The Role of Contract Law

- Provides a mechanism to deal with others
- The concept of freedom of contract means there are responsibilities to those who create binding relationships
- Contracts are the cornerstone of business—evolved over the centuries from merchant practice. Reflects what works well and adapts to innovations.
Definition of a Contract

- Sir Wm. Blackstone: “An agreement, upon sufficient consideration, to do or not to do a particular thing”
- Modern definition--centers on a promise: “A promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes a duty.”
- The promise itself creates a manifestation of intent
- Contracts are the basis of legal relationships and duties among parties
- Not all promises are enforceable contracts--must meet the requirements of a contract to create an enforceable promise
Sources of Contract Law

- **Common Law**
  - Judge-made law
  - Each state differs
  - There is uniformity about general contract principles that run throughout most states’ laws

- **The UCC, Uniform Commercial Code**
  - All states have adopted except La.
  - Covers contracts for sale of goods
  - See next chapter

- **Many countries rely on Code Law for their basic legal framework**
Types of Contracts

- Express and Implied Contracts
- Quasi Contracts
- Bilateral and Unilateral Contracts
- Executory and Executed Contracts
- Valid, Void, Voidable and Unenforceable Contracts
Express and Implied Contracts

Express Contracts
- Direct statement by the parties of the promises made
- May be oral or written
- All important terms are expressly stated between the parties

Implied Contract
- Actions and circumstances infer and define the terms of the contract
- May be words, conduct, gestures
- These contracts are implied at law
Bilateral & Unilateral Contracts

- **Bilateral Contracts**
  - 2 promises
  - A promise in exchange for a promise
  - Ex: I promise to pay you $25 to mow my lawn; you promise to mow my lawn
  - If promises are broken, there may be responsibility if losses are incurred

- **Unilateral Contract**
  - Only 1 promise
  - A promise in exchange for a performance
  - Ex: I promise to pay you $25 to mow my lawn; you go out and mow it
  - Once performance has been made, the other party’s duty arises to fulfill his/her promise
Valid, Void, Voidable and Unenforceable Contracts

- **Valid**: Everything is okay—all elements are there
- **Void**: One of elements is missing—lacks a requirement of a contract
  - This contract does not exist at law
- **Voidable**: Is valid but capable of being voided by a circumstance
  - i.e. minors’ contracts
- **Unenforceable**: Was initially valid, but not enforceable due to a change in law or it is held to violate public policy. No remedy.
Quasi Contract
(Also called *quantum meruit*)

- Quasi (means “almost”)—not a true contract
- Equitable concept used by courts to prevent injustice
- Courts apply this classification in equity (out of a sense of fairness) to give relief to innocent parties
- Example: You watch as a crew (in good faith) comes to your house and paves your driveway. Do you have to pay the bill when it is sent to you? Yes, at least partly, under *quasi contract*
Elements of a Contract

- 1. An Agreement
  - Offer
  - Acceptance
- 2. Consideration
- 3. Contractual Capacity
- 4. Legality
- 5. Genuine Consent
- 6. Writing (if necessary per Statute of Frauds)
Element #1: THE AGREEMENT
(Mutual Understanding Between Parties)

◆ The Offer
  – Creates the *Offeror* and *Offeree*
  – 1. Manifestation of Intent
    ◆ Preliminary Negotiations vs. Intent to Offer
      – 2. Definite
      – 3. Communication

◆ The Acceptance
  – Expression of assent
  – 1. Unconditional
    ◆ Must be a *mirror image* of the offer
    ◆ If conditions are added, they create a *counteroffer*
  – 2. Unequivocal
  – 3. Communicated
Termination of Offers

- **Revocation**
  - Withdrawing of offer by the Offeror

- **Rejection**
  - By Offeree
  - Through lapse of time (*Option Contracts* are different)
  - *Counteroffers* reject the original offer but keeping negotiations open by presenting new offer

- **Operation of Law**
  - Intervening Illegality
  - Destruction of subject matter
  - Death or insanity of offeror or offeree
Ardente v. Horan

- Horans offer to sell house in Newport; Ardente offers to pay $250,000
- Horans indicate that offer acceptable and Horans’ attorney prepared a contract for signature by Ardente
- Ardente returns signed contract with a $20,000 check and letter concerning items to remain with the real estate (furniture, fixtures, etc.)
- Horans do not agree to include items, refuse to sign the contract, and return the check to Ardente
- Ardente sues Horans for specific performance.
- Trial judge holds Ardente’s letter is a counteroffer; no contract here
- Ardente appeals. Indicates his letter is an absolute acceptance with a request of a “gratuitous benefit.”
- **HELD:** Plaintiff’s letter of acceptance was conditional; a rejection of defendants’ offer, thus no contract. Mere intent to accept an offer is not sufficient; acceptance must be unequivocal and definite. This is not a conditional acceptance; rather is a counteroffer.
Mailbox Rules:

- Acceptance is good on sending
  - *Here June 3*
- Revocation is good on receipt
  - *Here June 4*
- Acceptance occurred prior to revocation
- There is a valid acceptance

- June 1: Offeror sends offer
- June 2: Offeror sends revocation of offer
- June 3: Offer is received by Offeree
- June 3: Offeree sends acceptance to Offeror
- June 4: Revocation of offer is received by Offeree
- June 5: Acceptance is received by Offeror
- **Valid acceptance? Yes.**
Unilateral Contracts & Acceptance

- **Usual rule by courts:**
  - Performance must be completed for acceptance to take place
  - Total performance is equal to acceptance

- **Some courts:**
  - Once performance is begun by offeree, the offeror loses the right to revoke the offer
  - Partial performance cuts off offeror’s right to revocation
Element #2: Consideration

(If consideration is absent, neither party may enforce the promise or agreement)

Definition: Something of value or something bargained for in exchange for a promise

Traditional Rule: Must create--

- Legal detriment to the promisee OR
- Legal benefit to the promisor
- Actually the legal detriment and benefit usually occur at the same time
Hamer v. Sidway (1891)

- William Story, Sr. promises nephew $5000 to refrain from “drinking, using tobacco, swearing, and playing cards or billiards for money“ from age 16 to age 21.
- After 5 years nephew wrote to his uncle that he did what was promised; uncle promised the money but died. Executor of estate refuses to pay the $5,000, saying there was no consideration.
- **Held: Nephew should receive the money**
- “A waiver of any legal right is a sufficient consideration for a promise”
Adequacy of Consideration, Preexisting Duty Rule, and Past Consideration

◆ Adequacy of Consideration
  Courts Don’t Look for Fair Market Value:
  If a party bargains poorly, courts usually won’t interfere
  Those who bargain take on the risk of their own errors
  There are exceptions such as fraud, duress, etc.

◆ Preexisting Duty Rule
  – Obligation that existed (preexisting duty) before a new agreement is not consideration for present agreement
  – Every contract needs new consideration by both parties

◆ Past Consideration
  – Is not equal to new consideration for making a contract
  – No new consideration has been given in exchange
  – Such promises usually are considered “gifts”
Enforceable Promises Without Consideration

- Promissory Estoppel or Detrimental Reliance
  - Use of this doctrine avoids injustice due to the promisee's reasonable reliance on the promisor’s promise

- See Hoffman v. Red Owl,
Hoffman v. Red Owl
Promissory Estoppel Case

- Hoffman owns bakery; wants to buy a convenience store; Red Owl negotiates with him; Hoffman will need $18,000 & experience
- Hoffman leases a building, buys inventory & begins running a grocery store; 3 mos. later: Red Owl says to sell the store
- Hoffman sells, puts $1000 on the site for new store; sells the bakery, loses $2000; Red Owl asks for $24,100 instead of $18,000
- Hoffman coughs up the new money
- Week later: Red Owl says $26,000--$2000 more; Hoffman says no
- Red Owl says forget it, no consideration, no contract
- Hoffman sues under promissory estoppel, and trial court held for Hoffman; Red Owl appeals
- Held: Affirmed. Injustice would result if Hoffman is not granted relief even though no contract existed
Element #3
Capacity

- Refers to the legal ability to create a contract
- Some have limited capacity to contract
  - Minors
  - Intoxicated persons
  - Insane persons
- If there is no capacity, the contract is void
- If there is partial capacity, the contract is voidable—may disaffirm
Minors

Defined as a person under the legal age of majority
Traditionally, the age of majority was 21
Now it is 18 years old in all states for most contracts
Minors have partial capacity
Contract is voidable
Legal policy to protect the young from the “results of their own folly”

General Rules

- #1: Minors may disaffirm contracts at their option
- #2: If a minor disaffirms after receiving benefits, restitution must be paid for the benefit
- Some contracts may not be disaffirmed, i.e
  - Enlistment contracts
  - Marriage contracts
  - Educational loans
- After reaching majority, the minor may ratify the contract
Mentally Impaired and Intoxicated Persons

**Mentally Impaired**
- If a person is *adjudicated insane*, the contract is **void**
- If person is *insane in fact*, the contract is **voidable**
- The person may disaffirm when restored to capacity
- Guardian of the person may disaffirm on the individual’s behalf
- If the contract is “just and reasonable”, some states will not allow the person to disaffirm it

**Intoxicated Persons**
- Under the influence of drugs or alcohol
- Test: Was the person so intoxicated as to not know the nature and substance of the agreement?
- Contract is **voidable** at the option of the intoxicated person
- **Example**: George falls off his chair and passes out after signing a contract
Legality

- **If a contract is lacking *legality*, courts will not enforce it**
- **Type #1: Subject Matter Must Be Lawful**
  - Criminal activities; sale of prohibited drugs; gambling activities in some states
- **Type #2: Regulated Professions**
  - Person is unlicensed
  - Unlicensed contractor/builder; clipping poodles w/o a license
- **Type #3: Interest rates on loans that violate *usury* laws**
Legality & Contracts
Contrary to Public Policy

- **Exculpatory Agreements** (contracts written to escape liability)
- **Unconscionable Agreements** (unequal bargaining power)
- **Contracts with Public Servants** (influence a public servant to violate duty owed to the government)
- **Contracts in Restraint of Trade**
General Commercial Packaging v. TPS Package Engineering

- General Commercial (GCP) subcontracts with TPS for packing services
- TPS signs a Covenant Not To Compete for 1 year for business from GCP’s good customer, Walt Disney
- TPS ignored the Covenant Not To Compete in the agreement, and began working for Disney
- GCP sued for breach of contract
- District Court holds for TPS--contract violated California’s prohibition against restraint of trade
- Held: Reversed
- The Covenant Not To Compete does not render the entire contract void as a restraint on trade
- TPS can still deal with other firms; therefore, not a complete restraint of trade
Element #5
Reality of Consent/Genuine Consent

- Concerns real choice to enter into agreement
- If reality is missing, there is no *meeting of the minds*:
  - If there is *unilateral mistake* (other than typographical error), contract usually cannot be avoided. If there are *mutual mistakes*, the contract may usually be avoided.
- Without this element, the contract is void or voidable (depending on the circumstances)
- Examples:
  - *Fraud*
  - *Misrepresentation*
  - *Duress*
  - *Undue influence*
Johnson v. Davis

- Davises contract to buy Johnson’s home—made a $5,000 deposit and another $26,000 payment.
- The contract states Davises have the right to obtain a written report from a licensed roofer regarding the roof; seller to make repairs
- Davises notice water damage; Johnson says it was a window problem (not the roof) & it was corrected

- Davises move into the house; 2 days later, water comes into the house during a rain storm
- Johnson’s roofers said $1000 to fix; Davises’ roofer said $15,000
- Davises sue; district and appeals courts hold for them. Johnson appeals
- Held: Affirmed. Johnson’s statements concerned material matters and constituted fraudulent misrepresentation
Element #6 (Sometimes Needed)
The Statute of Frauds (1677)

- **General Rule**: An express or implied contract, either written or oral, is enforceable; however:
- **Written contracts** are always best evidence of agreement; however:
- **Some contracts require a writing**
  - Sale of real property
  - Contracts that cannot be performed within one year
  - Promise to pay the debt of another
  - Promise by an administrator to personally pay estate debts
  - Promises made in consideration of marriage
Sufficiency of the Writing and The Parol Evidence Rule

**Sufficiency of Writing**
- Writing must set out the material terms of contract
- Names of parties
- Consideration
- Subject matter, etc.
- Invoices, E-mails, sales orders, checks, confirmations may satisfy this requirement

**Parol Evidence Rule**
- Oral evidence may not be admitted in court to contradict, change or add terms to written contract if writing clear
- If written contract is incomplete, unclear, proves fraud, mistake, or misrepresentation, then oral evidence may explain the problems
“Contracting With The Japanese”

- U.S. contracts tend to try to cover all contingencies
- Japanese view contracts as secondary to the ongoing relationships of the parties
- Contracts with the Japanese should be brief and flexible, not detailed
- The Japanese often want “good faith clauses” in contracts with Westerners
- Consensus among the negotiating teams is very important
Discharge of Contracts
(Terminating Contractual Obligations)

- **Assignment** (transfer of rights to another) and **delegation** (transfer of duties to another)
  - Many contracts can be assigned or delegated.

- **Performance**
  - Total performance = discharge and payment accordingly
  - Substantial performance: Usual remedy is contract price minus damages from lack of complete performance

- **Discharge by breach** (non-breaching party is discharged)
  - **Material breach**: Performance is substantially less than the contract provides
  - **Anticipatory breach or repudiation**: A party indicates inability or lack of desire to perform

- **Discharge by Agreement of the Parties**: Recission, novation, accord & satisfaction
Discharge of Contracts

- **Discharge by operation of law**
- **Failure of a condition precedent**
- **Occurrence of an express condition subsequent**
- **Occurrence of concurrent conditions**
- **Discharge by Impossibility**
  - An unforeseeable, unanticipated event occurs that makes performance impossible (*objective impossibility*)
  - The impossibility doctrine has been extended to *commercial impracticability* (unforeseen event creates an “extreme or unreasonable difficulty, expense, injury or loss”)


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Busse v. Dept. of General Services

- Busse contracts to build fountain for General State Agency
- Contract states he assumes all risks regarding “concealed or unusual conditions”
- Hurricane Agnes strikes, dumping silt & dirt that had to be removed to complete job
- Busse sues for the additional $85,000 in costs due to storm
- Held: Where there are two innocent parties, look to the contract as upon whom the risk was imposed
- This contract is not impossible to perform; is more expensive but not impracticable; the risk falls on Busse
**REMEDIES**

- **Monetary Damages ($$$$)**
  - Compensatory Damages
  - Expectancy Damages
  - Liquidated Damages
  - Nominal Damages
  - Punitive Damages *(if there is tort related to breach of contract)*
  - Special Damages

- **Equitable Remedies**
  - Specific Performance
  - Injunction
  - Restitution
  - Reformation
Copenhaver v. Berryman

- Berryman owns an apartment complex; contracts for Copenhaver to own & operate laundry facilities in complex
- After 1 year of a 5-year contract, Berryman terminates the contract and removes the machines on March 10
- By September 10, Copenhaver puts machines to use in other locations; sues for $13,886.58 for net profit for remaining 4 years of contract
- Trial court awards $3,525.84 for losses incurred from March to September
- Held: Affirmed. The injured party “must exercise . . . reasonable efforts” to minimize his damages
- No damage was suffered after September 10