

# Notes on Contract Law

Harsh Gupta

## One Page Summary

- Contracts are promises government will stand behind. For a promise to be considered a contract:
  1. There should be an intention to create legal relations
  2. Both parties should be serious about their promise
  3. The contract shouldn't be immoral or illegal
  4. It should be bargain, i.e., both parties should get something in return for their promise
- If one party takes another "over the barrel" to enter into a contract then the contract is not enforceable.
- A contract based on fraud or lies is not enforceable.
- It is implicit that both the parties are contracting about the same thing, if both the parties are mistaken about some important fact on which the contract relies then the contract is not enforceable.
- One sided mistakes doesn't make a contract void.
- Unless required by a statute, it is not necessary to put a contract in writing to be considered a valid contract.
- A contract is interpreted not only through its literal interpretation, but also by taking its purpose and context in consideration.
- When a party breaches its contractual obligations, the courts can either force them to keep their side of the promise (called specific performance) or can ask them to pay monetary damages.
- The damages are calculated comparing the would be scenario where the promise was kept and where it wasn't.
- When a person (agent) is acting on behalf of someone else (principal), to the outside world the principal is liable for actions of the agent.
- In a partnership, all the partners are entitled to the fortunes and liable for damages. A corporation is legal invention which allows this abstract entity to enter legal relationships as principal, protecting its investors and employees from liability.
- In contractual relations between consumers and businesses, often the government dictates certain terms of the contract (called regulation). This is done to protect consumers as expecting each consumer to negotiate good contracts with businesses is neither desirable nor feasible.

## Unit 1: Four Principles

### Unit Summary

- Contracts are promises government will stand behind. For a promise to be considered a contract:
  1. There should be an intention to create legal relations
  2. Both parties should be serious about their promise
  3. The contract shouldn't be immoral or illegal
  4. It should be bargain, i.e., both parties should get something in return for their promise

### Intention to create legal relationships

For promises to be considered a contract, there needs to be an intention to create legal relationships because the court doesn't want to deal with promises which are personal in nature.

Example: Prof. Fried's former student invites Prof. Fried for a dinner to impress her boss. Prof. Fried accepts the invitation. She (the student) spends a lot of money and energy in preparations, her boss is also here for the dinner but Prof. Fried doesn't turn up. Prof. Fried didn't keep his side of the promise, the former student cannot sue Prof. Fried because such a promise is of purely personal in nature.

### Both sides serious?

Both the sides should be serious about their promise. For example: Often people say I'll change my name if X does Y. Now someone cannot go to court to force that person to change her name because obviously such a promise is a joke.

### Cases

- Lenoard v. Pepsi

### Moral and Legal

- The contract should not be illegal or immoral, for example a promise by someone to become others slave for a lifetime for a million dollars now won't be a legal contract.

## Is it a bargain?

- The promises should be a bargain not a gift. For example: A case where X promises to give 20 dollars to Y in return of 10 dollars will be a gift not a bargain because X gives something for nothing.
- The bargain need not be a good bargain. So you can exchange things of very different values, if:
  - The two things differ sufficiently; say you exchange a 20 dollar note for a special 10 dollar note
  - The other party has taken a risk
- What one party gets is called a consideration. What is considered sufficient consideration can be very broad. For example, earlier it was argued that the GNU GPL License is not enforceable because a software released under GPL is simply a gift, but the fact that intention of the person releasing a software under GPL is “public good” was considered sufficient consideration. (From words of Matilal sir, I need to look up the case law)

## Unit 2: One Sided Promises

### Unit Summary

This unit discusses one sided promises in more details and also gives some specific scenarios where they might be considered valid contracts.

### Option Contracts

Consider the scenario:

Jordan is wood seller and Vivek is furniture maker. Vivek wants to protect himself against huge price fluctuations, so he goes to Jordan and says “The price of wood now is 100 Rupees per cubic foot, but it might increase in October when I might need 100 cubic foot of wood. I don’t want to deal with such fluctuations. Why don’t we do this, you promise to keep the rate of wood at 110 rupees per cubic foot for me in October which is slightly higher than the market rate now.” Jordan agrees.

Is this contract enforceable? No. Because Jordan promises to keep the rate of wood fixed but doesn’t get anything in return. Jordan isn’t the only seller of wood in the area, Vivek doesn’t promise to buy wood in October, if the prices are higher than 110, he can buy from Jordan and if they are lower he can buy it from someone else. To make such a deal enforceable Jordan can ask Vivek to give him some fee to keep the price fixed for him. Then the contract will be a bargain.

In an **option contract**, one party, gets an exclusive option to use a particular work by a person for a specific period. In return, that person gets a possibility that work might get used by the other party (published) and a consideration maybe in form of a lunch, small amount of money or a promise that work will be considered. Because of the consideration, even though the first party is free to use or not use the work and only the second party binds itself, an option contract is not an empty bag.

### Moral Obligation

In *Webb v. McGowin*: Webb was an employee in a firm owned by McGowin, as part of his work, he dropped a heavy wood block from ground floor and he saw McGowin was underneath the place where the block was about to fall, Webb, jumped to fall with the block and diverted its direction, saving McGowin’s life but he became crippled for life. For his act, McGowin promised Webb \$15 per week. McGowin continued give this “pension” but after he died, McGowin’s heir’s refused to give \$15 per week to Webb, claiming that McGowin’s promise was a promise to make a gift hence it is not enforceable. McGowin’s promise to

Webb was given **after** Webb had saved his life, by making this promise McGowin gained nothing which he already didn't have. But the courts said McGowin's heir's had a **moral obligation** to continue giving \$15 to Webb.

## Good Faith

Suppose your contract with a marketeer gives the marketeer the exclusive right to promote your brand in a particular geographic area. Now this situation is similar to something for nothing example we discussed, because the marketer can choose to not to promote your brand, but the contract is enforceable because the marketeer is assumed to act in **good faith**.

## Cases

- Wood v. Lucy, Lady Duff-Gordon
- Webb v. McGowin

## Unit 3: Offer and Acceptance

### Unit Summary

The offerer is the master of the bargain.

---

Contracts are of following types:

- **Promise for Promise:** Both the sides promise to do something, and the contract is completed when both the parties deliver their promise. Example: I promise to give you a pen next month if you give me a notebook next month.
- **Promise for Performance:** One does something and the other side promises to do something in return. The contract is completed when the promising side delivers her promise. Example: I promise to give you a pen next month if you give me a notebook now.
- **Performance for Performance:** You do something and I do something in return. Example: I promise to give you a pen now if you give me a notebook now.

Contracts come into life through offer and acceptance.

- **Mirror image rule:** To accept an offer, the offeree has to exactly complete his part of the deal. For example: If the buyer says I'll give you this book for 500 rupees, and you say I accept, I'll give you 300. Then the buyer doesn't have to sell you the book at 300, she is obliged to sell you the book at only if you give 500. Though you can make a counter offer and become the new offeree.
- For promise for performance, doing the expected performance is enough to accept the offer. For example: If someone advertises, I'll give anyone 4000 rupees if they find my lost cat Malti, to accept this offer you just need to find the cat Malti and return it to the owner, once you do this, the owner is obliged to pay 4000.
- For an offer to become complete, it need to be accepted within reasonable time, unless the duration in which the offer is explicitly mentioned, the period of acceptance depends on the context. For example: If the book seller says I offer to sell this book for 500, you cannot go 2 years later and say, "here are your 500 give me the book you were selling". Sometimes, you can buy a contract to keep the original contract open for a longer amount of time, option contracts we discussed are an example.

## Unit 4: Law at Margins

### Unit Summary

In this unit we discussed some of the cases where the courts are willing to enforce “contracts” even when they don’t fulfill the four principles discussed in Unit 1.

### Charitable Donations and Detrimental Reliance

- People often make promises to make donations to charitable organizations. By themselves these promises are contracts because there are promises to make a gift. Though the charitable organizations would want to be able to rely on such promises because they have to plan things. There have been many cases where a person promised to make some donation and then he/she died and their heirs refused to hold on to that promise because they weren’t required to. So, courts in the US made a rule that if the promise is clear enough and well thought out then the promise to make this gift is enforceable,
- In many other cases of one sided promise, the benefitting party can seek damages if they have been **detrimentally relying** on that promise. For example, in one of the cases discussed, an old man promised to pay his niece a regular sum of money and relying on which he expected her to quit her job, which she did. After the old man died his heirs refused to pay the niece the promised money. The niece sued and won damages as she was detrimentally relying on the old man’s promise.
- The conditions for detrimental reliance:
  1. The reliance must be reasonable. For example it is unreasonable for you to stock up 5 yrs of supply of dog food if I promise to give you a pup next month. 2. Hence you cannot sue me for the money you spent on dog food if I don’t give you the pup.
  2. The reliance must be foreseeable. Even if the reliance was reasonable, the promisor must know that you might be relying on his promise in that particular way. Continuing with the dog example, if I promise to give you a pup and I expect that relying on that promise you’ll buy a month worth of dog food. Then if I don’t give you the pup, you can sue me for the month worth of dog food, not the pup.



## Promises without promise

### Hoffman v. Red Owl

*(The details might not be exact)* Red Owl was a groceries franchise and Hoffman was bakery owner, he wanted to own a Red Owl franchise, so he entered into negotiations with the representatives of Red Owl, they encouraged Hoffman to get some experience in the grocery business and have \$18000 cash ready. While the negotiations were still on, Hoffman sold his bakery business, brought a grocery store in a nearby city and ran it for few months. The negotiations dragged on and finally they didn't conclude as Red Owl demanded much more money than what Hoffman initially expected. Hoffman sued. There was no formal contract or any specific promise, hence no contract was breached, though Hoffman won damages for all the trouble he had gone through because of Red Owl's encouragement.

### Texaco v. Pennzoil

Similarly in Texaco v. Pennzoil, Pennzoil was in negotiations with Getty Oil to buy their oil business, though the final details weren't worked out and no formal contract was signed, Pennzoil and Getty made a press release stating that an agreement was reached for Pennzoil to buy Getty. While the final details were still being worked out, Getty stated talking to Texaco and sold itself to it for a higher price. Pennzoil sued Texaco for interfering with its contractual rights and it won. The court said that Getty and Pennzoil had "agreed in principle" hence they had a contract.

## Unit 5: Mistakes

### Unit Summary

In this unit, we discussed what happens when there mistakes in the process of a contract. Contracts based on mutual mistakes, frauds or lies are not enforceable, whereas in cases where only one party is mistaken the contract is enforceable.

### Accidents by both parties; Mutual Mistakes

- The contract needs “meeting of minds”.
- Both parties should be contracting about the same thing.
- “Mutual Mistake” – both parties are mistaken about an important premise of a deal
- In case of mutual mistakes, “the deal lies where it falls”.
- Example (Wichelhaus v. Raffles): Raffles was a supplier of cotton from Bombay to Liverpool and Wichelhaus was a cotton dealer in Liverpool, because of the American Civil War the price of cotton were fluctuating greatly. Wichelhaus made a deal with Raffles to buy a certain amount of cotton at a certain price from a ship named “Peerless” which was to arrive months later. After the Ship arrived in April, Wichelhaus refused to buy the cotton because he claimed that he made a deal about a ship named “Peerless” which was to arrive in Feb. It turned out that there were two ships named “Peerless”, the contract didn’t mentioned the name of the ship or the date of the departure which could have differentiated the two ships. The court called the deal off because the two parties weren’t contracting about the same thing.

### Unilateral Mistakes

- Unilateral Mistake – contract is valid.
- Example: You gambled on a horse and it lost, it was your mistake and you cannot say it was a mistake to bet on that horse, I want my money back, because it wasn’t a mistake from the side of people selling the gamble.
- You need to be careful about exactly what you are contracting about it, in the case of the gambler, the contract is about hope/risk that the horse will win, both parties know that, no new fact is revealed when the race is over. As Prof Fried said “Where the contract is really about risk and both parties know that it’s about risk, and they’re both guessing, then there is no room for the court to let the party who gambles and loses off the hook.”

- Things are different in cases where the mistakes are not about risk, for innocent mistakes courts sometimes allow the mistaken party to call off the deal.

## **Fraud/Cheating**

In case the person being lied about some important details about the contract, that person call off the contract.

## **Speculation and Insider Trading**

- If you don't lie, you can make a deal on private information, you don't have to give it away.

## **Krell v. Henry; Frustration**

Krell advertised that for 75 pounds, he will allow anyone to view the procession of king's coronation from his window. Henry paid 25 pounds in advanced and promised to pay rest two days before the procession, though before that the king became ill and the procession was cancelled. Henry refused to pay the rest. Krell sued to get 50 pound, and Henry paid to sue 25.

Krell's argument: A deal is a deal, I didn't promised to make the procession happen. Henry can still use his window on the given day. Henry's argument: The basic premise of the deal was that there will be procesion. Court agreed and called the deal off.

To get such results:

- Any party should not be a cause of frustration.
- There should be no clause about frustration in the contract.
- The frustration should be important aspect of completing the contract.
- The parties should not have though that the thing causing the frustration can happen.

Suez Canal: The contract was to ship cargo from Texas to Bombay, when the ship reached Egypt, the gulf war broke out and the Suez Canal was blocked, so the ship had to take a longer route. The shipping company sued to get the extra cost, but it lost because the court said that the contract was to get good from A to B, it is your risk if something like the war happens, also cost isn't hell lot only 1/3 of the original cost. If it were 10 times or something then things would have been different.

- Other examples: An actor dies during production of a movie, or music hall burns down while production houses have contract for concern. In such example, the deal is off. Often parties buy insurance for such cases.
- Force Majoure – A clause about major unhappening, the clause specific the default rule, usually it is the the deal is off
- In cases where only one party claims surprise and the other party was aware of possibility of such happening then the deal is not called off.

### Cases:

- Wichelhaus v. Raffles
- Rose of Aberlone
- Laidlaw v. Organ
- Krell v. Henry

## Unit 6: Interpretation

### Unit Summary

In this unit we discussed how contracts are interpreted. Though it is not necessary to put contracts in writing, they often are written and signed, when a particular term or phrase is defined in contract the literal interpretation is important, though everything needs to read in the context and purpose of the contract.

- 
- A contract doesn't have to be in writing to be binding.
  - Informal reasons to put contract in writing:
    - People think it is important or required
    - It shows that they are serious
    - It shows that they have stopped negotiating
  - There is often a fight between the literal meaning of the words and their purpose and context.
  - When the court decides what a phrase means, it should be interpreted not only its present circumstance but also what does it mean taking the whole statute in consideration.
  - There is mutual aim for a contract, the contract needs to be interpreted in its aim.
  - Contract is a cooperative act, the parties need to act in good faith. For every promise there is an implicit promise that the parties will not hinder each in performing their obligations.

### Twin Tower Case

When buying an insurance there is usually a lower and upper limit of the claim you can ask for, these limits are defined “per occurrence” of some incident. In 9/11 two planes had hit the twin towers with difference of 18 minutes. Would that be considered one occurrence or two occurrences. The “owner” of the building had multiple insurance policies, in some insurance contracts word “occurrence” was defined and in others it wasn't. In the cases where it wasn't defined the word “occurrence” was open to interpretation and various set of juries gave different judgements.

## Fried Frozen Foods

There was a settlement between (hypothetical) Fried Frozen Foods and its investors. The settlement was the investor will get  $7500 * (x - 7)$  USD where  $x$  is the price of a share of Fried Frozen Foods on a particular date.

Before the date, the company did a reverse stock split, where they combined multiple shares to make a bigger share, in this case it was 4 shares combined to make 1 share. So the price of shares went from 9 dollar to 36 dollars so the investor claimed their settlement for  $(36-7)7500 = 217500$  dollars. *The company refused. The investors claimed that the formula was very clear cut and explicitly mentioned in the contract, the company argued that the reverse stock split is only a paper change, hence they should be compensated on the share value where the reverse stock split didn't happen, i.e., 9 dollars per share, that is only  $(9-7)7500 = 15000$  dollars.*

The court said that the point of giving settlements through this formula was to encourage the investor to participate in the growth of the company, hence humongous inflation in settlement though paper changes such as stock reverse split shouldn't be allowed and the settlement should take place considering the price as 9 dollars per share.

## Painter Example

Suppose the contract between a builder and painter is that she will get 2\$ per square foot. Now need to get a wall with windows and doors painted, you can interpret "2\$ per square foot" as 2\$ per square feet of paint, i.e., considering area of wall minus the area of doors and windows. Though painting a wall with doors and windows is also more difficult because you have to be extra careful without painting around these opening. Hence, the custom is that the amount is calculated by multiplying length and breadth of the wall, which sort of compensates her extra effort with saving on paint.

So unless the contract is very precise what does "2 dollar per square feet" means, the terms will be interpreted in the context of the customs of the trade.

## Unit Test: Short Answer

### Question

Last year, Hollywood Production Studios released Carwreck, featuring comedian Jamie Jumer. When negotiating the filming of Carwreck, the parties included the following clause in the contract: "If the partnership between Hollywood Production Studios and Jamie Jumer is successful, both parties agree to begin filming a sequel in 2017." The movie was critically

acclaimed and exceeded box office predictions. Jumer, who was relatively new to the comedy scene, became a household name. Despite her laidback comedic tone, Jumer was difficult to work with. She frequently argued with the director and oftentimes failed to show up for filming. After the buzz surrounding Carwreck died down, Jumer contacted Hollywood Production Studios to inquire when filming for the sequel would begin. Because of the difficulties with working with Jumer in the first movie, the production company does not want to film a second movie.

This question has three parts. (1) First, assume you are representing Hollywood Production Studios. What would you argue for your client? (2) Next, make the case for the other side-what are the best arguments supporting Jumer? (3) Finally, explain which argument you find more persuasive. Are there any potential facts that would bolster your conclusion? You may find it helpful to draft a definition of the term successful.

### Response

- (1) The clause in the contract to make a sequel of Carwreck is not enforceable because it was conditional on the fact that the partnership between Hollywood Production Studios and Jamie Jumer is successful. Irrespective of the commercial aspects of the series, it is implicit that the partnership can only be considered successful if both parties work well with each other, a partnership where one party is not cooperative with the other party cannot be considered a successful partnership. The fact that Jumer often didn't show up for filming shows her lack of cooperation.
- (2) By not working towards the sequel of Carwreck, Hollywood Production Studios have breached their contractual obligation. The contract for Carwreck clearly stated that both parties agree to begin filming a sequel in 2017 if the partnership was successful. The fact that Carwreck exceeded critical acclamation proves that the partnership was successful.
- (3) I find the argument from the side of Hollywood Production House more persuasive. The argument from Jumer's side focuses on the literal interpretation of the word "successful partnership", though taking the production context into picture, given Jumer's behaviour the partnership cannot be considered successful. Moreover it would be unfair to force Hollywood Production Studio to produce a sequel because that will be saying Jumer can behave whatever way he wants but Hollywood Production House will have to create the sequel anyhow. If it were known that Jumer acted the way she didn't even though she knew that it will cause considerable trouble to the production house, then it can be said that she acted in bad faith and hence the contract is unenforceable.

## Unit 7: Part 1: Remedies and Specific Performance

### Unit Summary

In case a party fails to their contractual promise, court can either ask that party to keep their promise or award damages to the other party. The usual way is to award damages

- 
- Specific Performance – Do X or go to jail
  - Damages – You are only entitled to your expectation. The expectation comes from what the deal was. “the victim of the breach is entitled to what he would have got if the promise was kept”
  - Usually the court asks to pay money, not specific performance.
  - Why damages in money:
    - Keeps things simple
    - Forcing people to do something might lead to a dead weight loss
  - Court don't want to get into the reasons of why you didn't keep your part of your promise.
  - In case of real estate contracts, the court usually the asks the breacher to deliver the peice of property.
  - Damages are restricted to amount that can be established with certainty, for example if you loose \$1000 by some breach, and you say that I would have invested that in Mutual Funds for 40% gain, then you have to prove that you certainly would have invested that money in mutual funds.

### Examples:

- I and a seller had a deal where I promised to pay \$500 for a desk and the dealer promised to deliver the desk.

Case 1: He delivers the desk and I don't pay. He sues and he can ask for damages of \$500 as that was deal, he would have got only \$500 if I kept my promise, he cannot claim that the desk was worth \$750, or I cannot claim that the desk was worth \$250.

Case 2: I paid but he doesn't deliver. If the desk the worth \$750 and I can prove it, then I can ask for \$750 for damages because I would have got a \$750 worth desk if the seller had kept his promise.



- Me and the seller had a deal for a desk for \$500, I promised to send him a cheque and he promised to deliver the desk when he gets it. I never give him the cheque:

Case 1: He sues me for \$500, gets the money and deliver the desk to me.

Case 2: Because he had to hold the desk for me and then the business went down and he had to sell it for \$250 to someone, he can sue me for \$250 as lost profit assuming I had kept my promise.

Case 3: He sells the desk for \$750 to someone, he cannot sue me for anything, because in that case he'll have to deliver the desk to me.

## **Hector Martinez Co. v. Southern Pacific Transport**

Mr. X had a exhibition of his invention to generate interest about it in the market, he hired a shiping company to deliver his intevention and the company promised to deliver the invention to the display place by a particular date, but they were too late. Mr. X had spent a quite a lot of money in travel, hotel booking and preperations, but he couldn't display his invention because the delay by the shipping company. He sued.

How much damages should he get?

It is difficult to conclude what would have happened if the shipping company had kept its promise, his invention might have generated a lot of interest, it might not have, but the court comepensated him for the money he spent to get that chance of success, i.e., the money he spent on hotel, flight tickets, his time and his assistant's time"

## **Non-Compete Clause and Specific Performance**

Case: Lumley hired Johana Wagner to sing at his Opera house, Gye came in offered Wagner more money and convinced her to sing at his Opera house. Lumley sued, the argument was that Wagner was someone unique and damages cannot fix that, also he'll loose a lot in competition. The court didn't force Wagner to perform at the Opera but it forbade Wagner from performing anywhere in London for a season so that Lumley doesn't loose from its competition. This is negative specific performance.

Reasons for not forcing a specific performance in this case: \* It is complicated (lot of oversight needed to make sure Wagner performs well) \* Great intrusion on personal liberty of person \* Might be unconstitutional in some countries

In high tech fields there is usually a non compete clause in employee contract where the employee is forbidden from joining a competitor for X months.

Issues with non compete: \* Employee is forced to work for a particular company for too long. \* It creates issues for competition

## **Assignment: Damages and Specific Performance Short Answer**

### **Question**

Three summers ago, Brenda and Bart Buyers went to the home of Sarah and Sam Sellers in the Washington, D.C. suburb of Bethesda, Maryland. The Buyers were interested in purchasing the house as they were planning to move to the Washington area from their prior residence in Chicago. The Sellers, for their part, were interested in selling as they planned to move from the Washington area to a small town outside of Boston; Sarah and Sam had both accepted new jobs in Boston, and they discussed their new job plans with the Buyers when they first visited.

On June 18th, the Buyers offered to purchase the home for \$500,000, and the Sellers accepted. The agreement was finalized in a document called the Contract of Sale. The Contract said that the closing date (that is, the day when the homebuyer pays the contract price to the seller and the seller gives possession of the home to the buyer) would be August 1st. At the time the Contract was signed, the Buyers paid a \$10,000 deposit to the Sellers. Included also in that Contract was an addendum, which provided:

A. Sale of the Home shall be contingent upon Buyers obtaining an expert inspection indicating that the heating system of Home (and all fixtures and appliances relating to said heating system) shall be in good working condition, and that no major repairs are needed to correct any condition in the heating system.

As we would expect, the Buyers hired an expert to inspect the heating system. The expert performed the inspection on July 12th, and he turned up something concerning. He found evidence that the property contained an old underground oil tank, perhaps used as part of the home's heating many years before. It was not, however, attached to the home's current systems at all and was instead buried some distance away from the house itself.

Mr. Buyers, however, apparently had environmental concerns about the underground tank. Despite the inspector telling him that the underground tank should be of no concern and that was certainly not part of the "heating system" of the home, Mr. Buyers refused to go forward with the home purchase as scheduled on August 1st. Before saying that the sale was off, Mr. Buyers bought a special metal detector for \$700, intending to use that to investigate the underground tank himself.

Meanwhile, the Sellers were planning their move to Boston. On July 10th, they rented a home in Cambridge (just across the river from Boston); they were to take possession of the rental house on July 28th and live in it until they could purchase a new home in that area. They also made some repairs to their home in Bethesda: the front curb was repaired (\$1,200) and the lights in the bathroom were rewired (\$150).

So on August 1st, the sale was not finalized, as Mr. Buyers stringently said it could not be given the tank situation. Instead of moving to Boston, the Sellers decided to remain in their home in Bethesda until it sold to someone else, even though their new jobs were starting in Boston. The home did sell to someone else on May 15th of the next year (over 10 months later). The new purchase price was \$476,000. This sale came after the Sellers worked tirelessly to sell the house to someone else; they showed it over 50 times and incurred \$600 in costs to provide refreshments to the visitors seeking to view the house.

Between August 1st and May 15th, the Sellers made several repairs to their home, to try to make it more appealing to new buyers. First of all, they had the underground tank removed (\$5,000) and did some other work inside the home (totaling \$2,500).

Having decided to remain in Bethesda, the Sellers paid \$4,000 to get out of their lease in Cambridge and to avoid a dispute with that landlord. They both commuted to Boston for work (after all, their new jobs would not wait), returning to Bethesda on the weekends. For the period from August 1st to May 15th, the total amount of their commuting costs was \$21,000.

Had the Buyers paid the purchase price on August 1st as planned, the Sellers planned to put the proceeds into a mutual fund account managed by National American. The funds in that account would earn a return for a while as the Sellers house hunted in Boston and lived in the rental house, and the return would allow them to spend a little more on their new home. As it turned out, the mutual fund that they planned to use skyrocketed in value between August 1st and May 15th, gaining 40% for those invested in it. Of course, the Sellers did not get that return as they never received the money they planned to put into it.

Eventually, later in the year after the house sold to the new purchasers, the Sellers sued the Buyers for not purchasing the house as agreed on August 1st. The court determined that the Buyers had breached the contract and that the underground tank problem was no excuse. As such, the court was forced to determine a remedy to attempt to make the Sellers whole.

A Judge's Ruling:

The court has decided that the Sellers should recover for both 1) the cancelled lease and for 2) their commuting expenses between Bethesda and Boston. The judge has asked you to write a paragraph explaining each decision to include in her opinion for the court. Write your draft below. Drafts should contain 2 paragraphs and be no longer than 800 words.

### **Response**

Given the facts of the cases it is established that The Buyers have breached the contract to buy the house being sold by The Sellers. The remedy to The Seller should try to make for the difference between the situation where the contract was kept and where it wasn't. The Seller should recover the cancelled lease because this cost wouldn't have occurred had The Buyers had kept their side of the contract. Similarly, The Sellers are entitled to their commuting expenses between Bethesda and Boston because it wouldn't have occurred had the house was sold on August 1.

The Sellers are not entitled to the interest on difference because there is no certainly that The Sellers would have invested that money in mutual funds. They are also not entitled to repair expenses because they might have occurred even if the The Buyers had kept their part of the contract.

### **Cases**

Groves v. John Wonder

Lumley v. Gye

Hector Martinez Co. v. Southern Pacific Transport

## Unit 7: Part 2: Third Parties

### Unit Summary

Often, a third party is the intended beneficiary of a contract, in such cases (in US) the court allows the third party to directly sue the person breaching the contract.

- 
- Promisee: The person who promises something
  - Promisor: The person to whom the promise is made
  - Third Party Beneficiary: The person other than the promisor who actually benefits if the promisee keeps her promise.

Case: Amy buys a bike for \$5000 from Xavier on credit, Amy sells another bike to Brad for \$5000 on a promise that he'll deliver the money next week. Now, when Brad delivers the money, instead of passing on the money herself to Xavier, she can ask Brad to sign a contract to pay the money to Xavier instead.

If Brad didn't pay, Amy won't be able to pay either. Hence, Xavier would have to sue Amy and Amy had to sue Brad, if both wins their suits, then Amy will get \$5000 from Brad, and Xavier will win \$5000 from Amy which is equivalent for Xavier getting \$5000 from Brad.

Now the US courts allow Xavier to sue Brad directly.

- Thing can get complicated if there is some issues with Amy's part of the contract with Brad.

### Bank cheque as contract

Bank owes me my money, I owe some money to X. So I write a cheque to X. The cheque is a contract between me and the bank for the benefit of third party.

### Chains of Contract

Here is an example given in a home work question:

Mary Jones lived in the City of Langdell for her entire life. Her entire family lived there and died there, and Mary intended to be buried in a serene plot of the Langdell Cemetery when she eventually passed away.

Unfortunately for Mary, that time came far sooner than expected. While she was vacationing in East Dakota, Mary died, miles and miles away from her home and family in Langdell. Distraught but determined to get dear Mary's remains back to Langdell, Mary's children and other heirs contacted Langdell's finest funeral home, Omega Funerals. Omega agreed to arrange for Mary's return as part of its package for funeral services. The agreement between Omega and Mary's children was made into a formal written contract and signed by the parties.

Omega, in turn, contacted a shipping company in East Dakota. The shipping company-Diamond Transportation-contracted with Omega to transport Mary's remains from the facility where she was housed in East Dakota to Omega's facility in Langdell.

Given that East Dakota was so distant from Langdell and since Diamond Transportation had no trucks that would soon be traveling in the direction of Langdell, it decided to pay for a commercial airline to fly Mary's remains to the Langdell International Airport, where Omega would take over the process. As it had done many times before, Diamond secured a spot for Mary in the cargo bay of a National Airlines flight, specifically National Airlines flight 3201 from East Dakota Regional Airport to Langdell International Airport. A representative of Diamond delivered Mary to the airport and there signed on Diamond's behalf National Airlines' standard Contract of Carriage and Agreement to Ship.

In yet another unfortunate twist, National loaded Mary onto the wrong plane. Instead of being flown directly to Langdell, where her funeral service would be held shortly thereafter, she was instead flown on a series of flights to the cities of Ames, Thayer, Pound, Landis, and Griswold, before she finally arrived in Langdell three days later than expected.

After the funeral was finally held and an appropriate period of grieving had passed, Mary's family decided that someone needed to pay for the extremely disturbing incident of her remains arriving days later than expected.

## Unit Test

### Question:

Clayton is a resident of Cambridge, Massachusetts. The City of Cambridge has a contract with Waterworks, Inc. Under that contract, Waterworks must supply high-pressure water and pump that water into the fire hydrants throughout Cambridge.

One night, Clayton has an incident in his kitchen, and his house begins to burn. Fortunately, though, the fine firemen of the local fire department show up to the house in plenty of time to prevent any significant damage. But there is one big problem: the only water coming from the hydrant is a slow trickle, barely more than a drip.

Without any good source of water, the firemen are unable to do anything about the fire, and the entire house burns down. Clayton, who is now both furious and homeless, decides to sue Waterworks based on a third-party beneficiary theory. He argues that the citizens of Cambridge were the intended beneficiaries of the high-pressure water contract made between the City and Waterworks.

How should the suit come out? Should Clayton be able to collect from Waterworks for the damages he incurred from the house fire?

Please state your position and give a reason, then move on to the next step.

### **Response**

I believe Clayton should be able to sue Waterworks for the damages as a Third Party Beneficiary.

Assuming no other law applies to the situation and Clayton is a tax paying citizen, a part of Clayton's taxes goes to The City of Cambridge, in return he expects to receive municipality services, this include services from the fire department. Because the fire department failed to deliver their part of the bargain, Clayton should be sue The City of Cambridge. Now, because Waterworks Inc. failed to deliver their contractual obligation with The City of Cambridge, the city should be able to sue Waterworks Inc. Hence, to prevent these double law suits, Clayton should be able to sue Waterworks Inc. directly as a third party beneficiary.

## **Unit 8: Agency, Partnerships, Corporations, and Regulation**

### **Assignment**

#### **Video 1**

- Barter: The items needs to be exchanged then and there, needs "double coincidence"

- Money: Change money for a good, then buy the required good from someone else, no need to “double coincidence”
- Credit: If I don’t have money now but hopes to get it later, I can give a promise to pay later.
- Assignment of Contract: The seller of the good can sell the promise (the contract) to someone else to get money then and there.

Example: Sohan buys Sandals from Mohan with a promise to pay \$100 in October. Dead weight loss avoided as we are able to make a deal. Now Mohan needs money now, so he can sell the contract to Betty banker \$90 now, another dead weight loss avoided as gets the money now and the banker is okay to give it as she makes \$10 in October when she gets the money.

## Video 2

In the above example, Mohan is an **obligor**, Sohan is **obligee** he is also an **assignor** in his assignment of Sohan’s contract to Betty who is the **assignee**

## Video 3: Risks

Risks with contract assignment:

- Death of party
- One parties side of a contract could be contest by the other
- Bankruptcy of the party

In case of delays from Mohan. Sohan and Mohan might have reached a compromise if it was between just two of them because they are old friends. Now when the Banker is involved, the banker is probably a complete stranger to them and she will probably not be willing to compromise. In the end, the professor asks, “What if everyone digs in their heels?”

I posted the following in the discussion forum:

If everyone digs in their heels then it can lead lot of dead weight loss. For example, in this case if it is know that people like Betty Banker are very uncompromising and she might sue the promisor even for delay of few days and it is know that the sandal maker might assign the contract to the banker. Then the boot maker will be less willing to offer promise of \$100 in October in exchange for sandals, because with exchange of promise will also come with a risk of being sued for small delays (which is costly)



hence it is likely that there will be no deal. The boot maker will not be able to enjoy the beach, the sandal maker will not get boot in October or even November and the banker will lose the opportunity to make 10 dollars. It is a dead weight loss.

This reminds me the discussion from the book “Debt the first 5000 years”, where the author said that one of the reason for the ruthless cruelty of the colonialists from Europe was that they were under debt and they had to get money somehow or other, their debtors won’t be compromising, so they cannot be compromising either.

## Video 4 and Video 5

Remember the original contract between Mohan and Sohan was for the exchange of sandals. Now when Betty Banker comes to Sohan in October to collect \$100, Sohan can claim that Mohan didn’t keep his part of the bargain as the sandals were worthless, which is a valid defence. Betty banker shouldn’t have to deal with all this because it increases her risk.

So the contract between Mohan and Sohan can be more general, he can say “I’ll pay you \$100 in October” that’s it and such a contract is called a **promissory note**. Betty Banker is more likely to accept it in exchange of \$90 and hence Mohan is more likely to accept it for credit. Then the prof discussed how it is similar to bank notes. In fact that’s how paper notes came to be, they are promises to pay a debt to someone. The British notes came to be when the Bank of England gave a large sum of money to the government and circulated the debt notes saying “take this 1 pound from the government”

The unconditional contract to pay is also called **negotiable instrument**.

## Agency

### Video 1 and 2

Situation: Prof Fried is an antique glass collector, he wants to participate in an auction to buy a particular glass bottle in another city but he cannot personally go there to buy a bottle he might be interested in, and he is willing to pay up to \$50 for that bottle, possibilities:

- He can send a fixed bid of \$50 dollars, but might overpay as the final prize might be 30
- He can participate through phone, but it is hard to judge thing over phone.
- He can ask a friend, Xena who is in that city to participate in an auction on his behalf for a fee of \$5, this friend is an agent.

### **Video 3**

Now assume Xena breaks by bottle after she buys it at auction, can Prof Fried demand the money back from the auctioneer? No, things also don't change if the auctioneer knows that Xena is agent and is not buying on her behalf.

## **Partnership and Corporations**

### **Video 1: From Agency to Partnership**

- Law Firms usually acts as partnership, so do many other organizations.
- In a partnership each partner is both a principle and an agent for the partnership, any advantage is incurred to the whole partnership and same goes for losses.

### **Video 2: From Partnership to Corporation**

In partnership the investors have lot of liability, they might loose too much. So a bunch can come together, put money in a "black box" and the "black box" acts as a principle to the outside world. Its liability doesn't extend to the investors. All the investors can loose is their investments.

### **Video 3: Governments and Corporates**

In this video Prof Fried talks about how governments creates corporations. In a partnership the agents and the principles are real people, you can point to a bunch of people and say this group of people forms the partnership. In a corporate there is nothing tangible that you can call a corporate, the investors aren't a corporate, the employees aren't a corporate, the building isn't a corporate, all this together is not a corporate. A corporate is an abstract entity and it exists because government allows and recognizes its relationship and contracts with other entities. Though government does it in its own terms, it regulate the corporate in several ways and in certain cases it might allow the people hurt by the corporate to sue the people behind the corporate wall.

## **Government Regulation**

### **Video 1 & Video 2**

Insurance companies are usually corporates, as due to some catastrophe they risk loosing all of the premium they have collected from people, investors in the insurance company can only loose their investment and not more than that. In

certain countries under certain circumstances, it is mandatory for people to buy an insurance. For example, employees have to provide health insurance, and it is mandatory to buy third party car insurance. These insurances are contracts, but they are not contracts which are freely entered into and freely negotiated as government mandates, or writes, certain parts of the contract. Prof Fried calls them “contract as taxation” or “contract as regulation” as they fall between totally free contracts and totally mandated law like tax.

## **Assignment Government Regulations**

### **Question**

Intermediate Form of a Contract

Oftentimes, the U.S. government regulates private industries for the benefit of consumers. For example, the U.S. Congress passed and President Barack Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 ("CARD Act"). Several of the main provisions address how credit issuers must interact with consumers, like a requirement that credit card companies give consumers 21 days or more to pay their bill from the date of mailing, and another that prohibits payment deadlines from falling on the weekend or mid-day.

First, consider why the government intervenes in private contractual relations. Second, make a normative judgment-determine whether you believe government intervention on behalf of consumers is the right approach, and include arguments justifying your position.

### **Response**

The government intervenes in private contractual relations to protect citizens from entering into contractual relationships which can substantially harm them. I believe in many situations government's intervention on the behalf of the consumers is the right approach, there are several reasons:

1. Consumer may not be sufficiently aware of potential harms to negotiate a “good contract” with a corporation.

Talking in terms of the Credit Card prompt, without the regulation, a credit card company might give a very short deadline for payment of bill or the deadline might fall on weekend which can be very harmful for the consumer. Ideally, if these factors are important, the consumer should negotiate a contract with the credit card company which takes these factors into account, I call such a contract a “good contract”. Unfortunately, a typical consumer might not foresee these issues while buying a credit card, hence she might enter into a “bad contract” unknowingly. Laws like CARD Act prevent such harms.

2. A single consumer might not be in position to negotiate a “good contract” with the corporate.

Second, because the consumer might want the money instantly, or because the consumer doesn’t have sufficient training or resources to negotiate a “good contract”. Taking advantage of this, the credit card company might put in terms which are harmful to the consumer. Also usually, there is no option for a single consumer to negotiate a contract on a credit card or some other product. Hence, regulation can be seen as a collective “negotiation” of a default contract with a company.

3. Regulations can increase efficiency by decreasing need of negotiation

Third, even if an individual consumer is in a position to negotiate a “good contract” with the corporate, instead of expecting each individual citizen to negotiate contracts with an individual companies, it is more efficient if the government “negotiates” certain terms of the contract for citizens as a whole.

### **Video 3 and 4: Mass Manufacturing, Government Regulation and Manufacturers**

Nice, Prof. Fried talked about mass manufacturing. Suppose you buy a car, you cannot negotiate every details of the car, there some choices but they are standard and limited, also the contract for the purchase of the car is very standard. It is not desirable or feasible for the company to negotiate a contract with every single consumer. Hence the government negotiates on the behalf of people with the manufacturers, to mandate certain parts of the contract. It is contract because the manufacturers can say if this is the regulation we won’t produce anything at all.

Such intervention is not required in Business to Business (B2B) contracts.

## **Unit Test**

### **Scenario 3**

After successfully passing the Affordable Care Act, which requires individuals to carry health insurance or pay a "tax" for failing to have health insurance, the United States government decided to pursue another program. This legislation, called the "Protecting Future Tort Victims Act," seeks to require every individual over the age of 18 to have general liability insurance that covers any unintentional torts committed by the policy-holder. Surprisingly to political commentators, the law passed and individuals now must carry general liability insurance. Lola owns a farm

with many chickens, and often gives their eggs to her friends and neighbors. Earlier this morning, while carrying a bowl with a dozen fresh eggs, she tripped over a chair and dropped the bowl, causing the eggs to splatter all over the kitchen floor. She negligently failed to clean up the mess before Harrison stopped by to pick up eggs. He slipped and injured his back. Lola did not have the requisite general liability insurance and was fined by the government. In addition to the fines, she was required to pay Harrison for the damages resulting from committing a negligent tort.

Short Answer,

2 Parts Now, assume that Lola (1) is organized as a corporation, or (2) formed a partnership with neighbor Nelly. Who would be liable in each of these situations, and is that a more or less desirable result than imposing direct personal liability on Lola?

### Response

If Lola's farm is organized as a corporation, then she won't be personally for the committing a negligent tort. If she forms a partnership with Nelly, he neighbour then both of them will be liable for damages. Both of these less desirable than imposing direct personal liability on Lola because Lola's negligence was her's alone, she should not be allowed to escape the liability or offload a part of it to someone else because of the organization of her farm. We need to draw a distinction between acts done in personal capacity and act done as part of the organization.