Northern Pacific region unwittingly integrate traditional and customary law and contract and sales law giving it a unique local character.

In these island nations, socio-cultural relationships are still governed primarily by customary and tradition law but it is clear that these relationships are being influenced by foreign concepts of traditional contract and sales law. These countries are in transition from a society based on tradition to one based on contract while implementing and integrating foreign standards.

These nations have retained the right to apply traditional rights or customary law and, under their constitutions or rule of decision statutes, traditional rights and customary law are superior to the common law of contract and sales in the event of conflict. However, these island nations recognize the value of anthropological assimilation despite language in some cases that they will not “slavishly” follow Anglo-American precedent. As it relates to contract and sales law, these island nations are at the same time making
significant efforts, as noted in the *Semens* \(^{1624}\) decision, to adopt or assimilate the rule of law recognizing uniform international contract and sales standards facilitating trade and commerce and attracting international investment. As blatantly stated by the FSM court in *Semens*, there are several significant reasons for this anthropological assimilation:

‘Common law’ is a label identifying a widespread historical legal process tracing its origins back to medieval England. This is a trial and error process in that common law judges base current decisions upon earlier precedents but, where those precedents are at odds with current accepted notions of social justice, the judges are free to modify or overrule earlier precedent. This system is now employed by numerous independent sovereignties throughout the world including Great Britain, the United States, India, and nations in Africa and throughout the Pacific. *Alaphonso v. FSM*, 1 FSM Intrm 209,220 (App. 1982). By linking ours to that long-established and widely used system of justice, we draw on the experience insights and improvements gained through hundreds of years of application in numerous cultural contexts. Moreover, our system of justice thereby becomes more recognizable and predictable. Hence, it is more familiar to other nations in this part of the world and; less threatening to potential investors. This in turn creates a better climate for economic development, an important goal of this new nation. \(^{1625}\)

\(^{1624}\) 2 FSM Intrm 131, 141-2 (Pon 1985)
\(^{1625}\) Id.
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