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Contract Law

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THE AGREEMENT PROCESS

Contract Law is a body of rules which deal with agreements made between people. These rules have been developed by our society for the purpose of protecting both individuals and the society as a whole from the difficulties which arise when people fail to live up to their obligations.

A contract is an agreement which will be enforced by a court of law in a peaceable and lawful manner. There are a number of requirements which must be satisfied before an agreement becomes a contract. If all of them are not satisfied, the agreement is not legally enforceable. A contract is a serious obligation. Each party must perform his part of the bargain or face the possibility of being sued. One of the reasons for having rules to follow when making a contract is to ensure that both parties realize that they are making a legally binding agreement, and not mere promises. The formalities of making a contract serve as a warning to be careful.

Some agreements are not legally enforceable even though all of the requirements may have been satisfied. The simplest example of this type of agreement is an agreement to perform an illegal act. There is no such thing as a contract to rob a bank.

At the heart of every contract is a "bargained-for exchange", which means that two persons bargain with each other until they agree to an exchange. The most common exchange is of goods for money. The exchange itself is not the contract. The contract is the agreement to make the exchange, and the exchange is the "performance" of the contract. The exchange can also be of money or goods for a promise. When you buy something at a store you are exchanging money for the clerk's promise to give you the goods. It is also possible to exchange nothing but

promises, as when you promise to pay a mechanic and he promises to fix your car.

Why should society be interested in enforcing an agreement between two individuals? Consider the following situation. Rod owns a small factory which manufactures plumbing fixtures. Dale is a building contractor who is preparing to build a housing development. Rod makes the lowest bid for the plumbing fixtures to be used in Dale's housing project. They make a contract which requires Rod to deliver enough fixtures for two houses every day for three months. Dale has enough plumbers to install all of the plumbing in two houses each day, and this contract will give them all the materials they need without forcing Dale to rent a warehouse for storage of surplus fixtures. Dale begins to build the houses, and simultaneously starts to sell them. He is operating on a very tight schedule. Two houses must be completed each day. Dale has contracts with many other suppliers who must also deliver their materials at certain specific times. All of the contracts are interrelated and depend upon everyone's cooperation.

Everything goes smoothly and Dale's housing development is on schedule, until Rod begins having trouble at his factory. A machine breaks down, and it takes all afternoon to fix it. The following day Rod delivers enough plumbing for only one house, which results in Dale's entire project being thrown off schedule by a half a day. All the workers then lose a half day's work, while all of the other suppliers have to bring their materials at different times and reschedule their entire operation. What at first appears as a simple problem between Rod and Dale can eventually affect the welfare of many.

This undesirable result could have been prevented. Rod's contract could have required that he inform Dale whenever a problem affecting their agreement arose. If such were the case, Rod could have warned Dale that he would only be able to deliver enough fixtures for one house the next day and the contract could then have allowed Dale to buy the rest of the fixtures somewhere else, billing Rod for any extra cost. In this way, the problem might have been avoided and Rod would have lost one day's profits rather than put many people out of work for half a day.

The foregoing demonstrates how important it is for people to abide by their agreements. Society, realizing this need, has developed rules governing the making and enforcing of agreements—the rules of Contract Law. The most important of these rules concerns determining when a binding agreement exists. Some of the other rules help determine what exactly is included in the agreement, and what will happen if problems

occur. By making rules which regulate how contracts must be made and how they may be enforced, society has provided an orderly means to make formal agreements and to settle disputes arising from those agreements.

FORMATION OF THE CONTRACT

Imagine that the bell has just rung, and that while everyone is leaving the classroom the teacher says, "I'll pay each of you five dollars if you read your assignment for tomorrow". What would you do? Imagine further that most of you read your assignment and come to class the next day ready to collect your five dollars. The teacher enters, but before anyone can demand their money she says, "I've changed my mind, and I'm not going to pay anyone". Should she have to pay? Is she legally obligated to pay? Outline briefly the reasons why you think she should pay. Look at your list of reasons. Are they "legal" reasons, or are they "moral" reasons? What is the difference?

This problem involves the creation of a contract. If a contract had been formed, then it would be legally enforceable, and a court would order the teacher to pay. If a contract was not formed, there would be no legal way the students could collect.

Think again about the teacher's statement "I'll pay each of you five dollars if you read your assignment for tomorrow". The teacher offered something you wanted in exchange for something she wanted, and later she attempted to back out of the trade. Would it have been permissible for the teacher to back out before you read the assignment? If everyone had laughed when the teacher offered to pay, saying they didn't believe her, could she have changed her mind? If only a few people said that they would do it, should she have to pay anyone else who read the assignment?

These questions deal with the concepts of "offer" and "acceptance".

The teacher made an offer. She was indicating her desire to enter into an agreement on certain terms, and unless the offer is accepted there can be no contract. Why is an acceptance necessary? What if the teacher had offered to take five dollars from everyone who did not read their assignment? Should an acceptance be required then?

THE OFFER

An offer must satisfy certain requirements before its acceptance creates a contract. First, the *offeree* must believe that the *offeror* intends to make an offer. If the offer seems reasonable to the offeree, it makes no difference that the offeror didn't really mean it. For example, suppose John decides to play a trick on Henry and offers Henry $50 for the pants Henry has on, showing him a check for that amount. Henry has been out of work for six months and needs the money, so he agrees and quickly starts to take off his pants. John laughs and tears up the check. Can Henry go to court and make John pay? Do John and Henry have an enforceable contract? Was there both an offer and an acceptance?

If Henry had actually believed that John was serious, the agreement would be legally enforceable. But if Henry had known that John was joking, Henry couldn't enforce the contract. Why do you suppose that an offer can be enforced even when it is just a joke? If the reason is to prevent people from making offers they don't mean, why should it make any difference whether or not Henry knows about the joke?

Dressed in old clothes, Betty, a wealthy singer goes to her local Jaguar dealer. She points to a $10,000 car and asks "how much?" The salesman thinks she is wasting his time and replies, "For you, $2,000". He assumes his humorous reply does not matter since she obviously has no money. Betty, however, reaches into her jeans and pulls out two thousand dollar bills. The salesman refuses to sell her the car and she sues to enforce the agreement. Does Betty win? Should she win? Do you think she believed that the salesman was serious about his offer? What difference would it make? If Betty reasonably believed the salesman was serious, she would win.

Another requirement for a valid offer is that its terms must be definite and certain enough that both parties know what to do and what to expect the other party will do. There should be no room for misunderstanding. Suppose Simon agrees to buy Bill's car, paying "$100 now and then some every week". The next week he gives Bill $2.50. Can Bill go to court and force Simon to give him more? What arguments could be

made on each side? Would the court be able to decide what the parties had intended when they made the contract? Since the terms of the contract are so uncertain, it is not possible for the court to determine how much should be paid each week. The court would probably either nullify the contract and have each party give back what he had gotten, or simply decide what weekly payment was fair under the circumstances and require Simon to pay that amount.

A common problem arises when a store advertises an item at a low price, and then either refuses to sell it at that price or claims they are "sold out". Emily sees an ad in a newspaper for a sewing machine at the incredibly low price of $26. She is first in line waiting for the store to open in the morning, and when the door is unlocked, she hands the salesman her money and demands the machine. He replies that the machine is not for sale. Can Emily enforce the agreement? Was there an offer and an acceptance? There is a rule that ordinary advertisements are not offers but merely requests for offers, because ads are generally not definite and certain as to the terms of the agreement. Emily made an offer which the store refused, and there is no contract to enforce. There are laws in some states which prevent stores from falsely advertising their products.

Do you think that a court should refuse to enforce an agreement which is uncertain or try to clarify it? Courts generally prefer not to re-write a contract and are primarily concerned with finding the "intent of the parties" at the time the offer was made. A court will say that no contract exists only when it cannot determine what the parties originally intended.

THE ACCEPTANCE

Think back to the teacher who offered everyone $5 to read their assignment. How did the class react? That reaction is important because the actions of the class determine whether or not there has been an acceptance of the teacher's offer. An acceptance may take many forms, but it must be recognizable to the offeror that it is an acceptance. If the teacher doesn't think that there has been an acceptance, and if there is no reason why she should think that one has been made, there can be no contract. Remember, a contract requires both a good offer and a good acceptance.

Assume that George owns an appliance store. One day the railroad delivers a carload of refrigerators to him. George did not order the

refrigerators, and has no idea why they came. What should he do? May George keep the refrigerators and refuse to pay for them? A court of law would probably decide the problem by stating that the shipment of refrigerators was an offer to George which he could either accept or refuse. If he takes the refrigerators he has accepted them, and must pay for them. When George takes the refrigerators, he has made an *implied promise* to pay for them. The opposite of an implied promise is an express promise. George would make an express promise if he either said or wrote, "I promise to pay for these refrigerators". A court considers many kinds of actions to be implied promises to pay. For instance, when you eat in a restaurant, you have made an implied promise to pay the bill. When you go to a gas station and say "fill it up" you have made an implied promise to pay for the gas.

Suppose you receive a book in the mail which you did not order. A letter with the book says you must return the book in ten days or pay for it. Since it costs 50 cents to send the book back, you refuse. Later a bill for the book comes. Must you pay the bill? Have you "accepted" the book? This is a special case. The rule is that an offer cannot hold silence equal to acceptance. In this case there would be no acceptance, and therefore no obligation to pay for the book. Some states now have laws which provide that unrequested merchandise received by mail may be treated as a gift. The item may be kept without making any payment in return.

Next door to your house there is a lot which is overgrown with weeds. The owner of the lot lives in another town. You write to him and offer to cut the weeds for $10. He writes back, "I accept your offer to cut my weeds for $10. Don't leave the clippings lying around". It would take a truck to haul the clippings away and you never intended to remove them. Can you refuse to perform? Can you rent a truck and send the man a bill for it? Can you cut the weeds and leave the clippings? When an acceptance *varies the terms of the offer* it is not considered an acceptance, but a *counteroffer.* It is the same as saying, "no, I don't like your offer but I'll make you an offer". The lot owner's reply added a term about not leaving the clippings lying around which was not in the original offer. Therefore the reply amounted to a counteroffer which you can either accept or refuse. Going ahead and cutting the weeds would be an "implied" acceptance of the offer by performance. You can accept an offer by doing what is asked or by saying you agree to do it. If you accept a counteroffer, you are obligated to perform all of it according to its terms.

HOW LONG IS AN OFFER EFFECTIVE?

When a counteroffer is made the original offer can no longer be accepted unless it is made again. If you tell the owner of the lot that you will charge $25 if he wants the clippings hauled, he cannot say, "O.K., just cut the weeds for $10", and then try to enforce the agreement. The original offer is no longer in effect and therefore cannot be accepted.

It is often difficult to sort out which offers are still in effect and which are not, but it is very important to follow an offer through and make sure that it is still effective at the time it is accepted. Otherwise there is no contract. Remember that a legally enforceable contract must have both a good offer and a good acceptance.

Suppose Lee says to you, "I'm tired of these phonograph records. I'll sell them to you for $10". You reply that you like the offer and will let him know. Three weeks later you go to Lee with the $10, but he refuses, saying, "I'm not tired of them anymore". Can you enforce the deal? Lee didn't specify how long his offer would be effective. How long should he keep the offer open? Courts say that in the absence of a stated time, an offer remains open for a reasonable length of time. How long would be a reasonable length of time in this case?

There are circumstances which terminate offers, such as the death of the person who made the offer, the destruction of the subject of the proposed contract, or a change in the law which makes the proposed contract illegal. For example, if someone offers to sell you his car, and then wrecks it before you give your answer, the offer is terminated. If you were offered a job in a fireworks stand, and the city subsequently rezoned the area so that the stand is illegal, the offer is terminated.

An offer is also terminated when the offeror *revokes* it. This is "revocation", which means that the offeror takes back the offer, and it can no longer be accepted. When the terms of an offer are unacceptable for any reason, the offeree can reject the offer. This "rejection" means that the offeree refuses to accept the offer. Rejection also ends an offer. If the offeror wants to form a contract with that particular offeree, the offeror must then make a new offer. The original offer is useless because the offeree has shown that he or she is not interested in it. The terms "revocation" and "rejection" can be confusing. Remember that the person who makes the offer revokes it, and the person to whom the offer is made rejects it.

PROBLEMS IN COMMUNICATION

Ron receives a letter in the mail from an auto repair shop which says, "For ten days only you can get a complete tune-up for only $10". He leaps into his car, and drives to the shop. When he arrives, he asks for the $10 tune-up. The manager says that the offer was open for ten days, and it expired several days earlier. Ron checks the letter and discovers that it is dated fifteen days earlier. Can Ron demand the $10 tune-up? In most states an offer sent by mail is good until received and the offeror takes the risk that it will be delayed in the mail. But if the offeree knows of the delay, or should know of it, then the offer can be accepted only within the time originally specified in the offer. Should Ron have realized that the offer had expired? In some states, however, an offer by mail runs from the time it should have been received, in which case Ron would be out of luck.

A few weeks later Ron gets another letter from the same shop advertising a complete brake job for only $40. Ron carefully checks the date and finds that the offer is still good, and that it requires sending a postcard to make an appointment. What is the purpose of the postcard? What is its legal significance? Ron quickly mails the postcard. The following day he receives another letter from the shop revoking the offer. Illness of the mechanic who was supposed to do the work is the reason given for the revocation. Can Ron enforce the contract? Surprisingly, he can in most states. The general rule is that an acceptance to a mailed offer is effective when the acceptance is mailed. As soon as Ron dropped the postcard in the mailbox he had an enforceable contract for a $40 brake job. Some states maintain that a revocation is also effective at the time it is mailed, in which case Ron would have to prove that he mailed his acceptance before the shop mailed its revocation. In any event, if Ron had received the revocation before he mailed his acceptance, there would be no contract, because the offer would have been legally revoked.

AGREEMENTS NOT INTENDED TO HAVE LEGAL EFFECT

Some agreements are not intended to have legal effect. For example, suppose John's father says, "John, if you get all A's on your report card I'll buy you a tape recorder". John studies very hard and gets all A's. Unfortunately, the strain of studying so hard exhausts John and while driving the family car home to show everyone his report card he runs a red light and almost hits a police car. After his father pays the fine on

John's traffic citation he says to John, "You can forget about that tape recorder". Can John go to court and enforce his father's promise? Should he be able to? Should someone be able to sue a member of his immediate family for breaking a promise? Generally, courts do not allow family members to sue each other. The reason given is that the parties did not intend for the promise to be legally enforceable. Does this sound like a good reason? Courts also say that if family members could sue one another, a flood of lawsuits would result. Does this seem like a good reason? Would there be more lawsuits?

Robert invites Carol to a formal dance, and she accepts. He buys the tickets, rents a tuxedo, and buys a corsage. When he arrives at her house to pick her up she says she does not want to go. Can Robert sue her for the cost of the tickets, tuxedo and corsage? Did the parties intend their agreement to be legally enforceable? Should it matter? Would it be better if the court decided in each case whether the parties intended to form a legal contract, and then either enforce the agreement or not on that basis? Generally courts feel that social promises should not be legally enforceable. Should they be?

MISTAKE

After a contract has been formed, the parties may often discover that they were mistaken about the object upon which their contract was based. Suppose Mary's aunt gave her a new typewriter for graduation. Mary tells you that she doesn't know what to do with the typewriter since her parents bought her one two years ago. On the following day you offer to buy Mary's typewriter. She is very pleased with the offer and agrees to sell it for $75. You think this is a very good buy since you know her aunt must have paid over $100. You borrow the money from your grandparents and go to pick up the typewriter. Mary gives it to you, but when you get home you discover that she has given you her old one. You go back to exchange it, but she refuses, saying she never intended to sell the new one. You tell her that you never intended to buy the old one. Mary then refuses to give you your money back. Can you force her to give you the new typewriter? Since you were both mistaken about the item bargained for, it would not be fair to force either of you to take something you had not expected. A court will refuse to enforce the contract because both of you were mistaken about the subject matter of the contract at the time the agreement was made. You get your money back and return the typewriter to Mary.

This rule regarding mutual mistakes applies only if the mistake is about the "substance" of the contract. The substance of the contract is the primary or most important item or fact upon which the contract is based. In this case the typewriter is the most important item in the contract, and the mistake concerns the typewriter. If both parties are mistaken about an unimportant aspect of the contract, a court will either fix the error or ignore that part of the contract.

A little girl finds a pretty rock and takes it to a jeweler. The jeweler doesn't think the rock is worth anything, but the little girl is cute so he gives her a dollar for the rock, thinking he can polish it up and do something with it. The stone turns out to be an uncut diamond worth $900. The girl's parents claim that there was a mutual mistake and want the diamond returned in exchange for the dollar. How would a court resolve this issue? The girl and the jeweler bargained for a pretty rock. Neither one of them expected the rock to be anything but what it appeared to be. Was there a mistake? The only mistake possible is if the rock was really ugly, or not a rock at all. In this case the jeweler simply had a stroke of good luck. Would it be fair to make the jeweler give back the stone? When both parties knowingly take a chance, there is no mistake if one of them gets lucky.

A famous case involves Rose the Cow. Rose is a prize winning cow, but she is growing old and has not had a calf for years. Since an old and barren cow is not worth much, the farmer sells her for $80. The buyer later discovers that Rose is pregnant and is now worth $800. The farmer claims mutual mistake and sues. Does the farmer get Rose back? The bargain was for an old and barren cow. Both the farmer and the buyer believed and expected that Rose was unable to bear a calf. Since Rose is pregnant, the farmer and the buyer made a mutual mistake concerning the substance of the contract. It is the same as if they had bargained for one cow and a different cow had been delivered. Can you see the difference between Rose and the pretty rock? In Rose's case a basic assumption was made, and that assumption turned out to be mistaken. In the pretty rock case no basic assumption about the rock was made. Would it be different if Rose becomes pregnant after she was sold? If such were the case couldn't the buyer claim that he took a chance and got lucky?

What happens when only one party makes a mistake? A common situation is that of a general contractor taking bids from subcontractors on part of a construction job. If the bidder adds incorrectly or forgets to include necessary items in the bid, should that person suffer for the mistake? Should it be permissible to submit a low bid which is accepted,

and then claim a mistake was made and the job will require more money?

Richard mows lawns to make money during the summer, and offers to mow a lawn for $3. When Richard is half done he says, "I am afraid I misjudged the size of your lawn, and I'll have to have $5". Must Richard finish the job for $3? If the homeowner demands that Richard finish and Richard refuses, can the homeowner make Richard pay to have someone else finish the job? It is a general rule that when only one party to the contract makes a mistake, that person must still carry out the obligation according to the original terms. Does that seem fair? The reason for this rule is that a mistake is not an excuse for the mistaken party to be relieved of the obligation to perform the contract. The other party expects performance of the contract, and may base other plans on that expectation. If this were not the rule, one could always claim a mistake had been made even though this may not be true, and either demand more money or to be excused from performing their part of the contract. Does the rule seem fair now?

MINORS CONTRACTS

Suppose Zack signed a contract when he was 17 years old. Shortly after he turns 18, Zack tells the other party to the contract that he refuses to perform his part. Can Zack do this? Isn't he obligated to perform because of the contract?

In order to prevent people from taking advantage of a minor's lack of knowledge and experience, the law prevents minors from making certain contracts, and allows minors to nullify other contracts. For example, in California a minor cannot make a contract to buy or sell land. If such a contract is made, it is void, that is, without legal effect. Most other contracts made by minors are "voidable", which means the contract is valid when made, but can be nullified by the minor either before or within a short time after reaching the age of majority. If, within this time period, the minor does not nullify the contract, then it is binding and remains effective. Thus Zack can refuse to perform the contract.

When a minor nullifies a voidable contract or makes a void contract, the minor must return any items received under that contract. If Zack's contract were to buy a new trumpet, paying $5 a month for one year, and after two months he voids the contract, Zack must return the trumpet to the seller. Only when the trumpet has been returned is the seller obligated to return the money which Zack paid.

CONSIDERATION

BARGAINED-FOR EXCHANGE

When the teacher offered the class money for reading their assignment, what did she want? Was she bargaining for something? Generally, when a person makes a contract it is to obtain something another person has in return for something the other person wants. A contract says, "I want that, and you want this, so we will trade". This exchange of items is called *consideration,* and is the third requirement for the formation of a valid, enforceable contract. In addition to a valid offer and a valid acceptance, there must be a bargained-for exchange, or consideration, before a contract is created.

The consideration can be an exchange of a promise for a promise. For example, "I promise to take you to school every morning if you promise to mow my lawn once a week". The exchange can also be of a promise for some performance, or a *forbearance*—"If you mow the lawn, I promise to pay you $2.00", or "if you don't play your electric guitar while I'm home, I'll raise your allowance". A helpful way to decide whether consideration is present is to find a detriment to the offeree. A "detriment" is a requirement to do something you did not have to do before, giving up a right which you otherwise would have been able to exercise, or giving up some property which you otherwise had a right to possess. Can you find the detriments in the examples just given?

Deciding whether or not there is consideration in a given case is not as easy as it might appear. There are many special rules which apply only in particular situations. For example, Dan owed money to Pete and is very slow about paying it. Pete tells Dan that if he pays the debt quickly,

he won't have to pay the interest. Dan quickly pays, but Pete sues him for the interest anyway. Can Pete win? Yes, he can win because of the "pre-existing duty rule". This rule states that a duty already owed cannot act as consideration for a new promise. Pete offered to forget about the interest, and Dan accepted the offer, but there was no bargained for exchange because Dan did not give Pete anything that Pete did not already have. Dan already owes Pete the money. Unless there is an offer, acceptance, and bargained-for consideration there can be no contract. Since there is no new contract, Dan still owes Pete the interest according to the original contract. Does this pre-existing duty rule seem like a good rule? Would it be better to let a contract be created when only one person gives up something?

Here is another example of the pre-existing duty rule. Bob is building a house, and hires Jack to dig the basement. When he is half finished with the basement Jack says, "This job is much harder than I though, so I'll have to have more money to finish". It would take Bob a long time to get someone else to dig the basement, so he tells Jack to go ahead. When the job is done, Bob refuses to pay the extra money. Can he do this legally? There is a good chance that he can. Since Jack is already obligated to dig the basement, he exchanges nothing for Bob's promise to pay more money. Remember when you are trying to decide if there is a valid contract make sure that there is an exchange of something.

Sam owes Gene $5,000. Gene is in no hurry to get the money back, even though it is past due. Sam, who has been having trouble with his business, finally goes bankrupt. Sam's creditors, including Gene, get 5¢ for each dollar Sam owed them. Sam feels very bad about hurting his old friend Gene, and so he writes to Gene and says, "Don't worry Gene, I'll pay you back as soon as I can". Two weeks later Sam wins the Irish Sweepstakes. But Sam forgets about his promise to repay Gene, and Gene sues Sam for the money. Can Gene win? Is there consideration for Sam's promise to pay? While there is no bargained-for exchange, there is a special rule which applies in cases like this. When a person's debts are cleared in *bankruptcy,* they are no longer enforceable by law. However, courts recognize that a moral obligation to pay old debts still exists. When the moral obligation exists, and a new promise to pay the debt is made, these two factors take the place of consideration and an enforceable contract to pay the debt is created. Sam would have to repay Gene.

Compare this next example with the case of Sam and Gene. Frank owes Nancy a lot of money. Frank is about to file bankruptcy, but he does not want to hurt Nancy. Frank tells Nancy that he is going into

bankruptcy, but that he will pay Nancy the money he owes her. After the bankruptcy, Nancy grows impatient and sues Frank for the money. Can she collect? In order to satisfy the consideration requirement, the moral obligation must exist at the time of the promise. Since Frank had not filed for bankruptcy when he promised to pay Nancy, no moral obligation existed. Nancy loses. These bankruptcy cases are used to illustrate contract principles, not bankruptcy principles. Bankruptcy is very complex, and is a legal specialty itself.

Another special rule is illustrated by cases where one person rescues another, and then the person who is saved promises to repay his rescuer. Since the rescue is over, it is *past consideration,* and past consideration is not good. The reason for this rule is that there can be no bargain for something which has already been given. In order for consideration to be effective it must come when the contract is formed. For example, Gordon beats his wife. She runs to a neighbor's house. Gordon follows her and begins beating her again. Gordon's wife grabs an ax and hits him with it, knocking him down. She then swings the ax at him, and would surely kill him, but the neighbor grabs the blade of the ax. As a result the neighbor's hand is mutilated. Gordon is very grateful to the neighbor for saving his life, and promises to pay all the neighbor's medical bills. When he does not pay the bills the neighbor sues. Does the neighbor win? Since Gordon did not ask the neighbor to save his life, there is no bargained for consideration and the neighbor loses. Is that fair? Didn't a moral obligation exist at the time the promise was made? Couldn't the court say Gordon had a moral obligation to pay the bills?

Suppose Alfred owes money to Simon, and is unable to pay it when the time comes. Alfred asks Simon to extend the time, and Simon says, "All right, if you will pay me more interest, I won't demand my money until I want it". Alfred is very grateful and agrees. If Alfred refuses to pay the extra interest, can Simon go to court and win? What did Simon actually promise? Couldn't Simon have asked for his money immediately? Yes, he could. Thus Alfred didn't receive anything he did not already have. Simon's promise is called an *illusory promise.* When there is an illusory promise, there is no consideration.

PROMISSORY ESTOPPEL

Sadie worked in a factory for forty years. On the day she retires the boss gives her a paper which says, "In consideration of forty years of faithful service I hereby grant Sadie a pension of $15 a week". Sadie did

not expect the pension, and is very grateful. Between the pension and social security she is able to live comfortably. Sadie had planned to work part-time after her retirement to supplement her income, but because of this unexpected pension she turns down the job offer which she originally intended to accept. Five years later the boss dies and his widow takes over the business. She does not like paying Sadie for doing nothing, and finally stops making the payments. Sadie sues. Does she win? Was there consideration given after the promise, or was it "past consideration"? According to what you have read so far in this unit, Sadie loses. Wouldn't that be unfair? To prevent this kind of unfairness courts developed the doctrine of "promissory estoppel". Essentially this doctrine means that you cannot break a promise if doing so causes injustice. Before a court applies the doctrine it must be shown that there was a promise, reliance on the promise (in this case Sadie's refusal of the part-time job was the reliance), and the only way to avoid injustice is to enforce the promise.

Another situation in which the doctrine of promissory estoppel is used occurs when someone promises to make a gift, and then reneges on the promise. For example, since Don's uncle wants him to grow up "right", he promises to give Don $5,000 on his 21st birthday if Don doesn't smoke, drink, swear or gamble before that time. Don accepts the challenge. He plans to use the money to pay his way through law school, and he does not work while he is going to college. Thus Don has no savings. When the time for payment comes, Don's uncle claims bad luck in the stock market and refuses to pay. Don sues. Is there consideration? Some courts say that not smoking or drinking is a detriment. The court might possibly find consideration, but it would be difficult to fight the case on those grounds. It is much easier to use promissory estoppel. Don's uncle made a promise, Don relied on the promise, and if the promise is not enforced there will be an injustice. Any time you cannot find consideration, or a valid offer and acceptance, try for promissory estoppel. Either promissory estoppel or a valid offer, valid acceptance, and consideration will mean that the promise is legally enforceable.

THE STATUTE OF FRAUDS AND THE PAROL EVIDENCE RULE

When you first began reading about contracts you probably thought a contract had to be in writing, and that if it wasn't written it couldn't be enforced. By now you should have changed your mind on that. However, some contracts must be written in order to be legally enforceable, and these are listed in the Statute of Frauds.

The first such statute was passed by the English Parliament in 1677. Its purpose was to prevent *fraud* and perjury in certain transactions in which a lack of proof is particularly harmful. The statute simply states that certain contracts must be written, and that they are not otherwise enforceable. Some of the agreements which are generally included among those which must be in writing are agreements which are not to be performed within one year from the date they were made; sales of merchandise over $500; promises to pay a debt owed by another; agreements in which the consideration is marriage, other than a contract to marry; leases for over one year or any transfer of land; and agreements not to be performed within the lifetime of the person making them.

The Statute of Frauds includes any contract which by its terms cannot be fully performed within one year. The reason for this was simply to avoid the failure of memory. Courts are busy enough without having to decide which party correctly remembers the terms of a contract made years before.

A promise to pay a debt owed by another is included because it is easy to say that someone has agreed to pay someone else's debt even though no such agreement was really made. Agreements involving marriage are included to protect a person who decides to get married because the prospective spouse has promised a large gift if and when they get married. Transfers of land are included because they are so important. There must be a record of such transactions so that the government knows who to tax, if for no other reason. Leases of over a year are included because they are much like transfers of ownership, although for a shorter period of time. Agreements not to be performed within the life of the maker are included because the person who made the promise will not be available to testify in court. Because of this provision, a contract to be performed after the promisor dies must be in writing.

Because it is often unfair for a court to refuse to enforce a contract because it is not in writing, courts find ways to avoid using the Statute of Frauds when its use would cause injustice. A common method of avoiding use of the Statute of Frauds is to invoke the doctrine of promissory estoppel. If the *promisee* can show reliance on the promise, that the promisor should know that the promisee is relying on it, and that injustice cannot be avoided except by enforcing the promise, a court will then enforce the promise, even though it is not in writing.

Another way courts avoid injustice is by enforcing contracts in which one party has already partly performed his or her side of the bargain. In these cases usually all that the performing party gets is the value of his services. This award of the value of services rendered is called "restitution", the rationale being that it is not fair for someone to work for nothing. Thus a court will order that a fair wage be paid for the services performed.

"Parol evidence" is oral evidence. It may not be used to vary the terms of a written contract. It would make little sense to make the effort to write down the terms of a contract if you could go to court and say that the writing meant nothing. However, parol evidence can be used to dispute the existence of the contract itself. You can go to court and say "I never agreed to that contract", but you cannot say "We have a contract, but I was supposed to be paid much more than is indicated in the writing".

All that you really need to remember about the parol evidence rule is that when you make a written contract, you are not bound by any oral agreements you make at the same time. Consider the following example. Dale has a car and always drives to school. Since he always passes

Marjorie's house, her father, a lawyer, asks Dale if he will take her to and from school every day for $5 a week. Since this will more than pay for the gasoline he uses in a week Dale quickly agrees. Marjorie's father suggests that it would be a good idea to put the agreement in writing so that there won't be any misunderstanding, and he tells Dale that he will draw up a little contract. Dale doesn't feel like arguing. The contract says, "I, Dale, promise to take Marjorie to and from school on every regular school day. I understand that I will receive $5 per week for performing this service". As Dale is preparing to sign the paper he asks, "Will you take her on days when I don't go to school". Her father replies, "of course". The arrangement works nicely for several weeks, until Dale catches the measles from his little sister. He telephones Marjorie and tells her that he won't be going to school for two weeks. She says, "But Dale, my parents left for Hawaii last night, and they will be gone for two weeks". Is Dale obligated under his contract to furnish transportation for Marjorie? Was her father's oral promise binding? Since the oral promise is not one of the terms of the written contract, Dale is stuck. He must find a way to get Marjorie to school. What should Dale have done to protect himself from this situation?

WARRANTIES

Derek buys a new ten-speed bicycle. As the salesman is writing the receipt, Derek asks him about the *warranty*. The salesman says, "It's in the owner's manual. It covers defective parts". Derek does not stop to read the warranty since the bike manufacturer is an established firm. He assumes that the warranty is a good one. As soon as Derek gets home he reads the warranty. It says:

Acme Bicycles, and Acme Parts, and accessories manufactured by Acme, are warranted to be free from defects in material and workmanship . . . no time limit. Acme will replace, without charge, any original part which is determined to be defective by the factory.

The warranty then tells about the free thirty day checkup at which time the dealer will check the bike and make final adjustments. Derek thinks this is a very fair warranty. Do you? A few days later Derek is riding the bike, and a brake cable snaps while he is trying to stop. He manages to stop safely, and quickly takes the bike to the dealer. The dealer cheerfully replaces the cable, which was obviously defective. Derek is now convinced that he made a wise choice of bicycles. A week later he approaches a stop sign, carefully applies the brakes, and feels both brake cables snap. To avoid the busy intersection, he hits a parked car and is thrown from the bike, breaking his arm and badly damaging the bicycle. Derek is a pitcher on the varsity baseball team and this accident puts him out for the season. He sues Acme for his medical expenses, for the damage to the bicycle, and for $10,000 to compensate him for not being able to pitch. Should Derek win his lawsuit?

The new and rapidly changing field of *strict liability* for defective products applies to this case, but strict liability is dealt with in the unit on Tort Law. Confine your thinking to Contract Law.

Acme's attorney suggests that Derek read the last paragraph of the warranty. It says:

Replacement of defective parts and those dealer charges specified above shall be the sole remedy of the purchaser under the Acme guarantee, and in no event shall Acme be liable on any implied warranty of merchantability or fitness, or for special or consequential damages. The foregoing warranties are in lieu of and exclude all other warranties not expressly set forth herein.

What does this warranty mean by "replacement of defective parts . . . shall be the sole remedy of the purchaser"? A *remedy* is what you get by suing. In this case Derek thought the right remedy was money, as payment for his injury. But the warranty states that the sole remedy available to Derek is replacement of the defective parts. Thus he only gets two brake cables. Did Derek agree to this when he bought the bicycle? Didn't he accept the bicycle and the warranty that went with it?

The warranty continues, " . . . and in no event shall Acme be liable on any implied warranty of merchantability or fitness, or for special or consequential damages". Do you have any idea what this means? "Liable" means "responsible for". "Fitness" means that the item will do what people normally expect it to do. A raincoat is normally expected to be waterproof. A bicycle is normally expected to carry a rider and to stop in a reasonable distance. Is Acme saying that it does not guarantee that the bicycle will carry a rider and stop in a reasonable distance? An item is "merchantable" if it is undamaged and in a proper condition for sale to customers. Is Acme saying that it does not guarantee that the bicycle is ready to be sold?

Whenever a merchant sells something, the merchant implies that the item is merchantable and fit. If Acme hadn't put those restrictions into the warranty, Derek would win his lawsuit because the bicycle did not stop in a reasonable distance. But because of those restrictions Acme escapes responsibility for Derek's injuries.

The money received by winning a lawsuit is called "damages". "General damages" are for the natural results of the acts for which a person is being sued. In this case Acme is being sued for using defective brake cables, and the general damages are the medical expenses and the cost of repairing the bicycle. "Special" or "consequential" damages are to pay for injuries which actually occurred, but which would not have happened to most people. In this case the special damages would pay Derek for being unable to pitch. The warranty says Derek cannot have

special.damages, but does it keep him from getting general damages? Didn't the warranty say replacement of parts was the sole remedy?

The last sentence of the warranty, which reads "the foregoing warranties are in lieu of and exclude all other warranties not expressly set forth herein", is called the *disclaimer*. By adding a disclaimer the company is again saying, "all you get from us is a new part". In fact, the whole warranty could be said in just those words. Why do you suppose it took two wordy paragraphs no one understands to say it? A warranty must be written in a way that gives the company the most protection possible. How long could a bicycle company stay in business if it was sued every time a child fell off one of its bicycles? But did Derek just fall off his bicycle? Shouldn't the company have to pay Derek's medical expenses since the accident was not really his fault? Do you think the company would be more careful when making its bicycles if it had to pay the medical expenses of everyone who was hurt because of a defect in the bicycle? If the company could prove that no amount of care would prevent some defective bicycles from being sold, should it still have to pay? This would naturally cause the price of bicycles to go up. Do you think it is worth while paying more for a bicycle if you know that your medical expenses will be paid if the bicycle is defective and you are hurt? Would medical insurance be a better way to protect people?

These questions do not have simple answers. They involve many of the serious issues now arising in the area of consumer protection. Because of the terms in the warranty, Derek would lose. He would have to pay his own medical expenses. However, the law is changing. The law recognizes that when a consumer needs an item, he must buy it no matter what the warranty says. Derek wanted the bicycle and so he had to take the warranty that went along with it. Changing the law is a slow process, but soon warranties of the type in Derek's case will not be allowed.

REMEDIES AND DEFENSES

A "remedy" is what you ask for and get if you win in a lawsuit. When the lawsuit is based on a contract there are three possible remedies: specific performance, damages, and rescission.

By ordering "specific performance" of a contract a court requires the party refusing to perform to go through with all the terms of the contract. This remedy is awarded when one party has performed and it would not be fair to let the other party not perform his part. It is also given when none of the other remedies are available. It is important that the person asking for specific performance is not to blame and that no other remedy is available.

Damages may be given alone or in addition to another remedy, and are awarded upon showing that a financial loss has been suffered because of acts by the person being sued. General and special damages have already been discussed in the section on warranties. There is another type of damages called "punitive damages". Punitive damages are given to punish the other party. However, punitive damages cannot be given in a lawsuit based on a contract.

By ordering "rescission" a court nullifies the contract. This is a drastic remedy in most cases, and for that reason, courts are very reluctant to give it. The party seeking rescission must prove that the contract was induced by fraud, force, or some other kind of unfairness. Rescission can also be given when the other party has "materially breached" the contract. A material breach is a failure of performance, which is of a serious nature, by the other party to the contract. For instance, Sol agrees to sell you a ticket to the baseball game, and you tell him to bring it to you the day before the game. If he brings it on the day of the game he

has *breached* the contract, but since you can still go, the breach is not material. If he brings it the day after the game the breach is material. It is often difficult to decide whether there has been a breach of the contract which is serious enough to be called material.

A "defense" is given as an excuse by a party being sued. That party hopes it will justify his or her conduct. If a court agrees with the defense, the party suing loses. If you are accused of breaching a contract, a defense is that you "substantially performed" the contract, which means that you did enough to avoid a material breach. For example, a builder has a contract to build a mansion, and a certain brand of pipe is specified for the plumbing. When the mansion is finished it is discovered that an identical kind of pipe with a different brand name has been used. The owner claims that this is a material breach and refuses to pay the builder. Does this sound like a material breach to you? Is it really serious? The court which decided this case did not think it was and ordered the owner to pay the builder.

Ralph opens a dry cleaning store, and leases a large sign from Jim. The contract provides that Jim must take care of the maintenance of the sign during the time the contract is to run. Shortly after the sign is installed someone throws a tomato at it, leaving a red stain. Ralph calls Jim every day for a week and tells him to clean the sign, but Jim never comes. Finally a rain storm washes off most of the stain. Jim eventually cleans the sign, but Ralph sues Jim for breach of contract anyway. Jim says that he has substantially performed. Who wins? The court deciding this case said that the stain was annoying, but hardly a material breach. Jim's defense is good, and Ralph loses.

Another possible defense is a claim that the contract is "unconscionable". The word itself means that no man of conscience could allow it. Whenever a court decides that a contract leads to an unconscionable result the court will either ignore the unconscionable part of the contract, refuse to enforce the contract, or limit the contract so that the result is not unconscionable. This defense is usually applied in situations where one of the parties is in a much stronger bargaining position than the other. An example of this difference in bargaining power was seen when Derek was buying his bicycle. Derek had no say about the terms of his contract. A court could say that the Acme Bicycle Company's disclaimer is unconscionable, especially if all bicycle companies have the same disclaimer so that Derek had no choice if he wanted a bicycle. Unconscionability is generally a successful defense only when someone has been physically injured, however it is now being applied to economic injury.

Two more defenses to a lawsuit for breach of contract are "impossibility" and "frustration of purpose". If performance of a contract is completely prevented through no fault of your own, and you could not have foreseen the events causing this prevention of performance, then the performance is called impossible and you are excused. For example, the Culture Club hires an auditorium for the purpose of holding four concerts. Before the day of the first concert arrives the auditorium burns down. Does the club have to pay the rent anyway? Could the fire have been foreseen? Courts agree that when a certain item is necessary to allow performance of the contract, and that item is destroyed, the contract is considered void, and both parties are excused.

Barbara orders a new car from a dealer. The car arrives, but before she can take delivery the showroom burns down and the car is destroyed. Is the contract void? This is a special case. Since the dealer can get her another identical car, the destruction of the first one does not matter. But, if the contract had been for a specific used car, its destruction would cancel the contract since the dealer could not replace it with an exact duplicate.

Tom rents a bar, and the lease says the building can only be used as a bar. Subsequently the prohibition amendment is passed. Are the parties excused? Since the performance is prevented by the operation of law, the contract is void. If the lease had not required that the building be used only as a bar, would the contract be void? If the lease had not required that the building be used in any particular way, Tom would remain bound to pay the rent even though all he wanted to do was run a bar.

To summarize, a contract is voided on grounds of impossibility only when the contract is really impossible, and not simply when it is inconvenient. The party seeking to be excused must also show that the impossibility was not that party's fault and that he or she could not have foreseen the events causing the impossibility. Finally that party must show that it would be impossible for anyone to perform and not just that he or she cannot perform.

Suppose Tom rents a bar, explaining to the landlord that all he is interested in is running a bar and that he has no experience in other types of business. The landlord agrees but nothing is said in the lease about limiting the use of the building to a bar. The prohibition amendment is passed. Is the contract void? According to the example above it would not be. Does that seem fair to you? In cases such as this courts have developed a doctrine which is a little less harsh than the doctrine of

impossibility. It is called the doctrine of "frustration of purpose". When the central purpose of a contract, if that purpose is understood by both parties, is frustrated or prevented, and the frustration is not the fault of either party, the contract is void. It is not frustration of purpose just because the business does not do as well as expected. If you lease a gas station your purpose is not frustrated simply because an interstate highway is completed and the traffic no longer passes anywhere near your location. Such an occurrence would just be a business risk. An example of frustration would be reserving a hotel room to stay in while attending a convention, after which the convention is cancelled. The whole purpose for renting the room is destroyed, and since the cancellation was unforeseeable the contract is void.

CONDITIONAL CONTRACTS

Once a binding contract has been formed, all that remains is the performance of its terms. Unfortunately, problems can arise which cause difficulty in the performance. Often these problems are easy to anticipate and the parties to the contract can make provisions in the contract concerning what is to happen should these difficulties occur. The most common way of doing this is to add conditions to the contract. A "condition" is a requirement which both parties agree must be satisfied before any duty of performance arises under the contract.

Albert is a truck farmer who grows strawberries. He agrees to provide Bertha with 540 boxes of strawberries for her delicatessen. Being an experienced farmer. Albert knows that if eight inches of rain do not fall during the two months prior to harvest he will not have a large enough crop to supply all of the strawberries called for in the contract. To protect himself, Albert inserts a condition into the contract which says. "In the event that less than eight inches of rain fall on Albert's strawberry field in the two months prior to harvest, this contract shall be void". What other conditions might Albert have used to protect himself? Should Bertha include a condition to protect herself?

Randolph, a concert pianist, contracts with the manager of a symphony to play a piano concerto, provided that the piano is tuned on the day of the performance. What is the condition in this contract? Why would the pianist make this condition? If the piano was not tuned, and Randolph refused to play, could the symphony sue him for breach of contract? No, because the piano had to be tuned before Randolph's duty of performance arose. If the piano was not tuned, could Randolph refuse to play and still demand payment? Yes, because the symphony breached its contract with him.

In the two cases just discussed, the conditions were very different. Bertha had no control over the rain, and if no rain fell she would not have breached the contract. However, the symphony manager could control the tuning of the piano, so if the piano was not tuned the manager would have breached the contract. In either case the other party to the contract would not have to perform. The difference is that in one case a party to the contract has promised that the condition will occur. That party has made what amounts to a contract within a contract. The failure of a condition to occur is not a breach of contract unless one of the parties has promised that the condition will occur.

Suppose that only 7 inches of rain fell on Albert's field. Would the contract be void? Would Randolph have to play if only half of the piano was tuned? Courts are strict in deciding whether or not a condition has been satisfied. It is the feeling of courts that the parties were perfectly free to write the conditions just as they wanted, and if they settled on a certain condition, then one of the parties cannot say that the condition meant something different. Should a court decide whether or not satisfaction of the condition is important and decide the case on that basis? Or is it better for courts to let the parties write their own conditions and then require that the conditions be satisfied exactly? What if Albert's strawberries had received plenty of rain anyway? Should it make a difference?

When there is a condition in a contract which neither party can control, like the rain on Albert's field, both parties must wait until the condition is satisfied before they begin to perform. If the condition is not satisfied the contract is void. When the condition is satisfied the person who has to perform first must begin performance.

When the occurrence of the condition is controlled by one of the parties, that party must perform the condition before the other party has any duty to perform his or her part of the bargain. There is however one exception to this rule which occurs when one party acts so as to prevent the other party from performing the condition. Suppose Randolph receives an offer to play in New York on the same night he has contracted to play for the symphony. He does not want to appear as though he is breaching the contract, so he has his agent tell the piano tuner not to show up. Randolph flies to New York to perform and his agent informs the symphony manager that Randolph will not perform because the piano has not been tuned. The symphony sues Randolph. Who wins? The symphony wins because of the rule that a person cannot take advantage of his own wrongdoing. If a party to a contract prevents the other person

from performing, that party has breached the contract. This also extends to contracts where the cooperation of both parties is required for the successful completion of the contract. For example you cannot sue a painter for not painting your living room if you were never home to let him in.

GLOSSARY

bankruptcy	the state or condition of being unable to pay one's debts; the status of a person who has been declared by judicial decree to be insolvent.
breach (of contract)	the failure, without legal excuse, to perform or abide by a promise which forms all or part of a contract.
consideration	something of value given or done in exchange for something of value given or done by another, in order to make a binding contract; the reason or material cause of a contract.
counteroffer	an offer of different terms made in reply to a prior offer.
disclaimer	the disavowal, denial, or renunciation of an obligation or duty owed to a person or group of persons; the clause in a warranty which seeks to prevent liability for injury or harm caused by the warranted item.
forbearance	the purposeful failure to act; refraining from action.
fraud	a deception deliberately done to secure an unfair or unlawful gain; a piece of trickery; a swindle.
illusory promise	a non-binding promise; a promise made in a way that the promisor is not obligated to do anything.
implied promise	a promise which is suggested by or gathered from someone's conduct; a promise which is not openly or directly expressed.

offeree	the person to whom an offer is made.
offeror	the person who makes an offer.
past consideration	an exchange of something of value which has occurred prior to the making of a contract.
promisee	one to whom a promise has been made.
remedy	a redress for injury; the object for which a lawsuit is begun; the means by which a right is enforced or the violation of a right is prevented or compensated for.
revoke	to withdraw; take back.
strict liability	liability without fault; the responsibility to compensate for injury, harm, or economic loss, imposed on someone by law, regardless of that person's carefulness, good faith, intention, or knowledge regarding the injury or loss.
varies the terms of an offer	the proposal of terms different from those contained in an offer.
warranty	a statement or guarantee made by the seller or maker of goods, regarding the nature, quality or condition of the goods, by which the seller or maker promises to fulfill certain obligations.