

Chapter 8 – Principles of Contract Law

Contract law deals with the formation and keeping of promises. Although aspects of contract law vary from state to state, much of it is based on the common law. In 1932, the American Law Institute compiled the *Restatement of the Law of Contracts*. This work is a nonstatutory, authoritative exposition of the present law on the subject of contracts and is presently in its second edition.

The Function of Contracts

Promisor—a person who makes a promise

Promisee—a person to whom a promise is made

Contract—an agreement that can be enforced in court; formed by two or more parties who agree to perform or to refrain from performing some act now or in the future.

Types of Contracts

Offeror—

Offeree—

Whether a contract is classified as unilateral or bilateral depends on what the offeree must do to accept the offer and to bind the offeror to a contract.

Bilateral contract—

An example of a bilateral contract is a contract in which one person agrees to buy another's automobile for a specified price. The contract comes into existence at the moment the promises are exchanged.

Unilateral contract—

Example: Joe says to Celia, "If you walk across the Brooklyn Bridge, I will give

you \$10.” Joe promises to pay only if Celia walks the entire span of the bridge. Only on Celia’s complete crossing does she fully accept Joe’s offer.

A problem arises in unilateral contracts when the promisor attempts to revoke the offer after the promisee has begun performance but before the act has been completed. For example, suppose that Roberta offers to buy Ed’s sailboat, moored in Ft. Myers Beach, on delivery of the boat to Roberta’s dock in Pine Island. Ed rigs the boat and sets sail. Shortly before his arrival at Pine Island, Ed receives a cellular phone message from Roberta withdrawing her offer.

In contract law, offers are normally revocable until accepted. Under the traditional view of unilateral contracts, Roberta’s revocation would terminate the offer. The modern view is that once performance has been substantially undertaken, the offeror cannot revoke the offer.

Express versus Implied Contracts

Express contract–

Implied-in-fact contract–

Quasi or Implied-in-Law Contracts

quasi contract–

Executed versus Executory Contracts

Contracts are also classified according to their state of performance.

Executed contract—a contract that has been completely performed by both parties.

Executory contract—a contract that has not as yet been fully performed.

Valid, Void, Voidable and Unenforceable Contracts

Valid contract—a contract that results when elements necessary for contract formation (agreement, consideration, legal purpose, and contractual capacity) are present.

Void contract—a contract having no legal force or binding effect.

Voidable contract—a contract that may be legally avoided (canceled or annulled) at the option of one of the parties. The party having the option can elect to either avoid any duty to perform or to ratify the contract. If ratified, both parties must fully perform their respective legal obligations.

Unenforceable contract—a valid contract rendered unenforceable by some statute or court decision.

Requirements of a Contract

1. Agreement—

Because words often fail to convey the precise meaning intended, the law of contracts generally adheres to the objective theory of contracts. Under this theory, a party's words and conduct are held to mean whatever a reasonable person in the offeree's position would think they meant.

Offer

Three elements are necessary for an offer to be effective:

Once an offer has been made, the offeree has the power to accept the offer. Offers made in obvious anger, jest, or undue excitement do not meet the serious-and-objective test. An expression of opinion is not an offer. Also, a statement of intention is not an offer.

Preliminary negotiations must be distinguished from an offer. A request or invitation to negotiate is not an offer; it only expresses a willingness to discuss the possibility of entering into a contract. An invitation to submit bids is not an offer. The bids that contractors submit are offers. In general, mail-order catalogs, price lists, and circular letters are treated not as offers to contract but as invitations to negotiate. On rare occasions, courts have construed advertisements to be offers because the ads contained such definite terms.

Definiteness—this is the second requirement for an effective offer. An offer must have reasonably definite terms so that a court can determine if a breach has occurred

and give an appropriate remedy. Definiteness is also required when a contract is modified.

Communication—this is the third requirement for an effective offer. Suppose that Tolson advertises a reward for the return of her lost cat. Dirlik, not knowing of the reward, finds the cat and returns it to Tolson. Ordinarily, Dirlik cannot recover the reward, because an essential element of a reward contract is that the one who claims the reward must have known it was offered.

The communication of an effective offer to an offeree gives the offeree the power to transform the offer into a binding, legal obligation by an acceptance. This power of acceptance can be terminated by action of the parties or by operation of law.

An offer can be terminated by the action of the parties in any of three ways:

Unless an offer is irrevocable, the offeror usually can revoke the offer as long as the revocation is communicated to the offeree before the offeree accepts.

Revocation—

Revocation may be accomplished by express repudiation of the offer or by performance of acts inconsistent with the existence of the offer,

The offer may be rejected by the offeree. As with revocation, rejection of an offer is effective only when it is actually received by the offeror.

Counteroffer—

Suppose that Burke offers to sell his home to Lang for \$170,000. Lang responds, “Your price is too high. I will pay \$165,000 for your house.” Lang’s response is a counteroffer. At common law, the mirror image rule requires that the offeree’s acceptance must the offeror’s offer exactly.

The offeree’s power to transform an offer into a binding, legal obligation can be terminated by operation of law if any of 4 conditions occur:

1. Lapse of time—

2. Destruction of the subject matter–

3. Death or incompetence of the offeror or offeree–

4. Supervening illegality of the contract–

Acceptance

Acceptance is a voluntary act by the offeree that shows assent to the terms of the offer. The offeree's act may consist of words or conduct.

To exercise the power of acceptance effectively, the offeree must accept unequivocally. Certain terms, when added to an acceptance, will not qualify the acceptance sufficiently to constitute rejection of the contract.

In a bilateral contract, communication of acceptance is necessary. Communication of acceptance is not necessary if the offer dispenses with the requirement. In a unilateral contract, notification is usually unnecessary because acceptance requires full performance of some act.

Mode and Timeliness of Acceptance

The general rule is that acceptance in a bilateral contract is timely if it is effected within the duration of the offer. Problems arise when the parties involved are not dealing fact to face. In such cases, the offeree may use an authorized mode of communication. Acceptance takes effect at the time the offeree sends the communication via the mode expressly or impliedly authorized by the offeror.

Mailbox rule–

2. Consideration

Consideration is usually defined as the value given in return for a promise. Consideration is broken down into two parts:

The “something of legally sufficient value” may consist of (1) a promise to do something that one has no prior legal duty to do, (2) the performance of an action that one is otherwise not obligated to undertake, and (3) the refraining from an action that one has a legal right to undertake.

The second element of consideration is that it must provide the basis for the bargain struck between the contracting parties. The consideration given by the promisor must induce the promisee to incur a legal detriment either now or in the future.

Legal sufficiency of consideration involves the requirement that consideration be something of value in the eyes of the law. Adequacy of consideration involves “how much” consideration is given. Adequacy concerns the fairness of the bargain. Courts do not question the adequacy of consideration if the consideration is legally sufficient.

Under most circumstances, a promise to do what one already has a legal duty to do does not constitute legally sufficient consideration because no legal detriment is incurred.

Promises made in return for actions or events that have already taken place are unenforceable.

If the terms of the contract express such uncertainty of performance that the promisor has not definitely promised to do anything, the promise is said to be illusory.

Sometimes individuals rely on promises, and such reliance may form a basis for contract rights and duties. Under the doctrine of promissory estoppel, a person who has reasonably relied on the promise of another can often hope to obtain some measure of recovery. The four elements of promissory estoppel are:

3. Capacity

Contractual capacity–

Minors usually are not legally bound by contracts. In almost all states, the age of majority for contractual purposes is 18. The general rule is that a minor can enter into any contract an adult can, provided that the contract is not one prohibited by law for minors.

For a minor to disaffirm a contract, he or she need only manifest an intention not to be bound by it.

Disaffirmance–

Note that an adult who enters into a contract with a minor cannot avoid his or her contractual duties on the ground that the minor can do so.

All states permit minors to disaffirm contracts, with certain exceptions, including executed contracts. States differ on the extent of a minor's obligations on disaffirmance. Courts in a majority of states hold that the minor need only return the goods subject to the contract. A minor who enters into a contract for necessities may disaffirm the contract but remains liable for the reasonable value of the goods.

Ratification–

Another situation in which contractual capacity becomes an issue is when a contract is formed by a person who claims to have been intoxicated at the time the contract is made. The general rule is that if a person who is sufficiently intoxicated to lack mental capacity enters into a contract, the contract is voidable at the option of the intoxicated person. Generally, contract avoidance on the ground of intoxication is rarely permitted.

If a person has been adjudged mentally incompetent by a court of law any contract made by the person is void. If a mentally incompetent person not previously so adjudged by a court enters into a contract, the contract may be voidable if the person does not know he or she is entering into the contract or lacks the mental capacity to comprehend its nature, purpose, and consequences.

A contract must be formed for a legal purpose to be enforceable. A contract to commit a tortious or criminal act or an action that is contrary to public policy is illegal

and unenforceable.

Examples

Contracts in restraint of trade usually adversely affect the public, which favors competition. An exception is recognized when the restraint is reasonable and it is ancillary to (is a subsidiary part of) a contract, such as a contract for the sale of a business or an employment contract. Many such exceptions involve a type of restraint called a covenant not to compete or a restrictive covenant. Covenants not to compete are often contained in contracts concerning the sale of an ongoing business.

Ordinarily, a court does not look at the fairness or equity of a contract; in other words, it does not inquire into the adequacy of consideration. In certain circumstances, bargains are so oppressive that the courts relieve innocent parties of part or all of their duties. Such a bargain is called an unconscionable contract.

Unconscionable contract—

Adhesion contract—

Exculpatory clause–

Exculpatory clauses may be enforced when the parties seeking their enforcement are not involved in businesses considered important to the public interest. These businesses have included health clubs, amusement parks, horse-rental concessions, golf-cart concessions, and skydiving organizations.

In general, an illegal contract is void. There are exceptions to the general rule that neither party to an illegal bargain can sue for breach and neither can recover for performance rendered:

1–justifiable ignorance of the facts–

2–members of protected classes–

Defenses to Contract Formation or Enforceability

Lack of genuine assent is a defense to the enforcement of a contract.

Genuineness of assent may be lacking because of mistake, fraudulent misrepresentation, undue influence or duress.

Mistakes

Courts distinguish between mistakes as to judgment of market value or conditions and mistakes as to fact. Only the latter normally have legal significance.

Mistakes occur in two forms—unilateral and bilateral. A unilateral mistake involves some material fact. In general, a unilateral mistake does not afford the mistaken party any right to be relieved from the contract. When both parties are mistaken about the same material fact (or mutual mistake), the contract can be rescinded by either party.

Fraudulent Misrepresentation

When an innocent party consents to a contract with fraudulent terms, the contract usually can be avoided, because he or she has not voluntarily consented to the terms. Typically, there are three elements of fraud:

Undue Influence

Undue influence arises from relationships in which one party can greatly influence another party, thus overcoming that party's free will. Minors and elderly people are often under the influence of guardians. Thus, they may be unduly influenced by an inscrupulous guardian. Undue influence can arise from other relationships such as attorney-client, doctor-patient, parent-child, etc.

Duress

Assent to the terms of a contract is not genuine if one of the parties is forced into the agreement. Forcing a party to enter into a contract because of the fear created by threats is duress. A party who signs a contract under duress can choose to carry out the contract or to avoid the entire transaction.

The Statute of Frauds—Requirement of A Writing

Statute of frauds—

Under the statute of frauds, a contract involving an interest in land must be evidenced by a writing to be enforceable. Also, a fixture (personal property so affixed or so used as to become a part of the real estate) is treated as real property.

Contracts that cannot, by their own terms, be performed within one year from the day after the contract is formed must be in writing to be enforceable.

A collateral promise or secondary promise is one that is ancillary to a principal transaction or primary contractual relationship. A collateral promise is one made by a third party to assume the debts or obligations of a primary party to a contract if that party does not perform. Any collateral promise of this nature falls under the statute of frauds.

The Uniform Commercial Code requires that an agreement involving the sale of goods worth \$500 or more to be in writing to be enforceable. The writing must be signed by the person against whom enforcement is sought.