Chapter 9 – Introduction to Contracts

I. Introduction

A. Contracts exist to make business matters more predictable.

B. Elements of a contract

1. Agreement - One party must make a valid offer, and the other party must accept it.

2. Consideration - There has to be bargaining that leads to an exchange between the parties.

3. Legality - The contract must be for a lawful purpose.

4. Capacity - The parties must be adults of sound mind.

5. Consent – No contract exists in cases of fraud and sometimes when a mistake is made.

6. Writing- A writing may be required under the Statute of Frauds. Note that while always advisable to have written evidence of agreement, legally a writing is not usually necessary.

C. Other important issues

1. Performance – If party performs, he or she is discharged.

2. Where incomplete performance and no legal excuse, aggrieved party will look for remedies.

II. Contracts

A. Definition - A promise that the law will enforce.

B. Types of Contracts

1. Bilateral and Unilateral Contracts
   
   • Bilateral: both parties make a promise (to do something) to each other.
   
   • Unilateral: one party makes a promise to the other that the other party can accept only by doing something specific. Unilateral contracts include
rewards.

2. Executory and Executed Contracts

• Executory: when one or more parties has not fulfilled its obligations under the contract.

• Executed: when all parties to the contract have fulfilled their obligations under the contract.

3. Valid, Unenforceable, Voidable, and Void Agreements

• Valid: satisfies the law’s requirements.

• Unenforceable: when the parties intend to form a valid bargain but some rule of law prevents enforcement.

• Voidable: when the law permits one party to terminate the agreement. Contracts involving fraud or misrepresentation are voidable.

• Void: one that neither party can enforce, usually because the purpose is illegal or one of the parties had no legal authority.

4. Express and Implied Contracts

• Express: the two parties to the contract explicitly state all of the important terms of their agreement.

• Implied: the words and conduct of the parties indicate that the parties intended to make an agreement.

- Personnel manuals may be treated as implied contracts.

III. Remedies Created by Judicial Activism

A. Even when there is no contract, a plaintiff may use promissory estoppel to enforce the defendant's promise if he can show that:

• The defendant made a promise knowing that the plaintiff would likely rely on it.

• The plaintiff did rely on the promise; and
• The only way to avoid injustice is to enforce the promise.

B. Even when there is no contract, a court may use *quasi-contract* to compensate a plaintiff who can show that:

• He gave some benefit to the defendant.
• He reasonably expected to be paid for the benefit and the defendant knew this; and
• The defendant would be unjustly enriched if she did not pay.

- The damages awarded are called *quantum meruit*, meaning that the plaintiff gets “as much as he deserved.”

- Note the benefit cannot be conferred voluntarily.
- Examples include a nursing home required to provide care to an impoverished resident.

C. Difference between Promissory estoppel and quasi contract: promissory estoppel involves a promise that the plaintiff relied on. The focus of quasi contract is receipt of a benefit by the defendant.

IV. Sources of Contract Law

A. Common Law – governs contracts for land, services

B. Uniform Commercial Code – includes articles on various topics. Created to standardize rules across state lines (1952).

• UCC Article 2 governs the sale of goods. “Goods” means anything moveable, except for money, securities, and certain legal rights.
• In a mixed contract, Article 2 governs only if the primary purpose was the sale of goods.

C. Restatement (Second) of Contracts

V. Meeting of the Minds

A. The parties can form a contract only if they had a meeting of the minds.
- They must understand each other and intend to reach an agreement.

- A judge will make an objective assessment of any disagreements about whether a contract was made -- whether or not a reasonable person would conclude that there was an agreement, based on the parties’ conduct.

B. Offer

- An offer is an indication by a party of a willingness to be bound to a contract under the specified terms.

- The offeror makes the offer. The offeree receives it.

- Under common law, the terms of the offer must be reasonably definite. Required details include identification of parties, subject matter of contract, consideration to be paid and delivery details. Must be sufficient information so that court could enforce. Must also be intent to make a bargain, as measured under objective theory.

- An invitation to bargain is not an offer.

- An advertisement is generally not an offer. (Consult consumer protection legislation for rules about bait and switch.)

  - Very specific ads may be treated as offers.

  - A letter of intent may or may not be an offer, depending on the writer’s intent. A letter of intent is document that summarizes negotiating progress.

C. Termination of Offers

  1. Termination by Revocation - effective when the offeree receives it.

     a. Note that offers are freely revocable, even when the offeror promised to keep the offer open.

     b. Exceptions to the rule of revocability include

        i. Options
ii. Unilateral contracts where part performance has occurred.

2. Termination by Rejection
   a. If an offeree rejects an offer, the rejection immediately terminates the offer.
   b. Termination by Counteroffer - If an offeree counteroffers, it is a combination of a rejection that immediately terminates the offer and a new offer.

3. Termination by Expiration
   • When an offer specifies a time limit for acceptance, that period is binding.
   • If the offer specified no time limit, the offeree has a reasonable period in which to accept.

4. Termination by Operation of law
   • Destruction - Destruction of subject matter terminates offer.
   • Death or mental incapacity

D. Acceptance

1. The offeree must say or do something to accept. In general, silence is not effective as acceptance, unless parties have otherwise agreed.
   • In a bilateral contract, the offeree generally must accept by making a promise.
   • In a unilateral contract, the offeree must accept by performing.

2. Mirror Image Rule (Common Law)
   - Requires that acceptance be on precisely the same terms as the offer.
   - Even a minor difference is enough to prevent contract formation.

3. UCC and the Battle of Forms – See chapter 13.
4. Clickwraps and shrinkwraps

- Clickwrap – language you are required to agree to before downloading software

- Shrinkwrap – packaged with electronic devices. Requires buyer to agree before inserting CD into computer.

- Wrap agreements often require arbitration, shift legal costs to loser, and limit seller’s liability to refund of purchase price, even where defective item caused significant consequential damages.

- Many courts enforce these, even against consumers.

VI. Consideration

A. Consideration means that there must be bargaining that leads to an exchange between the parties.

1. Consideration can be anything that someone might want to bargain for. Measurable value is required. This means thing bargained for must have real value. Exs – money, object, promise not to sue

2. Bargaining means the consideration induces the return promise/performance. Where no bargaining occurs, transaction is a gift.

   a. Past consideration is no consideration.

   b. Moral consideration is no consideration.

3. A promisor is the person who makes the promise, and promisee, the person to whom the promise is made.

4. The thing bargained for can be:

   • another promise. A promise to mow the lawn is as good consideration as actually mowing it

   • Promise to do something

   • Promise not to do something – ex – release

   • an action without a promise.
- Ex – finding lost dog shown in reward poster.

- An action that is legally required or constitutes the party’s obligations under an existing contract is not valid consideration.

  Ex - Police officer not entitled to reward for capturing criminal.

- *Hamer v. Sidway* 1891- Promise typically is a benefit and a burden but need not be. Forbearance can be valid consideration.

B. Illusory Promise

- If one party’s promise is conditional, the other party is not bound to the agreement.

**Chapter 10 – Legality, Consent, Writing**

I. Legality – Courts refuse to enforce contracts that violate the law or violate public policy

  A. Noncompete agreements – promise not to work for a competitor or enter into competition with the other party for some defined period of time.

    1. Used in connection with employment agreements and sale of business. Noncompetes are especially important if buyer is purchasing goodwill of business.

    2. Enforceable if reasonable in time, activity and territory

      a. Agreement prohibiting employee from working for anyone for 10 years would not be enforced.

      b. Agreement prohibiting business seller from opening competing operation within two mile radius for two years very likely enforced.

      c. Courts more likely to enforce noncompetes in connection with sale of business.

B. Exculpatory Clauses
1. This is a clause designed to eliminate legal liability.

2. Generally unenforceable when clause attempts to eliminate liability for an intentional tort or for gross negligence.
   a. Recall from tort chapter – gross negligence is extreme carelessness.
   b. An exculpatory clause involving ordinary negligence will NOT be enforced where the affected activity is in the public interest.
      i. This means a doctor or lawyer could not successfully use an exculpatory clause to eliminate malpractice liability.

3. An exculpatory clause also will be unenforceable where the parties have unequal bargaining power.
   a. Ex – Insurance company includes exculpatory clause in automobile policy. Assume state law requires drivers to have insurance coverage.
   b. These are “take it or leave it” contracts, involving no negotiations between the parties.

4. An exculpatory clause will not be enforced unless it is clearly written and readily visible.

C. Unconscionable Contracts

1. This is a contract courts refuse to enforce because of fundamental unfairness.

2. Typically these contracts involve oppression (one party uses superior power to force contract on weaker party) or unfair surprise (weaker party did not fully understand contract terms.)

3. DO NOT SIGN A CONTRACT WITHOUT KNOWLEDGE OF ITS TERMS OR WHEN UNCOMFORTABLE WITH ITS TERMS ON THE ASSUMPTION YOU CAN LATER RAISE AN UNCONSCIONABILITY ARGUMENT TO ESCAPE IT.

II. Voidable Contracts – Capacity and Consent

A. Where a contract is voidable, one party can terminate agreement without being sued for breach.
B. Capacity

1. This is the legal ability to enter a contract. Where a party lacks capacity, he or she can disaffirm the agreement. In other words, the contract is voidable by that party.

2. Disaffirm by notice, refusing to perform or suing to rescind.
   a. Restitution required to disaffirm. This means party must return consideration received, to extent he or she is able.
   b. Where consideration received has been lost or destroyed, most states still allow minor to disaffirm. Minority of states hold that where consideration has been lost or damaged, a retail store is only required to return its profit margin.

3. Minors lack capacity. A minor is someone under the age of 18.

C. Lack of valid consent also makes contract voidable.

1. Fraud
   a. Fraud is intentional misrepresentation.
   b. To prove fraud, the plaintiff must show:
      i. The defendant knew the statement was false or she made the statement with no knowledge as to its truth or falsity.
      ii. The false statement was material
      iii. The injured party justifiably relied on the statement.
   c. Opinions, puffery are not fraud.
   d. A statement is material where it is likely to influence the decision of the misled party significantly.
   e. Where a statement is obviously untrue, reliance is not justifiable.
   f. Where fraud, victim can sue to rescind, sue for damages or sometimes sue for both.
      i. Where suit for damages, plaintiff seeks difference between amount promised and amount delivered.
ii. A suit for rescission and damages may be appropriate where the victim is out of pocket even after rescinding the contract.

iii. Recall rescission is an order reversing a contract and returning the parties to the positions occupied before the agreement.

2. Mistake

a. Bilateral mistakes

i. Sherwood v. Walker – both sides erroneously thought cow was barren.

ii. Where parties contract based on important factual error, contract is voidable by injured party.

iii. Doctrine of mistake does not render contract voidable where error goes to prediction, as where party anticipates decrease in price of commodity.

iv. Mistake also inapplicable where party is aware of risk he or she is assuming. Buyer of car sold “as is”, who believes that he can repair the vehicle and get it to run, cannot later sue for rescission based on mistake.

b. Unilateral mistake

i. This means only one side was mistaken as to the facts.

ii. In general, courts are less receptive to unilateral mistake arguments. However, unilateral mistake can be basis for rescission where

   - enforcing contract would be unconscionable OR
   - nonmistaken party must have known of error.

3. Duress

a. Where party makes improper threat that causes victim to enter contract, and victim had no reasonable alternative, contract is voidable.
b. Duress applies only where threat is improper.

c. Economic duress can be raised, but difference between economic duress and hard bargaining may be subtle. Courts consider:

   i. Acts that have no legitimate business purpose

   ii. Greatly unequal bargaining power

   iii. An unnaturally large gain for one party

   iv. Financial distress to one party.

III. Written Contracts

   A. Statute of Frauds requires writing, signed by defendant, for certain contracts:

      1. Land

      2. Contract not capable of performance within one year

      3. Promise to pay the debt of another

      4. Promises made by the executor of an estate

      5. Promises made in consideration of marriage

      6. UCC contracts involving sale of goods worth $500 or more

   B. Note that the Statute of Frauds does not render an agreement void. If contract is fully performed, notwithstanding the lack of a writing, it is not subject to rescission.

   C. Land contracts

      1. Any interest in land must be written, including sale transactions, easements, mortgages, etc. Most states except short-term leases, usually defined as a lease of one year or less.

      2. Where seller fully performs, as by delivering deed, most courts are likely to enforce even though there is no writing.

      3. Buyer may be able to enforce an oral contract if she paid part of the purchase price and either entered the land or made improvements to it.

   D. Contract that cannot be performed within one year
1. Year runs from date of agreement, not date performance is to begin.

2. Writing not required if contract could possibly be performed within one year, even if that’s not likely.

E. Promise to pay debt of another

1. Collateral promise – promise to pay debt of another as favor to debtor.

2. Example – wealthy uncle promises to pay niece’s debt, in the event she is unable to, in order to assist niece in obtaining financing. If uncle is acting as a favor to his niece, a writing is required.

F. What is necessary if a writing is required?

1. The writing must be signed by the defendant. Signature is defined broadly to include any mark or logo placed on the document to indicate acceptance.

2. Document must state with reasonable certainty the parties’ names, the subject matter of the contract and all essential terms and promises.

3. Uniform Electronic Transactions Act
   a. Adopted in almost all states.
   b. Provides that electronic contracts and signatures are valid.

4. Under the UCC, involving contracts for the sale of goods worth $500 or more, the requirements for a writing are less strict.
   a. Writing must include signature of defendant and quantity of goods involved.
   b. Missing terms can be supplied using gap fillers.

G. Parol Evidence Rule

1. If a contract is integrated, evidence of prior or contemporaneous understandings is inadmissible.

2. An integrated contract is one that’s intended to be complete.

3. This rule means that evidence of what was said during negotiations or at the time of signing will not be heard in court.