

# CONTRACTS: JUST THE RULES

## ABOUT THE UCC

At the outset, take note that all contracts involving the sale of goods are governed by Article 2 of the Uniform Commercial Code. One's first question upon being presented with a fact pattern should be, "Does this contract involve the sale of goods?" If so, look to the UCC for the law. "Goods" include all movable, tangible goods, not real estate, and not intellectual property. UCC rules do not differ greatly from common law rules, but they do differ. In UCC cases, common law principles may still be applied in interpreting the law.

Some transactions involve both the sale of goods and the sale of services. Courts will apply one of two tests to determine whether UCC or common law rules apply to the case:

**Predominant purpose test:** In this, the more popular test, a court will determine what the predominant purpose of the contract is. If I have washed and detailed your car, the contract was primarily one for the sale of my services to you; the small amount of sealant that I applied to the car is technically a good that I sold to you, but that sale was not the predominant purpose of the contract. If this test is used, the court will apply common law rules to the case.

**Gravamen test:** Courts will sometimes apply this test, in which they determine what the conflict is primarily about. If the sealant I used on your car caused the paint to peel away, then the gravamen of the case is that good that I sold to you. If this test is used, the court will apply UCC rules to the case.

## ELEMENTS

A contract exists when two or more parties agree on promises to exchange things of value. Every contract must contain a valid offer, acceptance, and consideration. To understand these elements, understand that the offer represents the content of the agreement, the acceptance represents the agreement itself, and the consideration represents the exchange of value.

## OFFER

The offer represents the content of the agreement. Obviously, two or more parties cannot agree on nothing; they must agree on something. The offer is, or represents, that something. In a straightforward example, the offeror may say, "I'll sell you this car for one thousand dollars." The offer contains the content of the agreement.

The offer also conveys power of acceptance to the offeree. In the example above, the offeree may simply say, "It's a deal." He has exercised the power of acceptance conveyed to him by the offeror, and he has created a contract.

## WHAT IS AN OFFER?

**An valid offer must contain clear and definite terms and must convey power of acceptance to the offeree.**

**Clear and definite terms:** A valid offer contains clear and definite terms. To determine this, a common analytical device is the acronym QTIPS:

**Q:** Quantity of goods, services, etc.

**T:** Time for the contract to be performed.

**I:** Identity of the parties who are contracting.

**P:** Price.

**S:** Subject matter of the contract.

In the classical model, the offer contains all of the above, and the acceptance is merely an expression of assent. There are many exceptions to this.

For the moment, one must analyze an offer for clear and definite terms, and weigh the importance of their inclusion or omission. For instance, the omission of time for the contract to be performed will usually not make an offer invalid. Our example above does not indicate when the car will be delivered or when the thousand dollars will be paid. But the offeree's statement, "It's a deal," still forms a valid contract. Missing terms will be filled in by what is determined to be reasonable. If the offeror refuses to sell the car, his claim that he meant that he would sell the car five years from now, will not be judged to be reasonable.

Other terms, such as price, are more important. The statement, "I'll sell you my car," will generally not be judged to be a valid offer. If the offeree says simply, "It's a deal," and the two discuss the matter no further, has a valid contract been formed? Will the offeree be able to sue successfully? The court *could* fill in the gap with a "reasonable" price, for instance the blue book value, but it will more likely rule that the offer was invalid, and there is no contract.

Courts are more likely to fill in a "reasonable" price when the contract is for the sale of fungible goods, less likely when it is for unique goods.

It is said that the one indispensable term is quantity. If one shows up at a car dealership and says, "I'll buy some cars from you today for ten thousand dollars," all the terms are defined except quantity. This offer is not valid.

**Conveyance of power of acceptance:** A valid offer conveys power of acceptance to the offeree. In other words, a simple expression of assent by the offeree will conclude the bargain. The statement, "I would like to consider selling you my car for a thousand dollars, but first I need to sleep on it," does not convey power of acceptance to the person addressed, because it contains conditional language. To say in response, "It's a deal," creates no legal obligations, but merely acknowledges that further negotiation may take place in the future.

Needless to say, the more difficult cases are the more ambiguous statements. What about, "I would like to sell you my car for a thousand dollars."? Grammarians (and the offeror, if he were trying to renege) would note that the conditional voice ("would like") contains an implied "if." That is, "I would like to sell you my car for a

thousand dollars *if* I could, but the fact is I'm not going to." The "test" for conveyance of power of acceptance is whether a reasonable offeree would believe that power of acceptance had been conveyed. Like other formulations of the "reasonable person test," the test itself is ambiguous. These ambiguities give lawyers something to argue about, and they give law students something to write in their exams.

### WHAT IS NOT AN OFFER?

**An offer made in jest:** An offer which the offeree knows or should know is made in jest is not a valid offer.

**Preliminary negotiations and statements of future intentions:** "I'm thinking of selling my car for a thousand dollars," or "I am going to sell my car for a thousand dollars."

**Price quotations:** Generally, a price quote is not an offer, especially if it does not include a quantity, is not addressed to a particular offeree, or does not include words like "offer."

**Solicitations:** One must often determine whether a proposal is a solicitation or an offer, especially in the case of advertisements. A straightforward example of a solicitation would be, "I would like to sell you my car. Make me an offer." The speaker is understood to be soliciting an offer, not making one. Solicitations create no legal obligations. Advertisements will normally be construed by courts to be invitations to the public to make offers. However, an advertisement may be construed to be an offer if it would lead a reasonable prospective buyer to believe that an offer was intended. This would be so if the advertisement contains the elements of an offer: clear and definite terms, and apparent conveyance of power of acceptance to the offeree.

### A VALID OFFER:

**"I will sell you my car today for a thousand dollars."**

**Quantity:** "My car" (singular form indicates quantity of one).

**Time for performance:** "Today."

**Identity of parties contracting:** "I" and "you."

**Price:** "A thousand dollars."

**Subject matter:** "Sell you my car."

**Conveyance of power of acceptance:** "I will" (absence of conditional language).

### OFFER UNDER THE UCC

All transactions in goods are governed by Article 2 of the Uniform Commercial Code. UCC rules may mirror common law rules, or they may be quite different. In the realm of the offer, the UCC differs in that less emphasis is placed on identifying the offer and acceptance as separate elements. Specifically, UCC 2-204 states:

- 1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes that existence of such a contract.

- 2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.
- 3) Even 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.

## ACCEPTANCE

The acceptance is the offeree's manifestation of assent. It represents agreement, and it creates the contract. To be valid, the acceptance must be knowing, voluntary, and deliberate. In determining whether a valid acceptance has been made, the proper focus is on whether a reasonable offeror would understand that the offeree had accepted. As with the analysis of the offer, this is the objective, or "reasonable person" test. In other words, it does not matter what the offeror and offeree actually intended their words or actions to mean (the subjective test), it matters how a reasonable person would have interpreted them.

**Communication to the offeror:** The acceptance is generally not effective until it is communicated to the offeror.

**Accord with the substantive terms of the offer:** The acceptance must be in accord with the substantive terms and the procedural requirements of the offer. Regarding substantive terms, responding to, "I'll sell you my car for a thousand dollars," with, "OK, I'll give you five hundred for it," is not a valid acceptance, because the terms of the acceptance conflict with the terms of the offer. (The response would be a counteroffer rather than an acceptance.)

Historically, courts followed the "mirror image" rule. I.e., if the acceptance varied *in any way* from the offer, it was not valid. Modernly, minor variations will not invalidate the acceptance.

**Accord with the procedural requirements of the offer:** If the offer states that the acceptance must be received by fax before 3pm, and the acceptance is given by phone at 3:15pm, then the acceptance is not valid. If the offer states that the offeree may accept only by flying the Union Jack from the mast of his sailboat on All Souls' Day, then any other method of acceptance is invalid.

**Acceptance by performance:** If I say, "I'll pay you a hundred dollars if you mow my lawn tomorrow," and you say nothing, but you do mow my lawn tomorrow, this is a valid acceptance by performance. When such acceptance is possible, but performance cannot be accomplished instantaneously, then we must examine the duties of the offeror and offeree once partial performance has begun.

**Partial performance:** When acceptance may be by performance, and the performance cannot be accomplished instantaneously, the offeror may not revoke the offer once performance has begun. Or, as Restatement § 45 provides, an option contract is formed. This duty of the offeror exists any time acceptance *may* be by performance. The duty of the offeree, on the other hand, depends on what type of contract the offeror intended to create:

**Bilateral contract:** If the offeror intended to create a bilateral contract (a promise in exchange for a promise), then beginning performance constitutes an implied promise.

It is a valid acceptance and the offeree is obligated to finish performance.

**Unilateral contract:** If the offeror intended to create a unilateral contract, then acceptance is made when performance is finished. The offeree has no obligation to finish performance once she has begun. Modernly, courts will only find intention to create a unilateral contract when express language exists.

**Rewards:** An offer of a reward made to the public is an executory offer of a unilateral contract. Such an offer may be revoked by publishing the revocation with the same notoriety as the original offer. It does not matter if the notice actually reaches one who attempts acceptance. Exception: Note that when such an offer can only be accepted by one person (e.g. there is only one lost dog to be returned), then the offeree is a unique individual who is as yet unidentified. This means that if the person who eventually becomes the offeree by completing performance, had started to perform before the revocation was made, then the revocation was ineffective.

**Effective date of acceptance:** An acceptance takes effect when it is dispatched to the offeror. In, for instance, telephonic communication, dispatch and receipt of the acceptance are simultaneous. In the mail, acceptance may be dispatched within the time required by the terms of the offer, but received too late. The “mailbox rule” is that acceptance is valid upon dispatch, when the mail is an expressly or impliedly authorized method of acceptance. If one mails an acceptance, changes one’s mind, and telephones the offeror to reject the offer, the acceptance is valid even if the offeror received the rejection before the acceptance.

**Knowledge of the offer:** The offeree cannot accept an offer she doesn’t know exists. In the case of rewards offered for taking certain actions, the offeree must know about the reward offer before she takes the action.

**Silence as acceptance:** Generally, silence or inaction cannot serve as acceptance. Exceptions: if the offeree takes the benefit of the offer, or indicates that silence will operate as acceptance.

**Only the offeree has power of acceptance:** Only the offeree, as designated by the offeror, may accept the offer. If I say to you, “I’ll sell you my car for a thousand dollars,” and another person present says, “It’s a deal,” this has no legal significance.

**Revocation:** A revocation is effective when the offeree learns of an act by the offeror that is wholly inconsistent with the offer, such as learning that the offeror has sold the item in question to someone else.

**Rejection:** When the offer is for the sale of a number of items, acceptance of one or more of them may function as a rejection of the offer to purchase the rest of them.

## TERMINATION OF POWER OF ACCEPTANCE

Power of acceptance may be terminated in five ways:

- **Lapse of the offer:** The offer may lapse in a stated time, or after a reasonable time.
- **Rejection:** The offeree’s communication to the offeror, rejecting the offer, terminates her power of acceptance, should she later change her mind.
- **Counteroffer:** A counteroffer always includes a rejection of the original offer. If

the counteroffer is not accepted, the original offer cannot now be accepted unless it is offered again.

- **Revocation:** The offeror is “master of her offer” and may freely revoke it until acceptance. The revocation is only effective once it has been communicated to the offeree. This communication may be indirect, as when the offeree reliably learns, perhaps from a third party, that the offer is no longer open.
- **Death or mental disability of the offeror:** No contract may be formed if the offeror has lost the ability to form contractual intent before acceptance.

## ACCEPTANCE UNDER THE UCC

Acceptance under the UCC has its own set of rules. First, take note of the fact that the UCC is generally more flexible than the common law in finding agreement between contracting parties. The common law “mirror image rule” is rejected. Under the UCC, courts are more likely to find that two parties did in fact have an agreement, though the terms of the agreement are not clear. This is shown above in UCC 2-204, and in 2-206:

### UCC 2-206. OFFER AND ACCEPTANCE IN FORMATION OF CONTRACT

- (1) Unless otherwise unambiguously indicated by the language or circumstances
  - (a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;
  - (b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.
- (2) 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.

**Nonconforming goods:** When a buyer receives nonconforming goods and rightfully rejects them, she is entitled to damages for nondelivery. Such damages consist of the difference between contract price and market price at the time the buyer learned of the breach.

UCC 2-207 is intended to resolve situations in which a buyer and seller use standard forms that include terms that conflict with each other. The UCC, unlike the traditional common law, will find a contract. What becomes of the additional or different terms?

If either or both of the parties is not a merchant, then the terms of the offer become the terms of the contract.

If both parties are merchants, then the additional terms become part of the contract unless they materially alter it or acceptance is expressly made conditional on

acceptance of the additional terms, or the offeror reasonably rejects the additional terms. If any of these situations is the case, then the additional terms do not become part of the contract and remain mere proposals for additional terms.

If both parties are merchants and there are different and contradictory terms, then they obviously cannot both become part of the contract. The “knockout rule” then applies: contradictory terms are knocked out and UCC gap fillers (whatever is reasonable) replace them.

When printed words in a contract contradict typed or handwritten words, the typed or handwritten words are presumed to control.

UCC 2-207 is notoriously poorly written and has spawned an entire body of law based on interpreting it. Within a few years, the law is due to be simplified to reflect its simple purpose: replacing the common law mirror image rule with a rule that allows a contract to be formed even when offer and acceptance don’t match.

### **UCC 2-207. ADDITIONAL TERMS IN ACCEPTANCE OR CONFIRMATION**

- (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 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.

### **More UCC**

**Payment:** The UCC states that a contract which is silent as to the manner of payment calls for payment in any manner current in the ordinary course of business. The seller is entitled to demand payment in cash, but if she does so the buyer is entitled to a reasonable opportunity to procure it.

**Modification:** Under the UCC, no consideration is needed for a modification of a contract for the sale of goods (as opposed to the common law).

## **CONSIDERATION**

At the heart of the law of contracts is the question of which promises should be

enforceable by law, and at the heart of that question is the concept of consideration.

In ordinary language, “consideration” may be defined as “careful thought or deliberation,” or as “a factor that should be given careful thought in forming a decision,” or simply as “payment given in exchange for a good or service.” The link among the meanings of the word is clear in the idiom “in consideration of,” which means both “in view of” and “in return for.” The example of the statement, “In consideration of your years of service to my family, I’ve decided to refrain from evicting you,” brings the definitions together.

In legal terms, consideration is that thing of value, given in exchange for a promise, that makes the promise enforceable. The thing of value is usually another promise.

A promise of valuable performance is itself valuable. An important real life thing to remember is that just because consideration exists does not mean there will be any damages if a party breaches. If I promise to perform a service and you promise to pay, there is valid consideration, because these promises constitute detriments in that the other party could rely on them, creating damages in the case of breach. But if the day after we contract, before I have spent any time or money preparing to perform the service, you declare you intend to breach, I am not injured in any way. With no damages, there is no reason to sue, which is why such everyday cases are of no concern to lawyers.

Not all promises are enforceable. The clearest case is a gift. If, out of the blue, your uncle promises to buy you a bicycle tomorrow, and you happily accept his offer, and then he changes his mind, you have only your own powers of persuasion to compel him to carry through. If however, your uncle promises to sell you his car for a thousand dollars, and you agree, and he changes his mind, you have the power of the law on your side, for any damages you have incurred.

Consider the ways to determine when valid consideration exists:

**“A peppercorn”:** Historically, any consideration would do. A promise to give away one’s kingdom was unenforceable, but a promise to “trade one’s kingdom for a peppercorn,” was enforceable. Modernly, courts are willing to examine the sufficiency of consideration.

**Bargained-for exchange:** Consideration is more likely to be judged to be valid if it was bargained for. Thus, a court may balk at enforcing my promise to sell my new Mercedes for one hundred dollars, but if they find that you offered to buy it for fifty dollars and I insisted you pay a hundred, the consideration will more likely be thought valid.

**Benefit to the promisor or detriment to the promisee:** If I say, “I will give you my car,” I have made a promise. Standing alone, the promise appears to be an unenforceable gift. If I say, “I will give you my car in exchange for a thousand dollars,” we must examine whether the promise of the thousand dollars is valid consideration, and we may do so by judging whether it is a benefit to me, the promisor, or a detriment to you, the promisee. It is both, and it is valid consideration. If I say, “I will give you my car if you will also accept this fine leather steering wheel cover,” is your promise to take the steering wheel cover a benefit to me, or a detriment to you? It is not, and it is not valid consideration, but merely another gift. If I say, “I will give you my car if you will take with you all of the old motor oil bottles in my garage,” then the promise to clean out my garage is a benefit to me and a detriment to you, and is valid consideration.

**Sham consideration:** “Sham consideration is no consideration.” Parties to an agreement will often attempt to make a gift enforceable by “reciting” consideration, e.g. by writing into the contract, “in consideration of \$1 paid,” or similar language. Courts will generally judge this to be “sham” consideration, which is no consideration at all.

**Pre-existing duty:** A party’s action which he was already legally obligated to take cannot be consideration.

**Contract modifications:** A modification of a contract requires separate consideration.

**Mutuality of consideration:** Each party must be bound to do something, or neither is bound. Thus, each person is actually a promisor and a promisee. Looked at from this perspective, in trying to establish valid consideration, one does not seek a “benefit to the promisor or detriment to the promisee” but a “double detriment.”

**Compromise:** When a party agrees not to assert a cause of action that she believes in good faith she has the right to assert, in exchange for some promise or act by the other person, this may be called a compromise, and it is valid consideration.

## ALTERNATIVES TO CONSIDERATION

Whether these areas of the law are thought of as “alternatives to consideration” or “non-traditional types of consideration” is immaterial. These are theories under which promises may be found to be enforceable, outside of traditional consideration theory. It is useful to think of unjust enrichment and promissory estoppel as growing out of traditional consideration doctrine.

However, note that at common law, these theories did not exist. Therefore, if a question asks whether a promise is enforceable “at common law,” and enforcement depends on one of these theories, the answer is no.

Unjust enrichment (and its cousin, moral obligation and the material benefit rule) grow out of the “benefit to the promisor” branch of the consideration tree, while promissory estoppel grows from the “detriment to the promisee” branch. Further, unjust enrichment and promissory estoppel may be thought of as preceding and following consideration on a chronological timeline. That is, unjust enrichment (and especially the material benefit rule) may be thought of as dealing with “past consideration” and promissory estoppel may be thought of as dealing with “future consideration.” Options and firm offers deal with an intersection of offer, consideration, and promissory estoppel.

## UNJUST ENRICHMENT

Unjust enrichment’s link to consideration is through the “benefit to the promisor” concept. Sometimes the basis of the unjust enrichment claim clearly is a benefit to the promisor, but unjust enrichment theory may be applied even absent a promise. It is technically a separate cause of action distinct from contract, but we do find ourselves examining a benefit, and it is a benefit to the person who is or *would have been* the promisor.

Example: Suppose I say, “I promise to sell you some cars for ten thousand dollars,” and you agree and pay me the money. When I refuse to deliver any cars, you sue, and the court declares our contract void for vagueness. That is, in legal terms, we had no contract at all. But something must be done, because it would be unjust for me to keep your ten thousand dollars. What is done is that the court proceeds under the theory of unjust enrichment.

Unjust enrichment has two elements: injustice and enrichment (or benefit). It is not enough for a benefit to be gained, it must be unjust for it to be kept, or no cause of action arises. This is most clearly true in the case of “volunteers and intermeddlers,” that is, people who give a service without being asked and then demand payment. If you mow my lawn without being asked to, it would not be unjust for me to refuse to pay you and keep the benefit of your service.

Some sources base the measure of recovery on the plaintiff’s detriment rather than the defendant’s benefit.

## **MORAL OBLIGATION AND THE MATERIAL BENEFIT RULE**

The doctrine of “moral obligation and the material benefit rule,” which is related to unjust enrichment, deals with what may be thought of as “past consideration.” Generally, “past consideration is no consideration,” which may justify our decision to place this doctrine outside the bounds of traditional consideration theory. It is easy to see why past consideration should be no consideration. Can I give you a gift, free and clear, and then later claim that you owe me something for it? I cannot.

The material benefit rule, however, allows past consideration to make a subsequent promise enforceable, so long as there is found to be a moral obligation to fulfill the promise. Note that there is still technically “no consideration.” There are three elements:

<sup>35</sup><sub>17</sub> The promisor received a benefit from the promisee before the promise was made.

<sup>35</sup><sub>17</sub> The benefit unjustly enriched the promisor.

<sup>35</sup><sub>17</sub> The promisor subsequently made a promise to pay for the benefit.

The doctrine is most clearly accepted when a debtor promises to pay a preexisting unenforceable legal debt, though it may be used in other cases where the three elements are met.

## **PROMISSORY ESTOPPEL**

Promissory estoppel is a doctrine that applies when a gratuitous promise is made, and the promisee reasonably and foreseeably relies on it to her detriment. In this, it is very clearly linked to traditional consideration doctrine, in that ordinary consideration may also include detrimental reliance on the part of the promisee. The difference is that promissory estoppel applies in cases where there is no bargained-for exchange.

It should be clear why promissory estoppel is a worthwhile doctrine and resides firmly in the realm of contracts law (not tort law as some authors argue): a central principle of contracts is that promises should be enforced when they induce reasonable

expectations. Promissory estoppel deals with precisely that.

The general rule is that a promise may be enforced, even absent consideration, if:

<sup>35</sup><sub>17</sub> the promise is clear and definite,

<sup>35</sup><sub>17</sub> the promisor intended to induce the promisee to rely on the promise,

<sup>35</sup><sub>17</sub> the promisee detrimentally relied on the promise in a reasonable and foreseeable way, and

<sup>35</sup><sub>17</sub> enforcement of the promise is required to prevent an injustice.

**Pledges to donate to charities:** Some courts have tried to enforce charitable subscriptions through consideration or promissory estoppel theory. The Restatement § 90 takes the “because we said so” option, simply providing that a charitable subscription is enforceable without proof of reliance.

## OPTIONS AND FIRM OFFERS

Offers are generally freely revocable until accepted. However, an offeror may promise not to revoke an offer for a period of time. If this promise is supported by consideration, then it is a valid option contract. Courts are much less likely to examine whether the consideration is sham or nominal, in the case of option contracts.

Promissory estoppel intersects with offer in the world of construction bidding and subcontracting. When subcontractors submit bids to a general contractor, they are extending an offer to do some work for some amount of money, should the general contractor’s bid to the developer be accepted. Under the rules of offers and option contracts, the subcontractor’s bid should be fully revocable until it is accepted. However, the general contractor must rely on the subcontractors’ bids in making his own bid. This detrimental reliance serves to make the subcontractor’s bid irrevocable – in effect creating an option contract, even though consideration is absent.

Regardless of the promissory estoppel issue, note that when a subcontractor’s bid is actually accepted, then a contract has been formed, and, of course, the offer is no longer revocable.

### UCC 2-205. FIRM OFFERS

“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.”

**Modifications:** Generally, a modification to a contract must have its own consideration. However, beware of situations where a (seemingly gratuitous) agreement to extend the time for payment of a debt with annual interest is actually supported by the consideration of the additional interest.

# DEFENSES TO FORMATION

Defenses to formation are arguments that a party may raise to avoid enforcement of a contract, or theories that courts may apply to invalidate a contract. Arguing a defense to formation means arguing that a proper contract was never formed, since it is the very enforceability of agreements that makes them contracts. It is important to distinguish this from situations in which a party is arguing breach. In the case of breach, one party argues that a proper contract was formed, and the other party has breached it.

If a proper contract was never formed, the contract is either void or voidable. A void contract is no contract at all, but a legal nullity, and it cannot be enforced by either party. A voidable contract may be invalidated by the aggrieved party, or the aggrieved party may choose to keep the contract in force. “Voidable” and “avoidable” are the same thing.

There is not agreement on what constitutes a defense to formation. Taking the broadest view, defenses to formation may include an argument that the offer or acceptance was invalid, or that there was no consideration. These “defenses” are discussed above, under Elements. The narrowest view would exclude the doctrine of excuse due to changed circumstances, distinguishing an excuse from a defense. Here is one list:

## Defenses to Formation

### Void Contracts

<sup>35</sup>/<sub>17</sub> Illusory  
<sup>35</sup>/<sub>17</sub> Illegality  
<sup>35</sup>/<sub>17</sub> Vagueness  
<sup>35</sup>/<sub>17</sub> Public policy  
<sup>35</sup>/<sub>17</sub> Misunderstanding  
<sup>35</sup>/<sub>17</sub> Unconscionability  
<sup>35</sup>/<sub>17</sub> Extreme physical duress  
<sup>35</sup>/<sub>17</sub> Fraud in the factum

### Voidable Contracts

<sup>35</sup>/<sub>17</sub> Statute of Frauds  
<sup>35</sup>/<sub>17</sub> Frivolity  
<sup>35</sup>/<sub>17</sub> Incapacity  
<sup>35</sup>/<sub>17</sub> Mistake  
<sup>35</sup>/<sub>17</sub> Excuse due to changed circumstances  
<sup>35</sup>/<sub>17</sub> Release/waiver  
<sup>35</sup>/<sub>17</sub> Undue influence  
<sup>35</sup>/<sub>17</sub> Duress  
<sup>35</sup>/<sub>17</sub> Fraud in the inducement

## STATUTE OF FRAUDS

For certain types of contracts, there must be a writing signed by the party against whom the contract is being enforced, and the writing must include the substance of the agreement. If such a writing does not exist, the contract is voidable at the option of the party that did not sign. That party voids the contract by raising the statute of frauds as an affirmative defense. The six types are:

- <sup>35</sup>/<sub>17</sub> Sale of land or transfer of an interest in land
- <sup>35</sup>/<sub>17</sub> Services on contracts that cannot be performed within one year from execution
- <sup>35</sup>/<sub>17</sub> Contracts for sale of goods \$500+
- <sup>35</sup>/<sub>17</sub> Executor/administrator (as of a will)
- <sup>35</sup>/<sub>17</sub> Debt of another (suretyship)
- <sup>35</sup>/<sub>17</sub> Pre-nuptial consideration of marriage

The clearest way to do the analysis is in two steps: 1. Is the contract within the statute (i.e. does one of the above situations apply)? If not, your analysis is over; the contract is not affected by the statute. If it is within the statute, then: 2. Is there a writing signed by the party to be bound and containing the substance of the contract's terms? If so, the contract will not be found voidable on this basis. If not, it will.

The first three statute situations are the most common, and there are a few things to remember about each one.

**Sale of land:** This includes any transfer of an interest in land. This could technically include a lease, but only one for longer than a year. One limited exception to the statute of frauds is the "part performance doctrine," whereby a contract may be found to be valid, even if it violates the statute of frauds, if the conduct of the parties provides proof of the existence of a contract, for instance partial payment, partial occupation of the land, or partial improvement of the land.

**Services contracts:** Note that if the contract could possibly be performed within one year, it is not within the statute. A contract for a "lifetime supply" of a service is not within the statute, because the person could die within a year. Performance of a specific task is not within the statute because with unlimited resources, anything could be done within a year. A contract to perform a specific one-day service on a specific date thirteen months in the future is within the statute.

A five year lease that may be terminated at some time prior to one year, is not capable of being performed within one year, under the majority view, because termination is not the same as performance. Statute of frauds applies.

**Goods \$500+:** The sale of goods is governed by the UCC, which has its own statute of frauds, section 2-201, which states that "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." The price set by the contract is determinative, regardless of the actual value of the goods.

Exceptions are if the party to be bound admits the existence of a contract, or has paid for the goods, or if the goods are specially manufactured and partial performance has begun.

In addition, if both parties are merchants, then a signed writing by one party that is not objected to by the other party is sufficient.

The UCC treats a modification of a contract as a new contract. For this reason, if the new contract falls within the statute of frauds, it must be in writing. This is true if the original contract was for sale of goods less than \$500, but the modification would make it \$500 or more.

## ILLUSORY CONTRACTS

A contract is illusory if one of the party's promises is illusory. This may be thought of as another type of lack of consideration. An illusory promise is one that does not actually obligate the party to do anything, e.g. "I'll pay you if I feel like it."

## VAGUENESS/INDEFINITENESS

Courts may invalidate a contract if the obligation of one of the parties is so vague or ambiguous that it is impossible for the court to determine what enforcement would entail. In many circumstances, especially when the sale of goods is involved and the UCC governs, terms may be filled in by gap filler provisions. (See Interpretation and Construction below.) Quantity is the most important term to be present in order for a contract to be valid; if the quantity is not clear and definite, the contract is void for vagueness.

## MISREPRESENTATION AND FRAUD

Certain types of misrepresentation can make a contract void or voidable.

**Misrepresentation:** A false statement of fact. Misrepresentation of opinion is not actionable. Note that misrepresentation is also a tort.

**Scienter:** Misrepresentation made with the knowledge that it is untrue.

**Fraud:** Scienter made with the intent to mislead the other party. May be an express statement, deliberate concealment of a fact, or sometimes a failure to disclose a fact. When fraud is used to induce a contract, the contract is voidable.

**Fraud in the factum (void):** If the fraud consists of misrepresenting the actual existence of the subject matter of the contract, then the contract is void. E.g., selling a piece of property that does not exist.

**Fraud in the inducement (voidable):** If the fraud consists of misrepresenting the facts in order to induce assent to the contract, then the contract is voidable.

**Knowledge of falsity:** may include lying or reckless indifference to the truth.

### Three types of misrepresentation:

<sup>35</sup>/<sub>17</sub> **Fraudulent:** Made with knowledge it is untrue and intent to mislead; most serious.

<sup>35</sup>/<sub>17</sub> **Negligent:** Made carelessly with no intent to mislead; may give rise to a remedy.

<sup>35</sup>/<sub>17</sub> **Innocent:** Untrue but made without lack of care or intent to mislead; less likely to give rise to a remedy.

**Damages for fraud:** Damages may include rescission (releasing the parties from performance) as well as restitution for any unjust enrichment, if there has been partial performance. In some cases, punitive damages may be available. Although punitive damages are usually not available in contracts law, fraudulent misrepresentation is also a tort.

## **DURESS/COERCION**

**Duress:** Compulsion of a manifestation of assent by force or threat. May be actual physical force or threat of future adverse consequences. Threat may be of physical violence to the other party or a loved one, or may be a threat of economic harm or harm to a significant interest that cannot be measured in economic terms. The pressure must have been applied by one of the parties; the economic pressure of the marketplace does not constitute duress. Merely taking advantage of another's economic need generally is not duress.

Extreme physical duress makes a contract void; lesser duress makes it voidable.

Third party duress may make a contract void in the case of extreme physical duress.

Duress as it relates to modifications: Need more here.

## **UNDUE INFLUENCE**

Courts may make a contract voidable when one party abuses its power in a relationship of submissiveness or trust, but actual fraud or duress cannot be pinpointed.

## **UNCONSCIONABILITY**

Courts may refuse to enforce a contract, declaring it void, when the terms are unconscionable based on the mores and practices of the community, when the terms are unreasonably favorable to one party, or when there is an absence of meaningful choice on the part of one party in entering the contract. The injustice must be such as to "shock the conscience" of the court.

This doctrine is often applied in the case of contracts of adhesion. A contract of adhesion is a boilerplate "take it or leave it" contract that one party offers to another, with little or no opportunity for negotiation. A court may void an unconscionable part of a contract, leaving the rest enforceable.

The UCC has its own code: 2-302.

## **ILLEGAL CONTRACTS**

No one may contract to perform an illegal act. Such contracts are void. Performing work without a license when such license is required by law is held to be "illegal." Thus, an unlicensed plumber may not recover payment in contract, or even in quasi-contract. An innocent party may recover in quasi-contract, but if both parties know of the illegality of their contract, the courts will not enforce recovery of any benefits gained by either party, but will "leave the parties as it found them."

## **PUBLIC POLICY**

In the absence of illegality, courts may still declare a contract void, choosing not to

enforce it based on public policy concerns. One contract that is susceptible to this defense is a covenant not to compete. Such covenants may be employment contracts or sales of land, in which the employer or seller obtains an agreement from the employee or buyer that she won't open a competing business. A court may void such a contract if it is unreasonable in terms of time limitation, geographic limitation, or legitimate business need.

## **FRIVOLITY**

Courts will not enforce a contract when it is "clearly" made in jest. Whether a contract is clearly a joke will simply be a judgment call by the court based on what the judge thinks is "reasonable."

## **RELEASE/WAIVER**

As detailed in Excuse of Conditions under Conditions and Promises below, a condition may be waived by the party whom the condition is intended to protect. If the condition waived is so material as to constitute the whole of the other party's obligations under the contract, then there is no consideration and no contract.

## **INCAPACITY**

A person who lacks capacity to contract may avoid enforcement of a contract. There are two categories: minors, and those lacking mental capacity.

Generally, a minor may avoid enforcement of a contract simply by showing that she was a minor at the time the contract was entered into. The contract is voidable at the minor's option. She may enforce it if she wishes.

If the minor chooses to avoid the contract and the (adult) she contracted with has given her a benefit, the adult may recover for the value of the benefit she gave in quasi-contract.

If the minor chooses to disaffirm the contract, she may recover against the other party for restitution damages, which will be offset by the reasonable value of any benefit she received.

A mentally incompetent person's interest in avoiding a contract may be balanced against the other party's justifiable reliance. The court will weigh the degree and seriousness of the mental incompetence against the degree to which the other party engaged in exploitation or improper conduct.

Intoxication can be a valid defense if the following conditions are met: the promisor was truly impaired, the promisee knew of the impairment, and the promisor made a timely effort to annul the contract. Britney's Las Vegas wedding?

## **MISUNDERSTANDING**

Misunderstanding is when parties attach materially different meanings to contract

terms (parol evidence is admissible to determine whether there is a mistake). The court will find that, appearances to the contrary, the parties did not form a contract. The contract is void. Objective trumps subjective. An example of misrepresentation is the contract where the price was agreed upon as “fifty-six twenty.” One party understood it to mean \$56.20 and the other party thought \$5,620.00.

## MISTAKE

**Mistake:** The doctrine of mistake can be grounds for rescission of a contract when one or more parties makes a mistake about the factual circumstances underlying the contract. The following elements must be met:

- <sup>35</sup>/<sub>17</sub> The mistake relates to **facts in existence at the time** the contract was formed. (Mistakes of judgment don’t count. Mistakes about future events fall under excuse due to changed circumstances.)
- <sup>35</sup>/<sub>17</sub> The mistake relates to a **basic assumption** on which the contract was made (i.e. what the subject matter *is* rather than what it is worth).
- <sup>35</sup>/<sub>17</sub> The mistake has a **material effect** on the contract.
- <sup>35</sup>/<sub>17</sub> The complaining party **did not bear the risk** of the mistake. Assumption of risk may be explicit or implicit.

There are two types of mistake:

### MUTUAL MISTAKE:

Both parties make the mistake. The aggrieved party may rescind, provided she did not bear the risk of the mistake. Remember the “ostrich rule”: conscious ignorance on the part of one party eliminates the “shared” aspect of the mistake; this is implicitly assuming the risk of the mistake.

### UNILATERAL MISTAKE:

One party makes a mistake. It is more difficult for the mistaken party to get rescission. In addition to the above elements of mistake, the mistaken party must show that either:

- <sup>35</sup>/<sub>17</sub> Enforcement of the contract would be unconscionable, OR
- <sup>35</sup>/<sub>17</sub> The other party had reason to know of the mistake or actually caused it.

If the non-mistaken party detrimentally relied upon the mistaken party’s promise, then the mistaken party may not avoid the contract unless the non-mistaken party knew or should have known of the mistake. (Contractor-subcontractor example: *Drennan v. Star Paving.*)

## EXCUSE DUE TO CHANGED CIRCUMSTANCES

The three types of excuse due to changed circumstances differ from mistake in that they are concerned not with facts in existence when the parties enter into the contract,

but with new facts that arise after the contract has been formed. Each of these excuse the performance of a party because supervening events not of the parties' making make the original purpose of the contract impossible or impracticable to carry out, or frustrate the original purpose. These doctrines are closely interrelated, and are thought of by some courts as falling under a general label of impracticability.

When this type of excuse is applied, the contract is voided by the aggrieved party, the parties are excused from continued performance, and restitution or reliance damages are available.

### **IMPOSSIBILITY:**

The contract performance cannot be carried out (e.g. supervening illegality, supervening destruction, or death or incapacitating illness of a party). Note: if the conditions that made performance impossible were foreseeable at the time the contract was made, then they will be deemed to have taken those conditions into account at the time they made the contract. The likelihood that one of the parties may become too sick to perform is usually deemed to be foreseeable.

### **IMPRACTICABILITY:**

The contract performance is too burdensome to carry out; must be subjectively and objectively impracticable (i.e. the aggrieved party's belief that performance would be impracticable is insufficient; the courts will decide if it is reasonable to require performance).

### **FRUSTRATION OF PURPOSE:**

The contract performance can be carried out but it would not serve the original purpose of the contract. Both parties must have a shared understanding of what the original purpose of the contract was. (Coronation example: *Krell v. Henry*.)

## **INTERPRETATION**

### **INTERPRETATION AND CONSTRUCTION**

Courts may need to interpret or construe contract terms where the original terms of the contract are missing, or are unclear or ambiguous. Rather than declare a contract void for vagueness, courts will facilitate commerce by holding the contract valid with the additional interpretation or construction.

**Interpretation:** The process of discerning the meaning of ambiguous contract terms.

**Construction:** The process of adding contract terms by legal implication.

Courts will interpret and construe contract terms using both the subjective theory of contracts and the objective theory. Under the subjective theory, courts focus on the actual intent of the parties and what they understood each other's intent to be. Under the objective theory, courts focus on what a reasonable party would have expected

under the circumstances.

The Restatement sections 202 and 203 set forth guidelines for contract interpretation.

**Restatement § 202: Rules in Aid of Interpretation:**

- <sup>35</sup>/<sub>17</sub> Words are interpreted in light of all the circumstances.
- <sup>35</sup>/<sub>17</sub> The principal purpose of the parties is given great weight.
- <sup>35</sup>/<sub>17</sub> A writing is interpreted as a whole.
- <sup>35</sup>/<sub>17</sub> Words retain their generally prevailing meaning.
- <sup>35</sup>/<sub>17</sub> In a technical setting, technical words are given their technical meaning.
- <sup>35</sup>/<sub>17</sub> Any course of performance not objected to is assumed to be valid.
- <sup>35</sup>/<sub>17</sub> Parties' manifestations of assent are assumed to be consistent with each other and the circumstances.

**Restatement § 203: Standards of Preference in Interpretation:**

- <sup>35</sup>/<sub>17</sub> An interpretation that presents a reasonable, lawful, and effective meaning is preferable.
- <sup>35</sup>/<sub>17</sub> Courts follow this hierarchy in interpretation:
  1. Express terms
  2. Course of performance
  3. Course of dealing
  4. Usage of the trade
- <sup>35</sup>/<sub>17</sub> Specific terms are preferable to general language.
- <sup>35</sup>/<sub>17</sub> Separately negotiated terms are preferable to terms not separately negotiated.

The UCC sections 1-205 and 2-208 mirror the Restatement rules for the most part.

**Contract of adhesion doctrine:** where there is unequal bargaining power between the parties so that one party controls all of the terms and offers the contract on a take-it-or-leave-it basis, the contract will be strictly construed against the party who drafted it.

**Gap fillers:** Standard contract provisions that courts will fill in when parties have manifested an intent to be bound but have not agreed on all the terms (e.g. UCC implied warranty of merchantability). Often the courts will fill in a missing term with a "reasonable" term. Factors in determining reasonableness may include: conventional understanding in the community, promotion of efficiency in contracts, and societal goals.

**Implied warranty of merchantability (UCC 2-314):** Unless the parties take some action to eliminate the warranty, like including an "as is" clause, the warranty automatically becomes part of every contract for the sale of goods. The warranty only applies when the seller is a merchant with respect to goods of that kind. It states that goods must be fit for their ordinary purposes, including packaging and conformity with any label on the container.

**Good faith:** Beyond specific gap fillers, courts may enforce a general obligation to act in good faith. This "term" is added to the contract by implication. This obligation

may be enforced even when the contract terms are clear and unambiguous, and there are no missing terms. (E.g., the dissent in “*Saucy Sisters*”: even though the contract could be terminated “without cause,” for United to do so simply to make a better deal was bad faith.)

There is always an implied agreement that a party will not willfully prevent the performance of a condition to her obligation.

**Purposeful ambiguity:** A offers to sell B “my house on Main Street.” B accepts. A owns two houses on Main Street, but B only knew that A owned one of them. A valid contract has been formed for the house that B knew that A owned. A used a patently ambiguous term as to her own understanding. B is not guilty of such negligence (or intent). Therefore, credence is given to B’s construction of the term.

## PAROL EVIDENCE RULE

The “parol evidence rule” is a misnomer on two counts. First, “parol evidence” is defined as oral evidence, but the parol evidence rule applies to oral and written evidence extrinsic to a contract. Second, the rule is not only a rule of evidence, but a guide in interpretation and construction.

The parol evidence rule prohibits the introduction of extrinsic evidence of prior or contemporaneous agreements offered to contradict, vary, or modify an unambiguous writing which the parties intended to be a full and final expression of their agreement. Oral agreements made before or contemporaneously with the execution of the writing and written agreements made before the writing, are considered questionable, especially if they contradict the written contract. Courts may refuse to admit this evidence, keeping it from the factfinder.

Note that oral and written agreements made after the formation of the contract are not covered by the rule, because they can be considered new contracts or modifications of the original contract. Note that written agreements made contemporaneously with the original contract are not covered by the rule, because they can constitute part of the contract itself.

The parol evidence rule was once applied strictly: if a written contract was clear on its face, with no obvious omissions (“fully integrated”), then a judge would not even consider the content of evidence covered by the rule. Modernly, the rule has ceased to be a rule of evidence and is more of a guideline in analyzing such evidence. A modern court would consider the content of the extrinsic evidence in determining both whether it should be admitted at all and to what degree it should be allowed to influence the interpretation of the contract.

These two approaches to the rule are played out in *Mitchell v. Lath*. A buyer of real estate alleged that the seller had agreed orally to remove an unsightly icehouse, but the written contract did not mention this agreement. The majority held, under the strict, classical view, that because the written agreement appeared complete, the extrinsic evidence could not be considered at all. The dissent argued that the nature and content of the extrinsic evidence should be taken into account in deciding whether to admit the evidence, and how such evidence should guide interpretation. The dissent asked: How can the written agreement be complete if it excludes a term the parties

agreed to?

To eliminate these kinds of disputes, parties may include a term saying that the present writing is the full integration.

## CONDITIONS AND PROMISES

Conditions and promises are two types of contract terms that are important in determining the obligations of parties to a contract. In determining these obligations, it may be necessary to define whether a term is a condition or a promise, and what type, which is not always made clear by the written agreement. This determination may be thought of as part of the process of interpretation and construction. Note that a term of the contract need not be either a condition or a promise. It may be, e.g., a definition.

**Condition:** An event that creates, limits, or discharges an obligation.

**Promise:** An obligation.

**Condition precedent:** A condition that creates a future obligation.

**Conditions concurrent:** Simultaneous conditions that create simultaneous obligations.

**Condition subsequent:** A condition that negates a preexisting obligation.

Note that the distinction between conditions precedent and conditions subsequent is a fine one. The exact same change in obligation may be a condition precedent or a condition subsequent depending on wording. For example, if our contract states, "If it doesn't rain tomorrow, you must wash my car," a lack of rain tomorrow is the condition precedent to your obligation to wash my car. If our contract states, "If it rains tomorrow, you are released from your obligation to wash my car," then the rain tomorrow is a condition subsequent to your release from your obligation to wash my car. The distinction is only important in determining parties' burden of evidence. Assuming you failed to wash my car, in the former case, I would have the burden of proving that it didn't rain. In the latter case, you would have the burden of proving that it did rain.

**Express condition:** A contract term that is articulated as a condition through the use of "conditional language," such as "conditional upon," "subject to," "provided that," etc. A statement like, "Seller will provide a steering wheel cover" is less likely to be interpreted as a condition than, "Buyer's obligations are conditional upon Seller's providing a steering wheel cover."

**Implied condition:** A condition inferred by the court from the facts of the case; based on the intent of the parties.

**Construed condition:** A condition created by the court as a matter of law; based on public policy principles.

**Pure condition:** An event that creates an obligation but is not itself an obligation.

**Promissory condition:** An obligation that, when satisfied, creates another

obligation.

**Pure promise:** An obligation that does not create another obligation.

To illustrate the differences among the above, assume that a contract states, “If it doesn’t rain tomorrow, you agree to wash my car. If you wash my car, I agree to pay you fifty dollars.” A lack of rain tomorrow is a pure condition. You washing my car is a promissory condition. Me paying you fifty dollars is a pure promise.

**Excuse of conditions:** Under some circumstances, an express condition may be excused.

**WAIVER AND ESTOPPEL:**

A waiver is a knowing and voluntary abandonment of a right. It may be made expressly or impliedly. It is one-sided, without anything being received in exchange. If something were received in exchange, consideration would be present and the change would constitute a modification contract. If the right is material, the non-waiving party may not raise waiver as an excuse.

Estoppel comes up when a party abandons a right (it need not be voluntary, it may be careless), and the other party relies on the abandonment to her detriment. The abandoning party is estopped from exercising the condition.

**OBSTRUCTIVE OR UNCOOPERATIVE CONDUCT:**

Performance of a condition may be excused if the other party engages in obstructive or uncooperative conduct. (This has the effect of making the obligations of the obstructive party unconditional.)

**UNFAIR FORFEITURE:**

Courts may choose to excuse performance of a condition if it would result in an unfair forfeiture on the part of the party to perform.

**Burdens of proof:** Generally, the plaintiff has the burden of pleading and proving that all conditions precedent and concurrent with the ripening of defendant’s duty of performance have either been performed or excused. Once this is established, if defendant wishes to rely on the escape possibility provided by any conditions subsequent, she has the burden of alleging and proving the happening of the event that satisfied the condition subsequent as an affirmative defense.

## BREACH

### COMMON LAW BREACH

The doctrine of breach arises when one party is alleged to have failed to perform its obligations under a contract. The court will determine whether the party alleged to have breached has committed a **material breach** or has **substantially performed**. These two things are opposites: a party has always materially breached or substantially performed. To determine that a party has materially breached is to determine that it has not substantially performed.

The distinction is important because if the breaching party has substantially

performed, she may enforce the contract, holding the non-breaching party to her performance (usually payment), minus any allowance for the economic loss of the breach. In contrast, if the breach is material, the breaching party has no claim to damages under the contract. She may only pursue a limited claim under unjust enrichment for the benefits conferred by her part performance.

**Damages:** Note that in order to find for a party claiming breach of contract, there must be damages. A court may find that there was a breach, but no damages, and so the breaching party owes nothing.

**Material breach:** A substantial violation of a contractual obligation, usually excusing the aggrieved party from further performance and affording it the right to sue for damages.

**Substantial performance:** Performance of the primary, necessary terms of an agreement; contract continues with further performance, some damages may be awarded.

**Factors in determining whether a breach is material:** Different authorities present slightly differing lists of factors in determining whether a breach is material. Therefore, consider this a list of some factors that *may* be used.

<sup>35</sup>/<sub>17</sub> Deprivation of expected benefit: If aggrieved party was deprived of a reasonable expected benefit, material breach may be found.

<sup>35</sup>/<sub>17</sub> Adequacy of compensation for loss: To the extent that the aggrieved party may be adequately compensated for their loss, material breach will not be found.

<sup>35</sup>/<sub>17</sub> Part performance: The greater the part of performance that the breaching party has completed, the less likely material breach will be found.

<sup>35</sup>/<sub>17</sub> Likelihood of cure for breach: to the extent that the failing party seems likely to be able and willing to cure the breach, material breach will not be found.

<sup>35</sup>/<sub>17</sub> Willfulness of breach: A willful breach is more likely to be found material.

<sup>35</sup>/<sub>17</sub> Delay in performance: a delay in performance will generally constitute a material breach only if it operates to significantly deprive the other party of the benefit. (Exception: one can write into a contract, "Time is of the essence.")

<sup>35</sup>/<sub>17</sub> Forfeiture: To the extent that the injured party's withholding of performance would cause the breaching party to suffer a forfeiture, or cause undue economic waste, material breach will not be found.

<sup>35</sup>/<sub>17</sub> Good faith: To the extent that the breach comports with good faith and fair dealing, material breach will not be found.

**Divisibility:** If both parties intended to separate the contract into a series of contracts that may be thought of as standing alone, then a breach of one part may be interpreted to not constitute breach of the whole, allowing the breaching party to keep the non-breached parts of the contract in force.

## UCC BREACH

**Breach under the UCC:** The UCC has its own rules for breach that apply to sales of goods. The important difference is that historically, under the perfect tender rule, *any* breach is a material breach. Modernly, courts have interpreted the rule as applying only to “substantial” breaches. Needless to say, the distinction between “substantial” and “material” is a fine one. The two other significant UCC rules for breach, cure and installment contracts, differ little from the common law material breach factors of cure and divisibility.

**UCC Perfect Tender Rule:** If goods fail in any substantial respect to conform to the contract, the buyer may reject them. This constitutes breach, unless the defect is cured. To determine substantiality, the UCC looks to trade usage, course of dealing, and course of performance.

**Cure:** When non-conforming goods are rejected by the buyer, the seller has the right to cure the defect by sending conforming goods within the time for performance, provided she seasonably notifies the buyer of her intent to cure.

**Installment contracts:** An installment contract is a contract calling for separate deliveries. The right to reject is limited. The buyer may reject an installment only if it substantially impairs the value of that installment and cannot be cured. In addition, the buyer may cancel the whole contract if a defect in one installment substantially impairs the value of the whole contract.

## ANTICIPATORY REPUDIATION

**Anticipatory repudiation:** Repudiation of a contractual duty before the time for performance, giving the injured party an immediate right to damages, creating her obligation to mitigate any further damages, and discharging her remaining duties of performance (if the breach is material). The breaching party must have made it clear by her actions or statements that she does not intend to perform. Note that in real life this happens all the time. If we make a contract for anything at all, and then five minutes later I change my mind, I can simply say, “Never mind. I want out.” I intend to breach, sure enough, but I have prevented you from any detrimental reliance, so you have no damages to sue for.

**Materiality:** The anticipated breach, of course, must be either material, or constitute substantial performance. If it is material (or “total”), then anticipatory repudiation excuses the non-breaching party from further performance and gives her the right to sue immediately for damages based on the entire contract. If, on the other hand, the breaching party has substantially performed, then the aggrieved party is not relieved from performing, but may still sue for damages based on the partial breach.

**Words:** The breaching party may make it clear by her own statement that she intends to breach. She may do this because she knows she will breach and repudiation initiates the non-breaching party’s responsibility to mitigate damages. The statement must make it “quite clear” that breach will occur; vague doubts about ability to perform will not do. (However, expression of vague doubts may allow the non-breaching party to request reasonable assurances; the failure to give them will constitute repudiation.)

**Action:** The breaching party may also make her intention to breach clear by her actions. In this case, the non-breaching party may sue for damages immediately.

However, the action must be voluntary, and must make it clear that performance will be impossible, or that there is a prospective inability to perform.

**Retraction:** After the breaching party has repudiated, she may still retract the repudiation before the time of performance, as long as the non-breaching party has not materially altered her position.

Anticipatory repudiation does not apply when the non-breaching party has fully performed.

## REMEDIES

Remedies and damages are the same thing. Contract remedies operate on a compensation principle: they seek to make the aggrieved party whole. Thus, contract damages are compensatory damages. There are no punitive damages in contract disputes, except where there is also a tort involved.

There are two forms damages may take:

**Legal damages:** Money damages.

**Equitable damages:** Court orders such as specific performance or injunctions.

Don't try to find meaning in the words "legal" and "equitable" as they are used here. The names derive from the "courts of law" and the "courts of equity," which had could grant different remedies; the words do not refer to our understanding of what might be legal or equitable in a certain case. The vast majority of all remedies ordered by courts in contract disputes are money damages. Courts will very rarely actually require a party to take or refrain from taking a particular action. This is done only when money damages would be inadequate, for instance when the contract was for something unique, like real estate, or an antique object.

In addition, there are three categories of damages. Judicial remedies serve to protect one or more of the following interests of a promisee: her expectation interest, her reliance interest, or her restitution interest.

**Expectation damages:** Non-breaching party is put in a position as if the contract was performed. Assuming money damages, the amount is measured by the loss in value to the injured party caused by the failure of the failing party, plus consequential and incidental damages, minus any costs she avoided by not having to perform. Though the measurement is of losses *to the injured party*, they must be objectively reasonable. The measurement may refer to the market value of the performance, or to a substitute transaction.

**Reliance damages:** In promissory estoppel or in breach of contract, the promisee is reimbursed for the expenses she incurred in reliance on the promise. Another way to look at it is that the non-breaching party is put back in the position she would be in if the contract was never entered into. In breach of contract, reliance damages are used when expectation damages are too difficult to calculate. Reliance damages can be essential (direct) or incidental (costs incurred in preparing to take advantage of a

benefit expected under the contract). Only essential damages can be recovered traditionally; modernly reasonable incidental damages are permitted.

**Restitution damages:** In unjust enrichment, the party that was not unjustly enriched is reimbursed for value conferred to the party that was unjustly enriched OR in breach of contract, if the aggrieved party is unable to calculate what its expectation or reliance damages would be, it may only be entitled to restitution damages. In addition, in some circumstances of breach, the benefit conferred on the breaching party may be more than the expectation damages, so the non-breaching party would seek restitution damages. Restitution is measured by market value. Direct damages only.

Within the category of expectation damages, there are three types:

**Direct damages:** Damages that naturally flow from the breach of contract.

**Consequential damages:** Damages that are the consequence of breach of contract, i.e. loss of profits, damage to property, etc. Breaching party will be liable for reasonably foreseeable consequences of the breach.

**Incidental damages:** Costs incurred in coping with the breach of contract, i.e. arranging for alternative performance, etc.

There are three tests for the validity of damages, or limitations on recovery:

**Reasonable certainty:** The damages must be reasonably certain. E.g. if you thought the contract was going to make you a millionaire, that's great, but how certain was it?

**Foreseeability:** The consequential damages must be foreseeable. E.g. I failed to repair your car on time and so you missed a meeting where you were going to seal an important business deal. The key is whether you informed me of the importance of the timing when we contracted: this is what makes the damages foreseeable.

**Mitigation:** Post-breach (or post-anticipatory repudiation), the non-breaching party has a duty to mitigate damages to a reasonable degree. Damages that result from the non-breaching party's failure to mitigate are not recoverable.

**Damages under the UCC:** Much of the doctrine of remedies is the same under the UCC as under the common law. Obtaining substitute goods is called "covering."

**Liquidated damages:** A liquidated damages clause in a contract makes certain ("liquidates") the amount of damages in case of breach; this is done because it is expected that damages would be difficult to calculate. For the clause to be enforceable, the amount must be reasonable in the light of the anticipated or actual loss caused by breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable because it would constitute punitive damages. Traditionally, only the estimated loss at the time the contract was entered into was considered in deciding reasonableness; modernly the actual damages are considered. Traditionally, the rule that damages had to be difficult to calculate at the time the contract was entered into was a strict one; modernly, it may be understood to be one aspect of judging the reasonableness of the clause in light of the anticipated loss.

## THIRD PARTIES

Sometimes parties other than the original contracting parties have enforceable rights or duties under a contract.

**Assignment:** After a contract is formed, one party (assignor) may assign her rights under the contract to a third party (assignee), who now has contract rights against the other original party (promisor or obligor). When a right is assigned, the assignor no longer has the right. Most rights are assignable, but there are exceptions. A contract can contain terms limiting or prohibiting assignment. In addition, if the assignment would materially change the obligor's circumstances, assignment is not permitted. Rights to certain personal services cannot be assigned.

When a contract prohibits assignments, any assignment actually made is still valid and the assignor is liable for breach of the agreement not to assign. The right to assign has been given up, but not the power to assign.

Assignments may be oral. Major exception: assignments of land or interests in land: statute of frauds applies.

Gratuitous oral assignments are freely revocable. Gratuitous written assignments (of a simple chose only?) are not revocable.

If no contract presently exists, no assignment can be made. However, a promise to assign one's rights under a future contract, if and when such contract is formed, may still be enforceable: courts may impress a constructive trust on the proceeds from whatever rights were attempted to be assigned.

Homeowner's insurance is usually not assignable when a homeowner sells her home, because the insurer's risks may change depending on who the buyer is.

A contract to buy real estate, when it is contingent on a future mortgage, may not be assigned by the party who will attempt to secure the mortgage, because the other party cannot be forced to accept the assignee's credit risk.

Scholarships are usually not assignable.

Before the obligor learns of an assignment by the obligee, if an obligor and obligee agree in a commercially reasonable manner to a valid modification of the contract, the modification is effective as to the rights which the assignee has acquired against the obligor.

An assignment confers upon the assignee whatever rights the assignor had at the moment of assignment, and only those rights. Thus, if the obligor had any defenses against the assignor at the time of assignment, she also has them against the assignee.

Although an assignment does not imply a warranty that the obligor will perform, an assignment for consideration does imply a warranty that at the time of the assignment, the obligor had no defenses.

**Delegation:** After a contract is formed, one party (delegor) may delegate her duties under the contract to a third party (delegee). The delegor is still ("secondarily") responsible to the original promisee for her contract duties should the delegee fail to perform. However, the delegor has recourse against the delegee for her failure to perform.

Older cases require express assent to the assumption of delegated duties, but

modernly when such delegation is clearly coupled with assignment of rights, the acceptance of the assignment of the rights operates as assent to the delegation of the duty.

Under the UCC, delegation of a duty is reasonable grounds for uncertainty on the part of the party to whom the duty is owed as to whether it will be performed, entitling it to demand reasonable assurances and suspend its own performance until such assurances are received. Failure to furnish such assurances is a repudiation of the contract.

**Novation:** When both parties agree to a transfer of duties, the delegor is completely released from her contractual duties.

A helpful example is that of a sublease. A tenant may sublease her apartment without informing her landlord, provided the lease does not prohibit this. She thereby assigns her rights and delegates her duties to the subtenant. If the landlord doesn't fix the heat, the subtenant can sue her, and the original tenant cannot. But if the subtenant doesn't pay the rent, the landlord can sue the original tenant or the subtenant. If the landlord agreed to the transfer of rights and duties, then this novation would mean that the landlord would have to go after the subtenant for the rent, not the original tenant.

**Third party beneficiary:** A contract may be formed between two parties for the benefit of a third party. A life insurance contract is a common contract with a third party beneficiary. Any intended third party beneficiary can enforce the contract against the promisor. If the third party is expressly named in the contract, that is the most powerful evidence that she is an intended beneficiary. If not, there is a strong but rebuttable presumption that she is not an intended beneficiary. Note that we are talking about the promisor who has made a promise that would benefit the third party.

Note that a party is only a third party beneficiary if the contract calls for performance to be made directly to her. If two people contract and one of them intends to give a gift after performance of the contract, the intended recipient of the gift is only an "incidental" beneficiary of the contract and has no rights.

The general rule is that the original promisor and promisee may modify or rescind the contract, and a donee third party beneficiary has no remedy. However, once her rights have vested, or once she relies on the promise, then she has enforceable rights under the original contract.

Promissory estoppel applies to third party beneficiaries under the Restatement and the modern trend. Thus, a gratuitous promise made for the benefit of a third party which induces reasonable reliance on the part of the intended beneficiary, may be enforced as against the promisor.

**Creditor-beneficiary:** A third party beneficiary who is intended to benefit from a contract between two other people based on an obligation that one of them owes her.

**Donee-beneficiary:** A third party beneficiary who is intended to gratuitously benefit from a contract between two other people.

**Donor-promisor:** One of the two contracting parties, when a contract is for the benefit of a third party. The donee-beneficiary may enforce her rights against this party.

**Donor-promisee:** One of the two contracting parties, when a contract is for the benefit of a third party. The donee-beneficiary has no enforceable rights against this party.