# Legal Contract

A contract is a legally enforceable agreement between two or more parties. It may be oral or written. A contract is essentially a set of promises. Typically, each party promises to do something for the other in exchange for a benefit.

### Required Characteristics

To constitute a legal contract, an agreement must have all of the following 5 characteristics:

* **Legal purpose.** A contract must have a legal purpose to be enforceable.
* **Mutual Agreement.** All parties to the contract must have reached a "meeting of the minds." That is, one party must have extended an offer to which the other parties have agreed.
* **Consideration.** Each party to the contract must agree to give up something of value in exchange for a benefit.
* **Competent Parties.** The parties to a contract must be competent. That is, they must be of sound mind, of legal age, and unencumbered by drugs or alcohol. If you enter into a contract with a minor or an insane person, the contract will not be enforced.
* **Genuine Assent.** All parties must engage in the agreement freely. A contract may not be enforced if mistakes have been made by one or more parties. Likewise, a contract may be voided if one party has committed fraud or exerted undue influence over another. Ifagreement was made under duress, the contract is not valid.

So long as the contract meets the requirements above, it is enforceable in a court of law which means that a court can compel non compliant party to abide by the terms of the contract.

Generally, a contract does not need to be in writing and in many cases an oral agreement with all of the elements listed above will constitute a valid and enforceable contract.

Some situations however require that a contract be in writing to be enforceable.

### Oral v. Written Contract

Contracts made only by spoken agreement may be legally enforceable. However, it is best to memorialize them in writing, especially if a legal remedy becomes necessary, so that there will be proof in court. Also, there are certain types of contracts that must be in writing in order to be enforceable:

* Contracts involving the sale or transfer of land
* Promises to pay someone’s debt obligations
* Contracts that cannot be completed within one year of its making
* Contracts involving the sale of goods for more than $500
* Contracts that will go beyond the lifetime of the one performing the contract

### Bilateral or Unilateral Contracts

Most contracts are bilateral. This means that each party has made a promise to the other.

A bilateral contract is an agreement in which each of the parties to the contract makes a promise or set of promises to each other.

For example, in a contract for the sale of a home, the buyer promises to pay the seller $200,000 in exchange for the seller's promise to deliver title to the property. These common contracts take place in the daily flow of commerce transactions, and in cases with sophisticated or expensive precedent requirements, which are requirements that must be met for the contract to be fulfilled.

In a unilateral contract, one party makes a promise in exchange for an act by the other party. Insurance policies are unilateral contracts. When you buy liability insurance or any other type of policy, you pay a premium (an act) in exchange for the insurer's promise to pay future claims.

In unilateral contracts one party makes a promise, but the other side does not promise anything. In these cases, those accepting the offer are not required to communicate their acceptance to the offeror.

In certain circumstances, an implied contract may be created. A contract is implied in fact if the circumstances imply that parties have reached an agreement even though they have not done so expressly.

**Invitation to treat**

Where something is advertised in a newspaper or on a poster, this will not normally constitute an offer but will instead be an invitation to treat, an indication that one or both parties are prepared to negotiate a deal.

**Electronic contracts**

Entry into contracts online has become common. Many jurisdictions have passed e-signature laws that have made the electronic contract and signature as legally valid as a paper contract.

### ****The Contract as a Document****

The term "contract" often refers to a written agreement, typically including some or all of the following elements:

* introductory material (sometimes known as "recitals" or "whereas provisions")
* definitions of key terms
* a statement of the purpose or purposes of the agreement
* the obligations of each party (and conditions that may trigger obligations)
* assurances as to various aspects of agreement (sometimes phrased as warranties, representations, or covenants)
* boilerplate provisions
* a signature block
* Exhibits or attachments.

### ****The Contract as a Process****

"Contract" is a noun, but it can be used as a verb, too. When you contract with somebody, you participate in a process that typically involves three phases.

* ***Phase 1: Contemplating the deal.***The parties each assess the prospective arrangement and its risks ("Can I trust her?") and attempt to predict the future ("Will I regret paying this price for the computer next month? Will it be outdated?").
* ***Phase 2: Reaching an agreement*.** During this phase the parties negotiate and agree on the terms, usually formalized in a written contract or some other documented evidence of the arrangement (such as a receipt or purchase order, for example).
* ***Phase 3: Performance and enforcement***. Once the contract is in place, the parties are legally required to perform their mutual obligations. If one party fails to perform, the other can sue to enforce the deal.

# Agreement vs. Contract

An **agreement** is any understanding or arrangement reached between two or more parties.

A **contract** is a specific type of agreement that, by its terms and elements, is legally binding and enforceable in a court of law.

## Comparison chart

Differences — Similarities —

| Agreement versus Contract comparison chart | | |
| --- | --- | --- |
|  | **Agreement** | **Contract** |
| **Definition** | An arrangement (usually informal) between two or more parties that is not enforceable by law. | A formal arrangement between two or more party that, by its terms and elements, is enforceable by law. |
| **Validity based on** | Mutual acceptance by both (or all) parties involved. | Mutual acceptance by both (or all) parties involved. |
| **Does it need to be in writing?** | No. | No, except for some specific kinds of contracts, such as those involving land or which cannot be completed within one year. |
| **Consideration required** | No | Yes |
| **Legal effect** | An agreement that lacks any of the required elements of a contract has no legal effect. | A contract is legally binding and its terms may be enforceable in a court of law. |

## Benefits

The primary benefit of an *agreement that does not meet the criteria of a contract is that it is inherently informal. Where the agreeing parties have a longstanding relationship and share a considerable degree of trust, the use of a non-contract agreement can save time and allow for more flexibility in the fulfillment of the agreed-upon obligations.* Agreements lacking all the required elements of a contract may also be more viable in situations where the drafting of a contract would prove prohibitively burdensome on the parties involved.

The main advantage of contracts is that *they spell out the specific terms that the contracting parties have agreed upon, and in the event of a breach – where one or more parties fail to fulfill their obligations – serve as a guide for a court of law to determine the proper remedy for the injured party or parties.* Even where parties have a good relationship and trust one another*, the use of a contract provides an extra layer of assurance that the obligations entered into under the contract will be fulfilled as the parties themselves intended.* Contracts are generally advisable over less stringent agreements in any official business or commercial matter due to the added protection they provide.

### BREACH OF CONTRACT

If one party fails to fulfill his or her duties under the agreement, that party has breached the contract.

**Breach of contract** is a legal cause of action and a type of civil wrong, in which a binding agreement or bargained-for exchange is not honored by one or more of the parties to the contract by non-performance or interference with the other party's performance.

Breach occurs when a party to a contract fails to fulfill its obligation as described in the contract, or communicates an intent to fail the obligation or otherwise appears not to be able to perform its obligation under the contract.

If one party breaches a contract, the other party may suffer a financial loss. The resulting damages will have to be paid by the party breaching the contract to the aggrieved party.

### What Should You Do in the Event of a Breach

If there has been a breach of contract, your **first step** is to look at the contract to see if there are instructions as to what you should do in the event of a breach.

Many contracts will talk about mandatory arbitration or about a liquidated damages clause that goes into effect. It’s important to thoroughly read the contract before you make any quick decisions.

Your **second step** should be to let the other party know that a breach has occurred. If you are committed the breach but do not want to tell them, then you can face more serious consequences if you attempt to hide the breach.

If the other party breached, then it’s important to tell them that you are aware of a breach and ask them if they can verify it. While a breach of contract can be stressful, giving the other party an opportunity to remedy the breach can strengthen your case if you go to court.

The **third step** is to discuss the situation either with the other party or a lawyer. If you feel that the breach will require you to go to court, then contact your lawyer right away and let them know of the situation.

Be sure to hold onto any documents related to the contract and keep careful record of every incident that occurred from the contract. This will make it easier for you to argue the merits of your argument and be compensated for the breach.

# Four Types of Contract Breaches

There are four types of contract breaches: anticipatory, actual, minor and material.

### *Anticipatory breach vs. actual breach*

* An actual breach occurs when one person refuses to fulfill his or her side of the bargain on the due date or performs incompletely.
* Anticipatory breach occurs when one party announces, in advance of the due date for performance, that he intends not to fulfill his side of the bargain.

Both actual and anticipatory contract breaches are bad news for the individuals and organizations at hand. They can waste both money and time, and certainly lead to frustration for everyone involved. A breach of contract, no matter what form it may take, entitles the innocent party to maintain an action for damages.

### *Minor breach vs. material breach*

* A breach is likely material if one party ends up with something significantly different than what was specified in the contract.

For example, if you contact with a web designer to build a new site for home cafe, but end up with a blog about bagels that doesn't even mention your place, the breach is probably material. In most cases, a material breach means the non-breaching party is no longer required to perform his or her end of the deal and has a right to remedies.

* A minor breach, sometimes called a partial breach. In many cases, a minor breach means that one party failed to perform some part of the contract even through the specified item or service was ultimately delivered.

Consider the cafe website contract. If the finished product met all the client's demands but was completed a day after it was requested, the breach might be considered minor. Unless the initial contract terms specifically mentioned that 'time is of the essence' or that the website was under a tight deadline, a reasonable delay from the web designer would only be considered a minor breach.

* **Fundamental Breach:** This occurs when one party violates the contract terms so egregiously that the other party may terminate the contract (as well as seek damages).

### Requirements of a breach of contract

1. The *contract must be valid*. It must contain all essential contract elements by law. A contract isn't valid unless all these essential elements are present, so without them, there can be no lawsuit.
2. The *plaintiff*or the party who's suing for breach of contract must show that the defendant did indeed breach the agreement's terms.

The plaintiff must have done everything required of him in the contract.

The plaintiff must have notified the defendant of the breach before proceeding with filing a lawsuit. A notification made in writing is better than a verbal notification because it offers more substantial proof.

### Types of remedies for broken contracts

You have several options for obtaining compensation.

1. **Sue for Damages.** You may sue the contractor for damages.

There are many kinds of damages, including the following:

1. ***Compensatory damages***aim to put the non-breaching party in the position that they had been if the breach had not occurred.
2. ***Punitive damages***are payments that the breaching party must make, above and beyond the point that would fully compensate the non-breaching party. Punitive damages are meant to punish a wrongful party for particularly wrongful acts, and are rarely awarded in the business contracts setting.
3. ***Nominal damages***are token damages awarded when a breach occurred, but no actual money loss to the non-breaching party was proven.
4. ***Liquidated damages***are specific damages that were previously identified by the parties in the contract itself, in the event that the contract is breached. Liquidated damages should be a reasonable estimate of actual damages that might result from a breach.
5. **Specific Performance.** You can compel the contractor to complete the work required by the contract.

If damages are inadequate as a legal remedy, the non-breaching party may seek an alternative remedy called specific performance.

Specific performance is best described as the breaching party's court-ordered performance of duty under the contract.

Specific performance may be used as a remedy for breach of contract if the subject matter of the agreement is rare or unique, and damages would not suffice to place the non-breaching party in as good a position as they would have been had the breach not occurred.

1. **Other Remedies**. If the contractor tricked or forced you into signing the contract, you might convince a court to terminate the agreement or amend its terms.

***Cancellation and Restitution***

A non-breaching party may *cancel* the contract and sue for *restitution* if the non-breaching party has given a benefit to the breaching party.

"Restitution" as a contract remedy means that the non-breaching party is put back in the position it was in prior to the breach, while "cancellation" of the contract voids the contract and relieves all parties of any obligation under the agreement.

### Defenses to a Breach of Contract Lawsuit

As in all lawsuits, the defendant—the party being sued—has a legal right to offer a reason why the alleged breach is not really a breach of contract or why the breach should be excused. In legal terms, this is called a defense. Common defenses against a breach of contract include:

* ***Fraud***

This means ​**”**knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." When a defendant presents this defense, he's saying that the contract isn't valid because the plaintiff failed to disclose something important or because he made a false statement about a material or important fact. The defendant must establish that the fraud was deliberate.

* ***Duress***

This occurs when one person compels another to sign a contract through physical force or other threats. This, too, can invalidate a contract because both parties did not sign of their own free will, which is a standard contractual prerequisite.

* ***Undue influence***

This is similar to duress. It means that one party had a power advantage over the other and that he used that advantage to force the other to sign the contract.

* ***Mistake***

Anerror committed by the defendant can't invalidate a contract and take away a breach of contract case, but if the defendant can prove that both parties made a mistake about the subject matter, it might be enough to invalidate the contract and this would serve as a defense.

* ***Statute of Limitations***

Many types of cases have time limits imposed by law, deadlines by which a case must be brought and filed. A breach of contract case can be thrown out of court if the defendant can show that the statute of limitations has expired. Statutes of limitations cases are based on time frames that are set by individual state law so they can vary. They average from three to six years for a written contract.

### If You Think Your Contract Has Been Breached

See an attorney if you think that the party you've entered into a contract with has breached it in some way. Law is intricate and small details of your case—things that you don't think are related or are a particularly big deal—can make a significant difference. Only a lawyer will be able to tell you if you have a strong case before you spend time and money launching into a lawsuit on your own—one that you could lose because of misunderstanding or an error.

And, of course, if you're accused of breaching a contract, you'll want legal help to sort out the details of your case and to help you establish a defense.

# What is Contractual Liability?

The term contractual liability means liability that one party assumes on behalf of another by way of a contract. Contractual liability is automatically covered by the standard I[SO](https://www.thebalancesmb.com/insurance-services-office-iso-462706) general liability policy.

### Indemnity Agreements

Many businesses engage in contracts like building leases, equipment leases, maintenance agreements, and construction agreements. These contracts are likely to contain an indemnity agreement.

An indemnity agreement is a promise by one party to assume liability for third-party claims filed against someone else. In a typical indemnity agreement, Party X agrees that if Party Y is sued by Party Z because of Party X's negligence, Party X will indemnify (reimburse) Party Y for costs that result from Party Z's lawsuit. The party providing indemnification is called the indemnitor while the party being indemnified is the indemnitee.

In a building or equipment lease, the property owner is usually the indemnitee while the lessee is the indemnitor. In a construction or service contract, the person doing the work or providing the service is the indemnitor while the property owner or general contractor is the indemnitee. An indemnity agreement is also called a hold harmless agreement. The following example demonstrates how such an agreement works.

### Example

Busy Builders is a general contractor that has been hired by a property owner to construct a new office building. Busy hires Lucky Landscaping to design and build the outdoor space. Lucky will be responsible for planning and installing walkways, gardens, fountains, seating areas, and other features.

Busy knows that Lucky could make a mistake while performing its landscaping work. The error could trigger an accident that injures someone or damages someone's property. The injured party might seek compensation from Busy Builders as well as Lucky Landscaping. To protect itself against potential claims, Busy requires Lucky Landscaping to sign a contract containing an indemnity agreement.

The agreement states that if someone sustains [bodily injury](https://www.thebalancesmb.com/bodily-injury-462648) or [property damage](https://www.thebalancesmb.com/property-damage-462653) because of Lucky's negligent landscaping work and the injured party sues Busy Builders, Lucky will pay for the loss. Lucky will pay any damages assessed against Busy and [defend](https://www.thebalancesmb.com/liability-coverage-and-the-duty-to-defend-462618) Busy (or pay its [defense costs](https://www.thebalancesmb.com/what-are-supplementary-payments-462635)).

### Risk Transfer

Busy Builders has used an indemnity agreement to transfer the risk of landscaping-related lawsuits to Lucky Landscaping. Lucky will be doing the landscaping work so it is in a better position than Busy Builders to prevent landscaping-related losses. For this reason, Lucky assumes the risks associated with those losses.

An indemnity agreement transfers from Party A to Party B the financial consequences of a loss. It does not eliminate Party A's liability for the injured person. In the previous example, Lucky Landscaping has agreed to pay damages and defense costs that result from lawsuits against Busy that arise out of Lucky's work. The agreement will not prevent lawsuits by third parties against Busy Builders, nor will it affect Busy's liability to an injured third party. It merely transfers liability for the financial consequences of the lawsuit (damages and defense costs) from Busy Builders to Lucky Landscaping.

### Contractual Liability Coverage

Most general liability policies contain a contractual liability [exclusion](https://www.thebalancesmb.com/insurance-exclusions-462464) like the one found in the standard ISO policy. The exclusion is located under Coverage A, Bodily Injury and Property Damage Liability. It eliminates coverage for the following:

*Bodily injury or property damage for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.*

The exclusion contains two important exceptions. It does not apply to:

1. Liability the insured would have in the absence of the contract; or
2. Liability assumed under a contract that qualifies as an insured contract

**Liability That Exists in the Absence of the Contract**

First, the exclusion doesn't apply to bodily injury or property damage for which you would liable if the contract did not exist. For example, suppose that you rent a forklift from an equipment rental company. You are using the forklift to move some crates outside your warehouse when you accidentally drop a crate on a truck that belongs to a customer.

When you signed the rental agreement, you probably assumed liability for damage you might cause to other people's property while using the forklift. If the rental agreement did not exist, you will still be legally liable under common law for the damage you have caused to the customer's truck.

**Liability Assumed Under an Insured Contract**

The second exception applies to liability assumed by an insured under an insured contract if the injury or damage occurs after the contract has been executed. Insured contract is a defined term that includes virtually any contract in which you assume the tort liability of someone else. If you engage in a contract that meets this definition, your assumption of liability should be covered.

In the Busy Builders scenario outlined previously, suppose that the building owner's cousin (Jim), is visiting the construction site when he is injured by a backhoe operated by a Lucky Landscaping employee. Jim sues Lucky Landscaping and Busy Builders for bodily injury. Lucky is liable for the claim against Busy under the construction contract. If Lucky is insured under a general liability policy, its insurance should cover Jim's claims.

### No Contractual Coverage for Personal and Advertising Injury

Note that contractual liability applies only to bodily injury or property damage. If you assume liability under a contract on behalf of someone else for claims that allege [personal and advertising injury](https://www.thebalancesmb.com/personal-and-advertising-injury-462622), the claims will not be covered under your liability policy. Contractual liability is specifically excluded under [personal and advertising injury liability](https://www.thebalancesmb.com/personal-and-advertising-injury-liability-coverage-462638)coverage (Coverage B).