NAILING  THE BAR

Simple CONTRACTS & UCC Outline

Tim Tyler, Ph.D., Attorney at Law

NINETY PERCENT of the LAW in NINETY PAGES®

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CONTRACTS & UCC
Outline

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NINETY PERCENT of the LAW in NINETY PAGES.®

It takes thousands of pages to completely explain the law of **CONTRACTS**. But such extensive knowledge is unnecessary to succeed in law school or on bar examinations.

This book gives a simple explanation of the common law of **CONTRACTS** and broadly adopted modern rules for beginning law students, including the provisions of the **UNIFORM COMMERCIAL CODE** governing contracts for the sale of goods. The purpose of this book is to provide law students with an **understanding** of the **basic law of contracts** without a lot of unnecessary blather.

This book simply tells beginning law students the **BLACK LETTER LAW** and **BRIGHT LINE RULES** they need to know to succeed in law school. The explanation is given in **plain English** with the aid of **examples**. Other than that, this book deliberately avoids or minimizes discussion of case law and historical development.

The reason for this deliberate omission is that extensive discussion of case law, minority holdings and historical development is **UNNECESSARY** and often **more CONFUSING than helpful** to beginning law students trying to gain a basic understanding of the law.

YOUR PROFESSORS will probably focus on the details of the law in one or more narrow areas of their personal interest. Those details may not be covered in sufficient depth here. **As you realize a need for more detailed knowledge** in a particular and narrow area of law, consult an appropriate **hornbook from your library** or some other authoritative reference source.

OTHERWISE, THIS eBOOK HAS ALL THAT YOU NEED to quickly understand the basic rules of law.

UNDERSTANDING THE LAW IS NECESSARY BUT NOT ENOUGH to succeed in law school! You must also be able to **explain** how the law applies to fact patterns presented on examinations.

THEREFORE, after you have developed an understanding of the law of contracts using this eBook, you MUST make additional efforts to prepare for your law school exams in contracts. To do that, use Nailing the Bar's **How to Write Contracts & UCC Law School and Bar Exams (Ae)**.

To test your knowledge and prepare for multiple-choice exams, use Nailing the Bar's **333 Multiple-Choice Questions for First-Year Law Students (MQ1e)**.

Details on these publications and how to obtain them in both hard copy and eBook (PDF) formats are given at the back of this book.

Table of Contents

Chapter 1: Contract Formation

The first major concern of contract law is whether a contract has formed at all. This is called **contract formation**. A contract is a **promise or exchange of promises** the performance of which the law will recognize as a **duty** and for the breach of which the law will provide a **remedy**.

The first part of this book explains the **common law** of contracts, and the last part in Chapter 10 explains how the **Uniform Commercial Code (UCC)** modifies the common law rules for **contracts for the sale of goods** in almost every state.

Contracts form when the parties reach agreement, and that is often called the **time of contract** or perhaps the **time of execution** of the contract. "Time of execution" does NOT refer to the time when contract duties are performed. The term "**parties**" means the people who have entered into a contract. There are usually two contract parties, but there can be more. While more than two people can enter into a contract it gets very unstable and messy like a ménage à trios.

Precision of terminology and attention to exact language is extremely important in all legal studies. You must pay attention to the **exact words** used to explain the law and strive to use exact words in answering law school examinations! It is tempting to argue that quibbling over exact words is "merely semantics." Of course it is. So what? Remember this:

SEMANTICS is the mother's milk of lawyers!

1. Contract Offers

The genesis of every contract is a **contract offer**. One party, the **offeror**, promises to do (or not do) something if, and only if, the other party, the **offeree**, will do (or not do) something **in exchange**. A contract offer is a **manifestation of present contractual intent** by the "offeror" communicated to the "offeree" with **sufficient certainty** of terms that an **objective observer would reasonably believe assent** would form a bargain.

When the term "offer" is used in contract law it usually means a contract offer, and "promises" may also be called "**covenants**". The person who makes a promise is called a **promisor** and the recipient of the promise is called a **promisee**.

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A. Manifestation of Intent

A contract offer must manifest intent to enter into a contract at the present time, not at some future time. That means an offer promising to do something such that a **reasonable person** would think immediate assent to the offer would create an agreement binding on both parties.

1) QUESTIONS as offers

Questions are usually not contract offers because they usually promise nothing; they just ask for information and don't make any promises.

> **For example:** "Would you like to buy an apple?" is NOT a contract offer because it just asks a question. If the people asked said, "Yes" it would just mean they would like to buy an apple, not that that they were agreeing to buy an apple.

But contract offers may be "**phrased" as a question** if concurrent **acts and circumstances** make it clearly a contract offer.

> **For example:** Holding out an apple to a customer and saying, "Would you give me $1 for this apple?" would be a contract offer because an objective person would reasonably believe saying "Ok" would form a bargain.

2) SUGGESTIONS as offers

"Suggestions" are not contract offers because they promise nothing.

> **For example:** "You should buy some of my apples!" is NOT a contract offer because it just urges the other party to buy without making any promise to sell.

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B. Present Intent

Contract offers must manifest intent to enter into a contract **at the present time** rather than at some future time.

> **For example:** "I will sell you this apple tomorrow for a dollar," is not a contract offer because it implies no intent to enter into a bargain at the present time.

But contract offers can be based on intent to enter into a contract **at the present time** for **future performance**.

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C. Reasonable Certainty of Terms

Contract offers must have **certain** terms such that a **reasonable objective observer** would believe mere assent to the offer (just saying "Ok") would be enough to form a contract. The common law considers a contract offer sufficiently certain if it specifies **price, subject matter, quantity, and time of performance**. However, the absence of some terms is not fatal. Time of performance will be assumed to be "within a reasonable time" if not stated.

The UCC considers contract offers sufficiently certain if they specify only **quantity**. The other terms can be imputed or presumed based on course of dealing between the parties and standard practices. That will be explained later in Chapter 10: UCC Modifications.

Often the final terms impliedly incorporate previous statements made by parties before the offer is accepted but not anything said after the offer has been accepted.

> **For example:** Tom says to Dick, "I am looking for organic fruit." Dick says, "These apples are $1 each." Tom says, "Give me 5." As Dick hands Tom the apples he says, "These have been sprayed with poison." There is no contract. Dick implied the apples were organic because he knew Tom was looking for organic fruit. So Tom's offer was subject to that **implied condition**. If the condition fails the contract fails.

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D. The OK Rule

The manifestation of intent to enter into a contract, and the terms of the offer must be so clear that a **reasonable person would think** simply saying "Ok" would be sufficient to immediately form a binding contract. I call this "**The Ok Rule**".

> **For example:** Annie asks Tom, "Will you buy some of my apples?" Tom says, "OK!" No reasonable person would think this would form a contract because there is **no quantity** or **price** stated. No Court could tell how much Tom owed Annie.

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E. Implied Offers

Contract offers are usually expressly stated but they may be **implied by acts**, rather than expressed by words, if the context of the act clearly implies a contract offer.

> **For example:** If an auctioneer says, "Who will give me $500?" and a member in the audience holds up his hand it is an implied offer to pay $500 for the item.

Note an auctioneer is never offering to sell; he is soliciting offers to buy. The bidders are setting the price, not the auctioneer. If the auctioneer was making an offer to sell, the first bidder would assent to the bargain, get the item and the bidding would have to stop immediately.

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F. Advertisements Rarely Offers

Generally advertisements and price quotations are NOT offers because they usually do not expressly state intent to enter into a bargain, do not identify the offeree and/or do not state the item or quantity offered for sale so **no reasonable person would think assent would form a bargain.**

> **For example:** A store advertises, "Apples, $1 each." It would not be reasonable to believe that walking into the store and saying, "Ok," would form a bargain. The store clerks would just look at you and say, "Ok what?" In such a case unequivocal assent does not form a bargain because there is no offer on the table stating quantity or terms.

An EXCEPTION to this general rule is that an advertisement is a valid contract offer IF it identifies the **exact item** for sale, the **price**, the **time** and **specific person** it will be sold to.

> **For example:** A store advertisement says, "We will sell a KBX stereo, stock number 1234, for $1 to the first customer in the door on Saturday morning, May 12." It clearly would form a bargain if the first customer in the door shouts, "I accept your offer!"

Another EXCEPTION is that a statement in direct response to an inquiry becomes an offer within the established context.

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G. Catalogues Never Offers

Catalogues (listings of goods offered for sale and the prices of each item) **are never contract offers** because "assent" to a catalogue will not indicate what items the assenting party agrees to buy. No reasonable person would believe "assent" to a catalogue forms a "contract".

> **For example:** Victoria's Secret catalogue comes in the mail. I open it and exclaim, "Ok!" No reasonable observer would believe a contract formed.

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H. Offeror is "King" of the Offer

The **offeror** is the "King" of the offer with complete control over the terms. The terms are either what the offeror expressly states or what they implied by the circumstances and contract law.

1) OFFEROR CONTROLS terms of offer and contract

Nothing the offeree says in response to an offer can change its terms.

> **For example:** Annie says to Bob, "I will sell you my pig for $100." Bob responds, "Ok. I will pay you next week." Does Bob get a week to pay? No, because that was not part of Annie's offer. Annie is the King (Queen?) of her offer. Nothing Bob says can change it.

The UCC changes this rule slightly for sales of goods. That will be explained in Chapter 11.

2) PLAIN MEANING defines the offer

The offeror is the "King" of the offer but is also bound to the **plain meaning** of its stated terms. If the offeror makes a mistake and the offeree accepts the offer the offeror is bound to perform as the **plain meaning of the terms** indicated unless the offeree knew the offeror made a mistake.

> **For example:** Col faxes Art and says, "I would like to buy the painting called "Sunflowers at Dawn" I saw in your gallery last February." Art responds with a fax saying, "I will sell you that painting for $25." Col faxes back, "It's a deal!" Art responds, "Oops, I meant to say $25,000". Too bad, he is bound to the terms of the offer he made (and that Col accepted) unless he can prove with a preponderance of evidence Col knew or should have known Art made some mistake when he quoted the price.

Pay attention to the <u>exact words</u> of the offeror, when they are given as a fact on an exam question.

3) DRUNKS and JESTERS

If drunks or joking offerors make offers the offerees know are not serious, **no power of acceptance** is created and **no contract** can form.

If offerees believe an offer is legitimate the **power of acceptance** is created even if the offeror claims to have acted without intent to create a "real offer" UNLESS an objective observer **would NOT have reasonably believed** that the offer was serious.

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I. Consideration

Every contract requires an exchange of "**consideration**". This means that the contract offer must be a **conditional promise** that the offeror will do something (or not do something) IF AND ONLY IF the offeree will do (or perhaps not do) what the offeror asks **in exchange**. Usually the offeror asks the offeree to make a promise in return.

The offeror's act of making a promise to the offeree and the offeree's response in doing what the offeror has asked are called an **exchange of consideration**. This condition that the offeror must do something, and the offeree must "do the thing asked for in return" is the basic requirement of every contract offer. [1]

1) CONDITIONAL PROMISES

A contract offer is a promise that is **subject to** the "condition" that the offeree must do or promise to do what the offeror has asked. A **condition** is a requirement that some event or situation must occur or exist (or not occur or exist) for a **promise to perform** to "**ripen**" into a **duty to perform**, or for an **existing duty to continue**. When a condition occurs or exists it is said to "**hold**". When it does not occur or exist it is said to "**fail**".

In the case of a contract offer, if the offeree does not do or promise to do what the offeror has asked for in return, then the **condition fails**, the contract **offer lapses**, and the offeror is **released from his promise**. In the alternative, if the offeree does what the offeror has asked, then the **condition holds**, the contract **offer is accepted**, and the offeror is **bound by his promise**.

While the terms "released", "discharged" and "excused" mean about the same thing in plain English, in contract law the term "**released**" is used to mean a person no longer has to fulfill his promise. The term "**discharged**" is used to mean a person who had a duty no longer has to fulfill the duty. And the term "**excused**" is used to mean a promise or duty that was subject to a condition is no longer subject to the condition.

However, under the UCC the term "excused" is used to mean a duty is "discharged". This may be a confusing contradiction. It is explained again in Chapter 10.

[1] Perhaps this term "consideration" arose out of the idea of "respect". Perhaps the courts held that the offeror should not be bound to his promise unless the offeree shows him proper "respect" or "consideration" by agreeing to do what the offeror has asked.

2) Offeree must GIVE IN EXCHANGE

Contract offers are always subject to the condition that the **offeree** (and nobody else) must **give something in exchange**. The offeree must do or promise to do or not do what the offeror asks for in exchange for the offeror's promise to act (or not act).

Any promise that is NOT subject to a condition that the offeree must do or promise to do or not do what the offeror asks in exchange for the offeror's promise is not a contract offer at all. Rather it is a **gift offer** or **gift promise**, the offer of a gift or gratuity. A gift offer NEVER binds the offeror to any legal duties.

> **For example:** Bob says to Tom, "I will mow your lawn." This is a gift offer, the offer of a gratuitous act because Bob asks nothing from Tom in return. Bob must say, "I will mow your lawn if you (do something)" to create a contract offer.

3) Offeree must GIVE AT LEGAL DETRIMENT

The thing each party promises to "give" must pose **legal detriment** to them. They must promise to do something or not do something that they have **no legal obligation to not do or do**.

> **For example:** Father says, "Son, I will pay for your college education if you do not smoke cigarettes." Son says, "Ok." Father had no legal obligation to send Son to college so his promise **to do** that poses legal detriment to him. And Son had no legal obligation to not smoke cigarettes so his promise **to not do** that also poses legal detriment to him.

Performing (or promising not to violate) pre-existing duties are never consideration. Performing or promising to perform a pre-existing legal duty, or promising not to violate a pre-existing duty, is never valid consideration because the **legal obligation already exists**. This is often called the "**pre-existing duty rule**".

Empty promises are never consideration. A promise to "think about" doing something, to "maybe" do something, to sell "all you order", to buy "all I want", or to do what you are legally obligated to do anyway are **illusory promises** and never valid consideration. An agreement based on an illusory promise is sometimes called an "**illusory contract**", but it is no contract at all.

> **For example:** Abby tells Bud, "If you give me a dollar I might kiss you." Since Abby is not obligated to kiss Bud whether he pays her or not, this is an illusory promise.

4) Promises to NOT ACT

A promise to NOT act in some manner poses legal detriment and constitutes consideration if the promisor has a legal right to act in that manner.

Promises to not commit illegal acts. If a party has **no legal right to act** in a certain manner, promising to NOT act that way poses no legal detriment and **is not consideration**.

> **For example:** Father says, "Son, I will pay for your education if you do not smoke illegal drugs." Son has no right to smoke illegal drugs so agreement does not form a contract.

Forbearance to sue on a claim. If a party agrees to NOT sue or attempt to collect on a claim against another party, their promise **to not act** on their claim is sufficient consideration in most Courts as long as the underlying claim is brought in **good faith**. However, some Courts have held that a claim must also be a **meritorious claim** in order for it to provide consideration for an agreement not to bring a suit, even if they hold a good faith belief in the claim.

> **For example:** Dick is injured on Tom's land. Three years later Tom agrees to pay Dick $1,000 if Dick will not sue him. In most Courts Tom would be bound to pay because Dick's promise to **not sue** would be sufficient consideration. But if Dick's claim was time-barred some Courts would hold Dick could not collect the $1,000 because he never could have collected from Tom anyway because his underlying claim lacked legal merit.

Forgiveness of debt. A common and particular form of the **promise not to act** is a promise to extinguish a debt. This is simply a promise not to act to collect payment of the lawful debt.

Accord and satisfaction. Another form of a **promise not to act** is a promise to ignore a breach of an existing contract. That is called an "accord and satisfaction". It will be discussed later.

5) Consideration must be BARGAINED FOR

An exchange of consideration must be the result of a **bargained for exchange at the time of contract**. That means that the promised performance of each party is offered to the other at the time of contract **on the condition** that the other party must act in exchange as asked of them. Promises that pose legal detriment are not valid consideration unless they are "bargained for".

Past acts are never consideration. Past acts by one of the party are never valid consideration because they were not given as part of a presently bargained for exchange.

> **For example:** Orphan Annie says to Daddy Warbucks, "You were so kind to me as a child I will pay for your nursing care." Annie's promise poses legal detriment to her because she had no legal obligation to care for Warbucks. But her promise does not form a contract because Warbuck's **past acts of kindness** were not ever "bargained for".

Moral obligation is never consideration. Ethical and religious concepts of moral obligation do not represent valid consideration because they are not presently bargained for". [2]

> **For example:** Tom says, "I saved your life, so you owe me a million dollars," and Dick says, "I agree." There is no consideration to support Dick's agreement because there is no bargained-for exchange. Tom saved Dick first and bargained the agreement afterward.

6) GIFT OFFERS and GIFTS

Promises that are not supported by consideration are **gift offers**. Gift offers are **not enforceable** at law. Gift offers can be revoked or breached at any time, and the only remedies when that causes harm are in equity. Equity will be explained in more detail in Chapter 9.

[2] Moral obligation was found to support contracts in a very small number of fact-bound cases long ago, but they do not represent a broadly adopted view and are to be disregarded as anomalies.

Since gift offers cannot form a legal contract "gifts" are seldom discussed in contract classes. In fact, they are hardly discussed in law school at all. But the rules for gifts are worth noting.

Revocability. Gift offers are always **legally revocable before conveyance** of the thing promised. But they are **irrevocable after conveyance** of the thing promised OR a thing symbolizing it. A thing symbolizing the gift is called a "**token chose**". Common "token choses" are keys or registration certificates for cars and deeds to land.

There are two common law exceptions when gifts are **legally revocable** after conveyance, **gifts in contemplation of death** and **gifts by incompetents**. Other exceptions may be created by statute.

Gifts in contemplation of death. Gifts given in contemplation of death are often legally revocable, and this is especially true if the donor dies soon afterward from suicide OR thought he was going to die but does not.

Gifts by incompetents. Gifts given by parties lacking contractual capacity (minors and adults adjudicated by a Court to lack capacity) are **legally revocable**.

> **For example:** Tom tells Dick, "I am giving you my car." Tom has a **legal right to revoke** his promise. But after he delivers the car or the keys to the car (a token chose) the gift is **irrevocable** unless Tom **lacks mental capacity**, is acting because he **thinks he is about to die and does not**, or **he soon commits suicide**.

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J. Offer Conditions

Every offer is a promise subject to the condition that the offeree must do or not do, or promise to do or not do, what the offeror asks for in exchange.

1) Conditions PRECEDENT and SUBSEQUENT

If a condition must hold before a promise will **ripen into a duty** to perform, it is called a promise subject to a **condition precedent**. And if a condition must continue to hold after a promise **ripens into a duty to perform**, the duty is subject to a **condition subsequent**. If the **condition subsequent fails**, the duty to perform is **discharged**.

Promises subject to conditions precedent do not create **duties** to perform until and unless the conditions hold. If the conditions hold, the promises become duties to perform. The promise is said to "**ripen**" into a duty. Or, it might be said the "future duty" becomes a "present duty" when the conditions precedent is satisfied (holds).

Existing duties to perform (present duties) that are **subject to conditions subsequent** are **discharged** (cease to exist) if the **conditions subsequent fail**.

Contract offers are always promises subject to at least one condition precedent: the offeree must do or promise to do what the offeror has asked for in return. But contract offers can be subject to many other conditions.

> **For example:** Mower says to Farmer, "I will mow your field on Saturday for $100 if it does not rain." Mower (the offeror) is making a promise subject to **four express conditions**. First, his **promise to mow is not a duty** to mow until Farmer (the offeree) agrees to pay him $100, a **condition precedent**. Second, Mower has no duty to mow until Saturday, another **condition precedent**. Third, he has no duty to mow if it is raining on Saturday, a third **condition precedent**. Fourth, if it starts raining on Saturday after he starts mowing, his duty to mow is **discharged**, a **condition subsequent**.

2) Conditions EXPRESS and IMPLIED

Conditions may be either **express conditions**, stated by the parties, or **implied conditions**, implied by the circumstances and the law of contracts.

> **For example:** Bob says to Tom, "I will mow your lawn for $20." An **express condition** is that Tom must promise to pay Bob $20. But the contract is subject to **implied conditions** that Tom has to accept the offer before Tom dies. Every contract offer is subject to the **implied condition** that the offer fails if the offeree dies before it is accepted.

3) FAILURE OF CONDITION

An offer is always subject to conditions. If the conditions fail, the offer fails.

4) TIME OF PERFORMANCE conditions

Some professors and legal writers do not consider "**time of performance**" to be a "condition" because "conditions must pose uncertainty and yet time is certain to pass".

This is a pointless distinction. Time of performance requirements create uncertainty because they delay the ripening of promises into duties to perform. The farther into the future performance is delayed, the greater the risk that events will cause performance to never occur at all.

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K. Unilateral and Bilateral Offers

1) UNILATERAL offers

A unilateral contract offer is one that **unequivocally and unambiguously demands or requires that it can only be accepted by the offeree performing a requested act** rather than by promising to act in exchange.

> **For example:** Bob tells Tom, "I will give you $20 <u>if and only if</u> you go into the girl's gym, flap your arms like a chicken and say "cluck, cluck"." Since Tom clearly must go into the girl's gym and act like a chicken to accept the offer, it is a unilateral contract offer.

2) GENERAL offers

General offers are offers made to the public at large, offering to pay a **reward or bounty** to anyone who performs a requested act. By implication these are **always unilateral contract offers**.

> **For example:** Mary posts a notice that says, "$100 REWARD. I have lost my lamb. $100 reward for its safe return." This is a **general offer** because it promises an award to <u>any person</u> who returns the lamb. It is also a unilateral contract offer because it demands performance, not just some "promise" to look for the sheep.

3) BILATERAL offers

All contract **offers that are not clearly unilateral offers are bilateral offers.**

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L. The Power of Acceptance

Receiving a contract offer gives the offeree the **power of acceptance**. That means the offeree receives the power to **bind the offeror to his contract promise** by accepting it. If offerees "**exercise the power of acceptance**" by accepting offers it binds both offerors and offerees.

1) OFFER MAILBOX RULE: Effective upon receipt

Under the "mailbox rules" of the common law, contract offers become effective and offerees receive the **power of acceptance** when offers are **received by offerees** or their agents.

> **For example:** Able and Baker are dickering over a pig. Able sends Baker a telegram, "I will pay you $100 for your pig." Able tells Charley about his offer. Charley calls Baker and tells him, "He offered you his pig for $100." Baker calls Able on the phone and says, "I accept your offer!" No contract forms unless Charley is Baker's agent because Baker's **power of acceptance** does not arise until he or his agent **receives the offer** from Able.

2) EXPRESS OFFER CONDITIONS

The offeree's power of acceptance is subject to all of the **express conditions of the offer**, and all offers have at least one express condition, the things the offerors ask offerees to do in order to accept their offers.

Offers may also state express conditions on the **manner** in which offers may be accepted, the **time** in which they can be accepted, that property offered may be subject to **prior sale**, or any other conditions.

If the power of acceptance fails because of a **failure of condition** the offer is said to have "**lapsed**". If the power of acceptance lapses the offer is also said to have lapsed.

If conditions must occur before offers can be accepted they are **conditions precedent** and there is no power of acceptance until the conditions occur. This is not a lapse because the power of acceptance has not yet existed. But if conditions fail so it is impossible for offers to ever be accepted the <u>offers</u> (not the power of acceptance) "**lapse**".

> **For example:** Able tells Baker, "I will sell you my car for $1000 if my son says he doesn't want it." Baker has no power of acceptance because the offer is subject to the **condition**

precedent the son must first decline to take the car. Baker will not have any power of acceptance until and unless the son declines to take the car.

If a condition will terminate the offeree's power of acceptance after it forms, it is a **condition subsequent**. If the condition subsequent fails both the power of acceptance and offer lapse.

> **For example:** Able tells Baker, "I will sell you my car for $1000 unless someone makes me a better offer. Baker has the power to immediately accept this offer. But if Baker delays and someone else offers Able more for the car Baker's power of acceptance is immediately terminated by failure of the **express condition subsequent**.

3) IMPLIED OFFER CONDITIONS

Offers are subject to **implied conditions** by law and circumstances. If any of these implied conditions fail the offer and power of acceptance lapse:

- The power of acceptance lapses if the **offeror dies** before effective acceptance;
- The power of acceptance lapses if the **offeree dies** before effective acceptance (offers cannot be accepted by the offeree's estate or executor);
- The power of acceptance lapses if **acceptance is untimely** (tardy);
- The power of acceptance lapses if the contract **purpose becomes illegal** before effective acceptance ("supervening illegality");
- The power of acceptance lapses if the **offer is revoked** before effective acceptance;
- The power of acceptance lapses if the contract **subject matter is destroyed** before effective acceptance;
- The power of acceptance lapses if the contract **purpose becomes fruitless** before effective acceptance;
- The power of acceptance lapses if the contract **subject matter is sold** before effective acceptance and the buyer was aware that was possible (prior sale);
- The power of acceptance lapses if **performance becomes impossible** before effective acceptance.

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M. Acceptance must be Timely

If a contract offer **states the time** in which the offeree must accept, the power of acceptance is subject to an **express condition subsequent**. The power of acceptance and offer both lapse if the offeree does not exercise the power of acceptance (accept the offer) within the **time stated**.

> **For example:** Tom tells Dick, "I will sell you my car for $500. I will give you a day to think about it." The offer will lapse a day later if Tom does not accept it first.

If a contract offer **does not state the time** in which the offeree must accept, the offeree must accept the offer within a "reasonable period." The power of acceptance and offer both lapse if the offer is not accepted within a **reasonable period of time**.

The reasonable period of time in which an offeree must accept an offer depends on the means by which the offer was communicated to the offeree. Under common law, **oral offers** lapse at the **end of the conversation**.

> **For example:** Tom tells Dick, "I will sell you my car for $500." Dick says, "I will think about it," and walks away. The offer lapsed because the reasonable period of time in which Dick had the power of acceptance ended with the conversation.

The "reasonable period" in which **written offers** must be accepted depends on the **means of offer transmission**, the **subject matter** of the offer, **trade standards**, the prior **course of dealing** between the parties, and **existing circumstances** known to the parties.

> **For example:** On June 1 Frank faxes Cheryl, "I have fresh salmon for immediate delivery at $9 a pound." Three facts suggest Sharon's power of acceptance is only viable for a short period of time. First, Frank uses a fax machine. Second "fresh salmon" is highly perishable. Third Frank says "immediate delivery". Suppose Cheryl waits three days before faxing back, "It's a deal." Obviously the reasonable period for accepting the offer of "fresh salmon" lapsed long before she responded.

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N. Acceptance Subject to Available Supply

If offerees know or should know that offerors are trying to **sell the same property or services to other potential buyers**, the offers are subject to the implied condition that the **power of acceptance will lapse if others buy first**. This might be called an implied condition of "**available supply**" or "**prior sale**".

> **For example:** Frank faxes Cheryl, "I have fresh salmon. Will sell you one for immediate delivery at $9 a pound. Supplies limited." If Frank sells out of fish before Cheryl responds, her **power of acceptance** will **lapse** because she knows he is selling fish to other customers and supplies are limited.

Courts are slightly SPLIT on whether an implied condition of "available supply" exists or not. Some hold that the condition **does not exist unless** offerees know or reasonably should know the offerors ARE trying to sell to other buyers. Other Courts hold the condition **does exist unless** offerees reasonably believe the offerors ARE NOT trying to sell to other buyers. In many cases this would depend on the nature of the goods being sold and the assurances of the offeror.

> **For example:** Frank offers to sell salmon to Cheryl and assures her, "I am holding one for you." If Cheryl promptly says, "I'll take it!" she has accepted the offer. If Frank says he is sold out he may be held in breach because he assured Cheryl he was holding a fish for her, and her **power of acceptance** was not subject to an implied condition of availability.

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O. Acceptance Must Occur Before Revocation

An implied condition of every contract offer is that the **offeror reserves the right to revoke** the offer, so the offeree's **power of acceptance is subject to the implied condition subsequent** that it lapses if the offeror effectively revokes the offer. But the offeror cannot revoke the offer after it has been accepted.

Many professors and legal writers use the term "lapse" to only refer to situations when acceptance is not timely (tardy acceptance). They do not use the term "lapse" to refer to revocations or other failures of condition such as destruction of subject matter. Be sensitive to the terms your professor prefers, but in every one of these cases the effect is the same: the **failure of an express or implied condition** terminates the offeree's **power of acceptance**.

1) REVOCATION MAILBOX RULE: Effective upon receipt

Under the "mailbox rules" of the common law, an offer is not revoked, and the power of acceptance does not lapse, until the offeree or his agent **receives notice** of the revocation.

> **For example:** Tom offers Dick his car for $1000. If Tom changes his mind, he has to tell Dick. Until he tells Dick (or his agent) Dick can accept the offer. And if Dick does accept, a contract forms and Tom can no longer revoke his offer.

2) INDIRECT revocation

An offer can be **indirectly revoked** if the offeree learns acceptance of the offer has become impossible or otherwise learns of inconsistent facts that imply the offer has been revoked.

> **For example:** Tom offers Dick his car for $1000. Later Dick learns Bob bought Tom's car. Dick knows Tom no longer owns the car so Tom's offer is **indirectly revoked**.

3) IMPLIED revocation

An offer is **impliedly revoked** and replaced by a new offer if the offeror makes the offeree a new, different offer that necessarily makes the prior offer ineffective.

> **For example:** Tom tells Dick, "I will sell you my car for $1000 with six months to pay." Later Tom tells Dick, "I've decided I want cash for the car." That impliedly revokes the prior offer. If Dick says, "It's a deal" he is agreeing to the new offer, not the prior one.

4) UNILATERAL offer revocation

Revocation of unilateral contract offers poses a particular problem. Since the offeree cannot accept the offer until performance is completed, the offeror under the common law could wait until the offeree has almost completed performance and then revoke the offer. In that case the offeree had no legal remedy and had to seek a remedy in equity.

> **For example:** Tom makes a unilateral offer to pay Dick $1,000 if and only if Dick builds a barbed-wire fence completely around his large ranch. But just as Dick gets to within a few feet of completing the fence Tom shouts, "I revoke my offer! Get off my ranch!" Under the

common law Dick had no legal "right" to payment, and Tom would reap an unjust enrichment. Dick could seek a remedy at equity, but not at law.

In response to the injustice this situation posed, some modern jurisdictions have adopted the following "saving doctrines" that may give the offeree a legal remedy as opposed to an equitable remedy, but **only if the offeror is aware that the offeree has begun to tender performance**:

1. BILATERAL CONVERSION. Some jurisdictions hold that once the offeror of a unilateral contract learns the offeree has begun performance the offer becomes a bilateral offer, the tender of performance is an acceptance, and **a legally binding contract forms** even though the original offer was for a unilateral contract. Under this approach both parties are bound by the contract.

2. OPTION CONTRACT. A second approach (typified by Restatement § 45) holds that when an offeree begins tendering performance the contract offer becomes subject to a **legally binding** "option contract" preventing the offeror from revoking until the offeree either completes or abandons performance.

Jurisdictions that do not follow those two approaches usually provide remedies based on two **equitable theories**:

1. EQUITABLE ESTOPPEL. A common equitable approach is to hold that when the offeree begins tendering performance the offeror becomes equitably estopped from revoking until the offeree either completes or abandons performance. This is effectively the same as the "option contract" approach, but instead of this being a "legal right" of the offeree it is a remedy the Court (judge) has discretion to grant.

2. EQUITABLE RESTITUTION based on IMPLIED-IN-LAW CONTRACT. This approach lets the offeror revoke the offer at any time but grants the offeree equitable restitution to prevent unjust enrichment and/or prevent the frustration of reasonable expectations. Implied-in-law contracts are not "legal contracts" at all. They will be explained in detail later in Chapter 9: Equitable Remedies. [3]

Most Courts hold offerors can revoke if they are unaware offerees are tendering performance.

> **For example:** Tom makes a unilateral offer to pay Dick $1,000 if and only if Dick paints Tom's remote mountain cabin. Dick starts painting the cabin, but never tells Tom what he is doing. Tom mails Dick a letter that says, "I have decided to not paint my cabin after all." Most Courts hold Tom owes Dick nothing because at the time he revoked the offer he had no idea Dick was already painting the cabin.

5) Revoking GENERAL OFFERS

To revoke a general offer, such as a reward offer, the offeree must **advertise and distribute notices** of the revocation in the **same manner** and to the **same extent** that the original offer was distributed, and the offer is not effectively revoked until this has been completed.

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[3] This may be called "quantum meruit" but that term is so misused it should be avoided. It may also be called "quasi-contract" which is another misused term that should also be avoided.

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r example: Mary posts a notice that says, "$100 REWARD. I have lost my lamb. $100 reward for its safe return." Later she decides the lamb isn't worth the money. To revoke this offer she has to post a **notice of revocation** in the same places and manner that she posted the reward notice.

6) OPTION CONTRACTS - irrevocable offers

A contract cannot be revoked by the offeror if it is subject to an **option contract**. There are two terms in contract law that sound the same but are quite different: "contract options" and "option contracts". They should be distinguished.

Contract options. A "**contract option**" is a provision in a contract that gives one of the parties the right to modify the contract. The party with **power to exercise** the option is said to "**hold the option**", and the power may or may not be subject to a time requirement. The option is **exercised** when the party holding the option **gives notice of intent to exercise** the option to the other party.

> **For example:** Mary leases an apartment for a year at $1,000 a month and the lease agreement says she has an option to extend the lease for a second year at $1,200 a month if she gives 60 days written notice. That is a typical "lease option".

Option contracts. An "**option contract**" is a very different thing. It is an agreement that an offeror that has made a contract offer (the "**underlying offer**") **will not revoke that offer** for a **specified period of time**. This typically is so the offeree can have time to arrange financing or otherwise decide whether or not to accept the offer. The offeree is said to "**hold the option**". The **option contract** is a separate, legal contract all by itself.

An option contract is <u>always</u> subject to a time requirement. To **exercise the option**, the offeree must **accept the underlying offer**. If the offeree does not exercise the option within the **option period** the underlying offer **automatically lapses** (unless otherwise agreed).

> **For example:** Developer wants to build a shopping center on Farmer's land. Farmer offers to sell the land to Developer for $1 million. This is the "**underlying offer**" Developer says, "I will give you $25,000 if you will **give me a 1 year option to buy for that price**." Farmer agrees, Developer pays Farmer $25,000, and the option contract takes effect. Developer has a year to find financing. If he succeeds he can accept Farmer's offer, pay Farmer $1 million, and build the shopping center. If he fails his option **expires**, Farmer's underlying offer to sell the land **lapses**, and Developer loses $25,000.

Firm offers. Under UCC § 2-205 an offer given by a merchant is irrevocable under certain conditions. That is explained in Chapter 10: UCC Modifications. The term "firm offer" is usually reserved for discussion of that particular UCC provision.

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P. Mailbox Rules: Offer and revocation both sent

In certain cases an offeror sends an offer and then sends a revocation. That raises the question of the effect of each given the Mailbox Rules for each.

1) Offer BEFORE revocation

The offer is **effective upon receipt**, and once received the offeree has **power of acceptance**. Therefore, if the offer is received first, the offeree has **power of acceptance** UNTIL the revocation is received. If the offeree accepts the offer before the revocation arrives, the revocation has no effect.

2) Revocation BEFORE offer

The revocation is **also effective upon receipt**, so if the revocation is received before the offer, the offeree NEVER has a **power of acceptance** at all.

2. Acceptance of an Offer

As explained above, a contract offer gives the offeree the **power of acceptance**. If the power of acceptance does not lapse because of a **failure of conditions** another thing can terminate the offeree's power of acceptance – **rejection** of the offer by the offeree. [4]

If an offer is **rejected** by the offeree the **power of acceptance is terminated** and the offeree cannot change his mind and accept the offer afterward. But if the offeree accepts the offer, and the acceptance is effective, a **contract forms**. After that both the offeror and the offeree are **bound to their contract promises**.

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A. The Mirror Image Rule

Under common law the terms of acceptance by an offeree must be an **unqualified assent** to the terms of the offer. It is often said the acceptance terms must be the "mirror image" of the terms of the offer and this is called the "**Mirror Image Rule**".

In other words the "acceptance" must be nothing more than saying, "Yes", "Ok", "I agree", "It's a deal" or something similar. If the offeree states the terms of the bargain in the acceptance, they must be exactly the same terms, stated the same way that they were stated in the offer. If there were a series of communications between the parties, the terms of the acceptance cannot inject any terms that were not agreed upon earlier by the offeror.

If the offeree's response says or suggests terms that are different from the terms of the offer it is considered a "**rejection and counteroffer**". That terminates the offeree's power of acceptance.

[4] As explained above, your professor may feel (strongly) that revocation is not a "failure of condition" and you must be sensitive to the proclivities of the professor. So if your professor is adamant that a revocation is not a "failure of condition" then just say the power of acceptance may be revoked OR lapse for failure of condition. Either way it is the same thing.

Under the UCC, which governs contracts for the sale of goods, the "Mirror Image Rule" is replaced with a very different rule. That will be explained in Chapter 10: UCC Modifications.

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B. Acceptance Determined by Plain Meaning

Whether or not the response of an offeree to a contract offer is an "assent" or not will be determined by the **plain meaning** of the words said in response in most cases. Words of "assent" are words like "yes", "ok", "I agree", "I accept", and so forth. Pay attention to the exact words of the offeree, when they are given as a fact on an exam question.

> **For example:** Bob says to Jim, "I will sell you my copyright for $100,000." If Jim responds, "That is a hell of a good offer," he did not say he agreed or disagreed. So it is NOT an acceptance and no contract has formed.

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C. Joking or Drunken Acceptance

If an offer is accepted by a drunk or joking offeree and the offeror knows it is not a serious acceptance, it is **not an acceptance** and **no contract** forms. Even if the offeror thinks an acceptance is legitimate it is not legitimate if no objective observer **would have reasonably believed** the acceptance was serious.

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D. Acceptance by Silence

As a general rule silence (or an ambiguous response to an offer) does not show assent to an offer. Acceptance does not necessarily have to be express, but the situations in which silence constitutes acceptance are very narrow because offerors would otherwise be able to claim offerees were bound to agreements they did not accept and had no intention of accepting.

1) IMPLIED acceptance by ACTION

A **nod of a head** or **shaking hands** is express assent to an offer, binding the parties, if a reasonable person would believe it was meant to show assent. And if the offeree silently **begins performance of contract duties with the offeror's knowledge** it is an implied assent. But if offerors do NOT know offerees are performing the "acceptance" is not "received" by the offeror and is not "effective" to bind the offeror.

Under the UCC **shipping goods** constitutes assent to an offer. This is explained in Chapter 10.

2) IMPLIED acceptance by SILENCE

If the parties have **an established course of dealing** in which silence means acceptance, AND the offeree **remains silent knowing the offeror would expect an objection** if the offer is not acceptable, the offerees' silence constitutes an implied acceptance.

3) IMPLIED acceptance by REQUIRED SILENCE

Silence constitutes acceptance if the **offer requires silence** as the means of acceptance, AND the **offeree deliberately and knowingly remains silent** to cause the offeror to believe the offer has been accepted.

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E. Mailbox Rule: Acceptance May be Effective on Dispatch

Under the "mailbox rules" of the common law, notice of acceptance by an offeree may be effective as soon as it is dispatched (by email, snail mail, overnight mail, fax, phone, etc.).

1) Acceptance by REQUIRED MEANS

If a contract offer **requires acceptance by a specific means**, the notice of acceptance is effective upon dispatch **if sent by the means required** whether the offeror ever "gets the message" or not.

> **For example:** Amir receives an offer from Abdul saying, "I will sell you drilling rights for $1 million. Respond by fax." Amir responds by fax, "It's a deal." Unfortunately, Abdul died after he sent his offer. Deal or no deal? If Abdul died before Amir sent his fax, the offer lapsed and it is "no deal". If he died after Amir sent his fax, a contract formed and Abdul's estate (his executor) is bound by the contract.

2) Acceptance by SAME MEANS OF TRANSMISSION

If a contract offer does NOT require acceptance by a specific means, the notice of acceptance is effective upon dispatch if **sent by the same means of transmission** the offer was sent whether the offeror ever "gets the message" or not.

> **For example:** Jackson sends his offer to Otto by carrier pigeon. Otto writes, "I accept!" on a piece of paper and attaches it to his own carrier pigeon and tosses it into the air. Acceptance is instantaneously effective, even if the pigeon is killed by a hawk.

3) Acceptance by EQUALLY QUICK MEANS

If a contract offer does NOT require acceptance by a specific means, acceptance is effective upon dispatch if **sent by a faster way** than the offer was sent whether the offeror gets it or not.

> **For example:** Freddy sends his offer to Otto by first class mail. Otto writes, "I accept!" on a piece of paper and sends it back to Freddy by fax. Acceptance is effective at that moment, even if Freddy's fax machine is out of paper.

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F. Mailbox Rule: Incorrect Acceptance is Never Effective

If a contract offer **requires acceptance by a specific means**, that becomes a **condition precedent** and notice of acceptance is never effective **if it is not sent by the means required**.

> **For example:** Tony Orlando says, "If you accept, tie a yellow ribbon around the old oak tree." If the offeree goes to Tony and says, "I accept!" that is not effective because it is NOT what Tony said the offeree had to do. (Did I mention the offeror is "King" of the offer?)

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G. Mailbox Rule: Slower Acceptance Effective on Receipt

If an offer does NOT specify a required means of acceptance, and the offeree sends acceptance by a SLOWER means than the offer was sent, the acceptance is **effective upon receipt**.

> **For example:** Freddy sends his offer to Otto by fax. Otto writes, "I accept!" on a piece of paper and sends it back to Freddy by first class mail. Since first class mail is slower than a fax, the notice of acceptance is not effective until Freddy receives it.

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H. Effect of Gift Promise Acceptance

As stated earlier a gift offer or gift promise does not constitute a contract offer because there is no bargained for exchange of value. Likewise, the "acceptance" of a gift offer also does not constitute consideration and cannot create a binding contract.

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I. Effect of Gift Promise Exchange

A common situation unsupported by consideration is the **exchange of gift promises**. This will not create a legal contract because it is simply an exchange of gifts, neither traded for the other.

> **For example:** Tom says, "I will not paint my house pink." Dick says, "That makes me so happy I will not paint my house black." Both of them can paint their houses whatever color they like because Tom did not condition his initial offer on receipt of a promise from Dick **in exchange**. Remember, nothing the "offeree" says in response can change the original offer from a "gift offer" into a "contract offer".

3. Rejection of Offers

If an offeree **rejects** an offer the **power of acceptance is terminated** and the rejection **cannot be retracted**. Rejections can be either express or implied.

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A. Express Rejections

If the offeree expressly rejects the offer of the offeror, the offeree's power of acceptance is terminated. But you must consider the **plain meaning** of the words stated very carefully. Words and actions of negotiation that leave the door open to (grudging) acceptance are not rejections. Look for the words "no", "not" or something equivalent.

> **For example:** If the offeror says, "I will give you five apples for a dollar", and the offeree responds, "Not in a million years," that is an express rejection, and it terminates the power of acceptance because the offeree has said the word "not".

1) QUESTIONS are never rejections

A question is never a rejection.

> **For example:** If the offeror says, "I will give you five apples for a dollar", and the offeree responds, "Will you give me six for a dollar?" it is not a rejection.

2) CRITICISMS are not usually rejections

A criticism of the offer or other display of bluster is not a rejection.

> **For example:** If the offeree says, "What are you, crazy? That is ridiculous. Only an idiot would pay that," that is also not a rejection.

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B. Implied Rejections

If an offeree says or does something that clearly implies rejection of the offer, it is an implied rejection. After that the power of acceptance lapses and the offeree cannot accept the offer.

1) COUNTEROFFERS always IMPLIED REJECTIONS

Any response from the offeree to the offeror **stating different terms** is a **counteroffer**, and an **automatic rejection** terminating the power of acceptance.

> **For example:** Al tells Bob, "I will give you five apples for a dollar." Bob responds, "I accept if you throw in a peach." That response includes a different term so it is a **counteroffer** that constitutes an **automatic rejection** of Al's offer.

This rule is drastically changed by the UCC as explained in Chapter 10.

2) ACTIONS may be REJECTIONS

> **For example:** If Al tells Bob, "I will give you five apples for a dollar," and Bob walks away it is clearly a rejection because oral offers lapse at the end of the conversation.

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C. Mailbox Rule for Rejections: Effective on Receipt

Under the "mailbox rules" of the common law, a rejection is effective when it is **received** by the offeror or his agent, and at that moment the **power of acceptance terminates**.

> **For example:** Gates offers to sell Blackacre to Trump for $1 million. Trump writes back, "I am not interested." But then Trump changes his mind, calls Gates, and says, "I accept!" If Gates already got Trump's letter the **power of acceptance terminated upon its receipt** and Trump cannot accept the offer. But if Trump's acceptance got to Gates first, the power of acceptance had not yet ended, and Trump gets Blackacre.

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D. If Acceptance and Rejection Both Sent

The preceding example raises a somewhat different issue of whether a contract forms or not when the following happens:

- The offeree sends BOTH an **acceptance** AND a **rejection** (in any order);
- The **acceptance** is **effective on dispatch** BEFORE the rejection is received;
- But the **rejection** is **received** by the offeror **first**.

> **For example:** Stanford sends Carnegie an offer by Pony Express to sell him all his stock in the Union Pacific Railway for $100 million. Carnegie sends back two letters by Pony Express. One accepts the offer and the other rejects the offer. Since Carnegie's acceptance is sent the same way Stanford's offer was sent, it is "**effective upon dispatch**" and should create a contract as soon as it is sent. But what if Stanford gets the rejection message first?

1) If OFFEROR REACTS - REJECTION effective

If the offeree sends both an acceptance and a rejection to the offeror and the acceptance is effective first but the rejection is received first, the **rejection is effective if the offeror changes position** in reliance on it. Then there is **no contract**.

2) If OFFER DOES NOT REACT – ACCEPTANCE effective

In the same situation, the offeree sends both an acceptance and a rejection to the offeror and the acceptance is effective first but the rejection is received first, the **acceptance is effective if the offeror does NOT change position** in reliance on the rejection. Then there **is a contract.**

> **For example:** Stanford offers by Pony Express to sell Carnegie his stock in the Union Pacific Railway for $100 million, and Carnegie sends two letters by Pony Express, one

accepting and one rejecting the offer. Carnegie's acceptance is "**effective upon dispatch**" and will create a contract as soon as it is sent **unless Stanford gets the rejection first and changes position as a result**.

4. The Battle of the Forms

Often a contract forms after a flurry of written offers get sent back and forth between the parties. Each side makes offers demanding favorable terms. Each party rejects the other party's proposal and sends back a counter-offer. Eventually a contract forms, and the last offer made, the one that is actually accepted by the other party, determines the terms of the bargain. Sometimes this is called the "**Last Shot Doctrine**" which means that the last offer made determines the terms of the contract.

So it is essential to determine **which offer** from **which party** was **THE offer** that was actually accepted to form the contract.

If the parties send a flurry of detailed written forms back and forth, each presenting offers with different terms and demands, it is often called a "**Battle of the Forms**". But often the communications are oral, and there are no "forms" involved.

And after a contract forms, the parties often continue to send communications back and forth that assert contract terms that were never actually part of the offer that created the contract. These may or may not be written "confirmations".

You must carefully determine which contract offer was the "last shot" that got accepted by the other party. That is the communication that established the actual contract terms.

If it is impossible to determine which offer was actually accepted in the end, the Court may apply the "**Knock Out Rule**" to interpret the contract terms. That will be explained later in Chapter 3.

5. Express and Implied-in-Fact Contracts

Normally offerors expressly state contract offers to offerees, and offerees expressly state their acceptance to the offerors. That creates **express contracts**.

> **For example:** Vinny says to Wanda, "I will sell you this bottle of wine for $10," and Wanda responds, "It's a deal." This is an **express contract**.

But sometimes offers are implied by the acts of the offerors, and/or acceptances are implied by the behavior of the offerees. In those situations **implied-in-fact contracts** form.

> **For example:** Vinny puts a bottle of wine on the counter at the liquor store along with a $10 bill. His actions imply an offer to buy the wine. Cindy the cashier takes the money, puts the wine in a paper bag, and hands it to Vinny. Her actions imply acceptance of Vinny's offer. This is an **implied-in-fact contract**.

Implied-in-fact contracts also can arise when parties mistakenly offer goods or services to other parties that never asked for them, but the offered goods and services are knowingly accepted.

> **For example:** Vinny knocks on Wanda's door and says, "I am here to clean the carpets." Wanda knows Vinny is at the wrong address. She never asked to have her carpets cleaned. But she opens the door and lets Vinny clean her carpets anyway. Since she knowingly accepted the services offered she is legally bound to pay for them under an **implied-in-fact contract**. The amount she must pay is the amount Vinny expected to be paid.

An implied-in-fact contract is a binding legal contract the same as an express contract.

It is very important to distinguish between the similar terms "**implied-in-fact contract**" and "**implied-in-law contract**". An "implied-in-law contract" is not a real contract at all. It is an equitable theory justifying the award of an equitable remedy in situations when no real contract exists at all. That will be explained in Chapter 9: Equitable Remedies.

6. Summary of Contract Formation

Contract formation means the process by which a contract is formed. Under the common law a contract forms when an offeror sends a **contract offer** to an offeree, the offeree **receives** the offer, and the offeree **unconditionally accepts** the offer.

For a promise to constitute a "contract offer" it must be **conditioned on a bargained for exchange of value**. And its **plain meaning** must be so clear that **a reasonable person would believe assent would form a contract**.

For a response to constitute an "acceptance" its **plain meaning** must be **an assent to all the terms of the offer**.

If an offer requires acceptance in a particular manner, acceptance by that manner is **effective when dispatched**, and an **attempt to accept in any other manner is never effective** at all.

If an offer does not require acceptance in a particular manner, acceptance by any means as fast or faster than the offer was sent is **effective upon dispatch**, and acceptance any other way is **effective upon receipt** by the offeror.

Offers, revocations and **rejections** are all **effective upon receipt**.

Chapter 2: Contract Enforceability

The initial consideration when interpreting the terms of a contract is whether it is a binding agreement at all. If the contract is not binding there are no legal remedies and the only possible remedy a party may obtain would be in equity which is explained in Chapter 9.

Professors and legal writers often call a binding contract a "**valid contract**" but that term has no consistent meaning. A better terminology would be to think of contracts as being VOID, VOIDABLE, UNENFORCEABLE, or ENFORCEABLE because those terms are used uniformly.

If a contract is enforceable it is **binding**, meaning that the parties have a **legal right** to a remedy if the contract is breached. This may also be called a "**legal contract**" or an "**enforceable contract**". Professors or legal writers may refer to this as a "**valid**" contract, but that term is also often used to simply mean contracts that are "not void", and that causes considerable confusion because some contracts that are "not void" are also "not binding". That is explained below.

Professors and legal writers also often refer to "**failed contracts**" but that term is also used inconsistently. Some use the term "**failed contract**" to mean any contract that is "**not enforceable**" or "binding". Others use the term "failed contract" to mean contracts were initially binding but **later became void or unenforceable**. Yet others use the term "failed contract" to mean contracts that are "**not void**", even if they are also not enforceable.

Most contracts are binding (i.e. "enforceable"), so it is easier to explain the reasons a contract might NOT be binding, and if none of those apply to a particular situation, the contract is binding by default.

When contracts are not binding, they cannot be enforced in a Court of LAW. Then the parties have no "right" to a legal remedy and can only plead for an equitable remedy in a Court of EQUITY. That is explained in Chapter 9: Equitable Remedies.

1. Void Contracts

If an agreement is **void**, no contract exists. If the agreement was void (not a contract) from the beginning it was **void ab initio**, and no contract ever existed. [5] In other cases the agreement may become void after it is first created because of events beyond the control of the parties, a subsequent **failure of condition**. In that case it was a binding contract until it became void, but after it becomes void neither party has any **legal right** to a **legal remedy** in a Court of LAW.

Void contracts are not actually contracts at all but they are generally called "**void contracts**".

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[5] Beginning law students absolutely love to say "supra" to show off what they learned in law school. Unfortunately "supra" only means "above" so why not say "above' anyway? So it you want to show off, say "ab initio" instead. It actually means something harder to say in English.

A. Contracts Void Ab Initio

Contracts that are void ab initio are "void from the beginning" and never contracts at any time. Many of the reasons a "contract" may be void from the beginning were explained above in Chapter 1: Contract Formation. Those include lack of **present contractual intent**, lack of **consideration**, **revocation** of offers before acceptance, **lapse** of offers before acceptance, **rejection** of offers before acceptance.

Two other reasons are **mutual mistake** and **illegality of purpose**.

1) Void by MUTUAL MISTAKE

A fundamental element of every contract is that there must be **mutual agreement** between the parties. If the parties do not have an actual, mutual agreement to enter into a contractual relationship, the **contract never forms**. Often this is called a "**meeting of the minds**".

If **both parties to a contract are mistaken about a material fact** of the agreement, there is no "meeting of the minds" and the contract is **void** from the beginning. This principal was established in the old English case called *Peerless*.

> **For example:** Importer Scrooge orders cloth from India. He is told it is coming to London on the ship *Peerless*. The Shipping News says the *Peerless* will arrive in March. Scrooge offers the shipment to wholesaler Cratchit for £400. Cratchit accepts and begins reselling the shipment to retailers for March delivery. When the *Peerless* arrives in March no cloth is on board. Investigation reveals there are two ships named *Peerless* and the ship with the cloth will not arrive until May. The Court held both parties were mistaken about a material fact, which ship had the cloth, so there was **no "meeting of the minds"** and **no contract**.

2) Void by ILLEGALITY of purpose

A contract is void ab initio if it is **for an illegal purpose**.

> **For Example:** Tom agrees to sell Dick some cocaine. Since the sale of cocaine is illegal, the contract is illegal and void from the beginning.

Licensing violations. Violation of **licensing requirements** will void a contract if the purpose of the licensing requirement is **regulatory** but not if the purpose is merely to raise **revenue**.

> **For Example:** Homer hires Bill to build a house for him for $200,000. When the house is half done Homer discovers Bill has no license. If Bill had no **contractor's license** the contract is void from the beginning because that is a regulatory requirement intended to protect consumers from incompetent and unscrupulous people "pretending" to be building contractors. But if Bill just didn't pay for a **city business license** the contract is not void because those are just a way for cities to raise revenue.

Partial illegality. If a contract is partly illegal and partly legal the illegal portions are not enforceable at law but the remaining portions are still enforceable (assuming other considerations such as "frustration of purpose" do not apply).

> **For Example:** Cutter and Tribe enter into a "**timber lease**" allowing Cutter to extract timber from 300,000 acres of Tribal lands. But Congress has banned timber extraction on 2000 acres of that area. The contract is illegal ab initio as to those 2000 acres, but still may be enforceable as to the remaining 298,000 acres where it is legal to extract timber.

3) Void because UNCONSCIONABLE

An **unconscionable contract** is one that is so one-sided against a party that a Court may refuse to enforce it on a finding that there was **no meeting of the minds** because **no rational person would have agreed** to such one-sided contract terms. If the Court finds that, the contract is void ab initio. Otherwise the Court may still refuse to enforce it on equitable considerations.

> **For example:** Maria, who only speaks Spanish, signs an agreement written in English that she will pay Slick's Appliances $10,000 for a $200 TV or else she will lose her home. A Court (jury or judge) may conclude that Maria had no idea what she was getting into.

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B. Subsequently Failed Contracts

Contracts are subject to both **express conditions** stated in offers and **implied conditions** and the failure of any of them **through no fault of either party** will void the contract after it forms.

The conditions that apply to offers were discussed earlier as "**offer conditions**". After contracts form they are still subject to most express offer conditions and somewhat different implied conditions. These may be called "**performance conditions**" or "**contract conditions**", and there is no real difference between the two terms.

1) Subsequent FAILURE OF EXPRESS CONDITIONS

Express conditions stated in offers are "**offer conditions**" before the contract forms, and become "**contract conditions**" after the contract forms. The only condition stated in an offer that does not become a contract condition is the **condition precedent** that the offeree must do or promise to do (or not do) what the offeror asked for in return. Once offers are accepted that condition is "**satisfied"**.

If offer conditions determine when contract promises **ripen** into duties to perform they are **conditions precedent**. If offer conditions **discharge duties** they are **conditions subsequent**.

> **For example:** Mower promises to mow Owen's field for $100 on Saturday if it is not raining. Mower's promise to mow does not ripen into a duty to mow until "Saturday", so that is a **condition precedent**. If it is raining on Saturday he has no duty to mow, so that is also a **condition precedent**. And if it starts raining after he starts mowing his duty will be **discharged**, so that is a **condition subsequent**.

2) Subsequent FAILURE OF IMPLIED CONDITION

After contracts form they are also subject to **implied material conditions**. The implied material conditions of every contract are explained in Chapter 3 below. If some implied material conditions fail **through no fault of either party**, the contract fails and becomes void. Some of the implied material conditions of contracts that might fail through no fault of either party are:

- The contract fails if the contract **purpose becomes illegal** after it forms ("**supervening illegality**");
- The contract fails if **performance becomes impossible** after it forms (perhaps the subject matter of the contract is destroyed);
- The contract fails if **the agreed exchange of consideration fails to take place** (a "**failure of consideration**").

Under UCC a **failure of intended supply source** voids a contract. That will be discussed later. Under the common law this may be a "frustration of purpose".

There are some implied offer conditions that are not implied contract conditions.

> **For example:** If either the offeror or the offeree dies before an offer is accepted by the offeree, the offer is voided and cannot be accepted (e.g. the offer cannot be accepted by the offeree's executor). But once a contract forms, that is no longer an implied condition.

3) Supervening ILLEGALITY

If contract performance becomes illegal after the contract forms the contract fails.

4) Supervening IMPOSSIBIILITY

If contract performance becomes impossible after the contract forms, through no fault of the parties, the contract fails. "Impossible" means that it simply cannot be done by anyone at all, not just that it is impossible for the promisor to perform or impossible to perform in the manner the promisor had originally intended.

> **For example:** Ace agrees to paint Owen's house for $3,000. Owen's house burns down. Performance is impossible so the contract fails.

5) Subsequent FAILURE OF CONSIDERATION

A "failure of consideration" means that after a contract forms the act promised by a party **no longer poses legal detriment**.

> **For example:** Store agrees to pay Guard, a private security guard, to periodically patrol its store at night. Guard gets hired by the local police department to do the same thing. Guard now has a legal duty to provide the same services (paid for by the police department) so his promise to Store no longer is "legal consideration." The contract fails for lack of consideration.

6) DEATH of a party usually does not void a contract

A contract offer fails if either party (offeror or offeree) dies before the offer is accepted. But a contract does NOT fail when a contract party dies **UNLESS the death makes performance impossible** or **pointless**. The **executor** of the decedent's estate has the responsibility to perform contract duties and the authority to demand contract performance from others.

> **For example:** Painter agrees to paint Michael Jackson's mansion for $20,000. Before the painting begins Jackson dies. Since his death does not make painting the mansion impossible or pointless the contract is NOT void. Jackson's estate is liable for the contract.

2. Voidable Contracts

Some contracts may be **voided** by one or both parties. This means parties have a right to legally rescind the contract so it is not a "breach of contract". The contract is binding until rescinded.

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A. Contract Rescission

A contract "rescission" is a "declaration" that a contract is terminated or void. The decision to terminate (rescind) can either be made by one or both parties or by a Court. If a contract is terminated by parties "calling it off" it is called a **legal rescission**. If a contract is declared void by a Court it is called an **equitable rescission**.

Contracts can always be terminated (voided; legally rescinded) by mutual agreement. In this case the agreement is an independent contract between the parties, subject to the same requirements any other contract must have (e.g. mutual agreement, exchange of consideration, etc.) The "consideration" supporting the agreement is that each party is excused from performance.

For a single party to rescind a contract, over the objection of the other, rescission must be justified, perhaps by the failure of an express or implied condition of the contract. If a Court later holds the rescission was not justified the "rescission" is not "legal" and instead is a **breach of contract**.

If one party has a right to void the contract and the other does not, it is a **voidable contract** as to that one party, and not voidable as to the other. But if one party voids the contract, it becomes void or terminated as to both parties.

In the **majority view contracts can be orally rescinded** even if the Statute of Frauds requires the original contract itself to be in writing. But **if a contract expressly requires rescissions to be in writing**, the rescission must be in writing.

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B. Rescission at Will

The most common "voidable" contract is an employment contract. Employment contracts are "at-will" contracts by default. Unless parties agree the contract is to last for a stated period of time, it is an "at-will" contract and either party can end it whenever desired. A party that terminates an at-will contract must give notice to the other. Until then the contract remains binding.

> **For example:** Boss offers Ed a job for $10 an hour. There is no agreement how long the job will last so it is an "at-will" contract by default. Ed works a few months and then quits. Boss cannot sue him for breach of contract because an implied condition of the contract was that Ed could quit anytime he wanted.

An 'at-will' contract differs from an illusory contract because both parties to an "at-will" contract promise to "give" something and both can quit when they want. In an "illusory" contract one party is bound to "give" while the other is not bound to give anything at all.

> **For example:** Boss offers Ed a job for $10 an hour on the condition that Boss does not have to pay Ed anything if he does not feel like it. Ed has promised to work, but Boss has not promised to pay. So that is an "illusory" contract.

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C. Rescission for Lack of Capacity

When parties void or rescind contracts they are said to have "**repudiated**" them. Contracts can be rescinded by parties that lacked contractual capacity at the time of contract **unless the contract is for the necessities of life**, food, shelter, clothing or medical care.

Generally parties who lack contractual capacity are minors or mental incompetents. Adults are presumed by law to have contractual capacity, but they may be found by Courts of law to lack capacity. Minors are presumed to lack capacity, but they may be found by Courts of law to have capacity. In that case they are called **emancipated minors**.

> **For example:** Reba leases an apartment from landlord Larry for six months at $5,000 a month, and a car from Cal Worthington for $1,000 a month. She is only 17 years old. She damages both the car and the apartment and stops making payments on both contracts. Worthington has no legal rights except to repossess the car because she is a minor and a car is not a necessity. But Larry has a right to bring an action against her for past rent and damage to the apartment because "shelter" is a necessity. [6]

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D. Rescission for Failure of Condition

A contract can be rescinded by a party if an express or implied condition of the contract gives them that right. The termination of at-will contracts is just a particular case of legal rescission based on an implied condition.

[6] Disregard the problems Larry would have collecting on a judgment. Perhaps Reba is very, very rich.

1) Rescission for LACK OF INTENT

As stated above, all contracts require a "meeting of the minds" and in some cases one of the parties has a legal right to rescind a contract because they were induced to enter into the contract because of **duress**, **fraud**, **concealment**, or **lack of disclosure** (in some situations).

In these situations a party has the right to rescind the contract ab initio, even if the action to rescind the contract takes place at a later time.

Duress. The most obvious situation when there is **no contractual intent** is when the "agreement" of one of the parties has been procured by means of duress. If **physical duress** is used by an "offeror" to make the "offeree" accept an offer there is no real "agreement" at all, and the **contract always is void**. You might call this "an offer you can't refuse".

But if **financial duress** causes an offeree to accept a contract offer there is mutual assent and a contract forms if and only if the offeree's **duress was NOT caused by the offeror**.

> **For example:** Contractor agrees to replace Owens' heat pump for $1,500. After installing the new heat pump Contractor tells Owen it will not work right unless he pays $150 more for a different thermostat. Owen angrily agrees. Since Contractor **created the situation** that caused Owen **financial duress** there is no actual mutual assent and Owen's "agreement" not legally binding. He can let Contractor install the new thermostat and then refuse to pay for it. [7]

Fraud or concealment. If either party induces the other into an agreement by making **false statements of material fact** or **concealing material facts** there is no "meeting of the minds" and any contract that results is **void**. The term "material facts" means important facts that might cause a potential buyer of property to decline, not just statements of opinion or "puffery".

> **For example:** Ford advertises its cars saying "Ford has a better idea!" This is just "puffery" and not a fraudulent statement of some "fact".

"Concealing facts" means acting to hide the true facts, not failing to act to reveal facts.

Lack of disclosure. Modernly, **sellers of real estate** have a general **duty to disclose material facts** about the real property. This is called an "**affirmative duty**" to disclose and the failure to disclose material facts may render any real estate contract void from the beginning or voidable by the buyer. Statutes may also require disclosure in other situations. Other than the sale of real property and specific statutory requirements the general rule of contracts is "**buyer beware**" and "disclosure" is not a general requirement of either party.

2) Rescission for UNILATERAL MISTAKE

As explained above if both parties enter into a contract because they are mistaken about a material fact, those contracts are void ab initio. But if only one party enters into a contract because of a mistake, the contract is voidable by that party if the other party knew there had been a mistake.

[7] I actually had an air conditioner contractor try to pull this on me.

An **implied material condition** of all contracts is that the parties must bargain in **good faith** at the time of contract If a party enters into a contract **knowing that the other parties is mistaken about important facts**, they do not act in good faith. Therefore an implied material condition fails from the start, and the mistaken party has a **legal right to void** (rescind) the contract **ab initio**.

When one of the parties enters into a contract because of a mistake of fact, and the other party knows it, the "knowing" party has **no right to void** the contract.

> **For example:** Col buys a painting at Art's gallery saying, "I think this might be a Jackson Pollack!" Art sells the painting, knowing that it is really a work done by a different artist. If Art later regrets selling the painting he has no right to void the contract.

When neither party knows one is making a mistake there is a SPLIT OF LAW.

> **Majority view.** Under the majority of jurisdictions **neither party can void the contract**.
>
> **Minority view.** In a minority of jurisdictions mistaken parties **have a legal right to rescind** contracts if they give **prompt notice** of their mistake, the other parties **have not substantially changed position** in reliance on the contract, and the mistaken parties **reimburse** the other parties for incidental expenses caused by the mistake.
>
> **For example:** Contractor submits a $400,000 construction bid to School District. Immediately afterward Contractor discovers his bid was calculated incorrectly and he immediately notifies School District of the error. Assuming School District had no means of realizing Contractor's bid was made in error, Contractor is **legally bound in the majority view**, and may only plead equity. But **in the minority view he has a legal right to void** the contract if School District has not substantially changed position in reliance on his bid and he reimburses School District its expenses as a result of his error.

3) Rescission for LACK OF SATISFACTION

If a contract is subject to an **express condition** that one of the parties must be "satisfied" with the performance of the other party, the party can rescind the contract if not actually "satisfied".

> **For example:** Mabel has her photo taken with an understanding she does not have to pay if she is not "completely satisfied". If the photo makes her look too fat she can rescind.

4) Rescission for TARDY PERFORMANCE

If a contract is subject to an **express condition** that performance must be "timely" the contract will usually say "time is of the essence". If performance is tardy the other party has no duty to pay.

> **For example:** Owen hires Ace to paint his house no later than September 1, and the contract says "time is of the essence". If Ace is tardy Owen can rescind the contract.

5) Rescission for FRUSTRATION OF PURPOSE

If both parties enter into a contract knowing the contract purpose of one party, **fulfillment of that purpose** becomes an **implied material condition** of the contract. If events beyond their control make performance pointless or fruitless for that one party, that one party can rescind the contract. But frustration of purpose **does not discharge duties owed to parties that were unaware of the other party's purpose** at the time of contract.

> **For example:** Alda orders a tuxedo for Molly's wedding from Tailor. If Molly and her fiancé call the wedding off, and Alda has not already accepted delivery of the tux, he can void the contract if Tailor is aware of his purpose for buying the tux. That makes **fulfillment of that purpose an implied material condition** of the contract. But if Tailor was not aware of Alda's purpose he cannot rescind the contract.

Contract parties can **expressly waive implied conditions**. Waivers of condition are explained more in Chapter 3: Contract Interpretation.

Availability from an intended source of supply may create an implied material condition. Then **supply failures** (e.g. availability of goods, raw materials, energy, etc.) may discharge a contractual duty to perform. Under the UCC it appears only seller has to be aware of the intended source. That is explained in Chapter 10. Under common law both parties may have to be aware of the intended source of supply for this to be an implied condition.

> **For example:** City agrees to buy hydro-electrical power from Utility. Utility is unable to generate power because of a lack of snowfall. Utility is discharged from the duty to deliver power because an implied condition of the contract has failed.

6) Rescission for NON-COOPERATION or INTERFERENCE

An implied material condition of every contract is that the parties will not **unreasonably hinder** the other party's performance or **unreasonably deny help** required by the other party.

> **For example:** Ace agrees to paint Owen's house. But when Ace tries to paint the house he is threatened by Owen's dog, Killer, and Owen refuses to take Killer out of the yard. That beaches an implied material condition and Ace can legally rescind the agreement.

7) Rescission for COMMERCIAL IMPRACTICABILITY

If **events beyond the control of contract parties** make performance so difficult it is **commercially impractical**, a party may be allowed to rescind the contract in some cases. In some cases **commercial practicability** has been held to be an implied material condition. Other cases have disagreed.

> **For example:** Tom agrees to dig a well for Dick for $3,000. Tom discovers he will have to drill through hundreds of feet of granite at a cost of $1 million. Not "impossible" but certainly not commercially practicable.

8) Rescission for FAILURE OF CONDITION compared to BREACH

Contract parties can only rescind contracts for **failure of conditions** as long as it is not their fault. Otherwise they are in breach. Parties are only discharged from performing duties after the rescission. Parties remain liable for breaches that occurred before the rescission.

3. Unenforceable Contracts

Some contracts are simply **not enforceable** in whole or part by one or both parties at law. That means parties have no right to a **legal** remedy. As explained above, **voidable** contracts can be enforceable before they are voided by a **failure of conditions** or otherwise **rescinded** by a party. After that they are only enforceable as to performance or breaches that occurred before the failure or rescission. For example, if a party to an at-will employment contract terminates the arrangement, the parties are still bound by the contract for services rendered prior to the termination but they are discharged from all other duties after the termination.

Contracts that are **void ab initio** are not enforceable at all, and not really even "contracts".

Other than those situations, the major reasons contract may be unenforceable are because terms are **fatally vague**, **parties lack capacity**, the contracts violate the **Statute of Frauds**, enforcement violates the **13th Amendment**, the contracts are **illegal non-competition agreements**, or **liquidated damages clauses** produce inadequate remedies.

Parties that have no legal remedy can only seek a remedy in equity as explained in Chapter 9.

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A. Fatally Vague Contracts

As explained above in Chapter 1: Contract Formation, contract terms must be reasonably certain for a contract to form. But contracts still may not be enforceable in a Court of law if:

- The terms are so vague **breach is impossible to prove**; and
- The terms may be so vague that **damages are impossible to prove**.

Under the common law contracts are generally required to specify the **parties**, the **subject matter**, the contract **price**, **quantities**, and **time of performance**. But if the parties have **already performed** as if a contract exists, then the Court must conclude a contract does exist. But it will not be an enforceable contract if the terms are so uncertain the Court **cannot tell if a breach has occurred** or **what damages the breach caused**.

The contract terms that must be stated with certainty vary by type of contract. For example,

- LAND SALE CONTRACTS must **clearly specify the land to be sold** (i.e. a legal description of the land) and the **price** to be paid;
- CONSTRUCTION CONTRACTS must **clearly specify the work to be done** and the **price** or **terms**.
- EMPLOYMENT CONTRACTS must **specify the work to be done** (i.e. the job description)**, the period of time** (if any) and the **wage** to be paid.

If a contract is too vague to prove a right to damages the parties can only seek a remedy in equity. That will be discussed in Chapter 9: Equitable Remedies.

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B. Contracts with Parties Lacking Capacity

As explained above parties lacking contractual capacity can rescind contracts unless they are for provision of necessities of life (food, shelter, clothing, medical care, etc.). If parties lacking capacity do not rescind, contracts for non-necessities still cannot be enforced against them.

But if people lacking capacity "gain capacity" later they must **repudiate** the contracts within a **reasonable time** or they will be deemed to have "**ratified**" the contracts. Then they are bound the same as if they had contractual capacity from the beginning. The time-period in which parties gaining capacity must repudiate is often set by statute.

> **For example:** Reba, aged 17, leases a car from Cal Worthington. She can void the contract at any time before she is 18 because a car is not a necessity. But once she turns 18 she **must repudiate the contract promptly** or she will be deemed to have **ratified** the contract as an adult. Then she would lose her right to rescind and would be liable for all unpaid lease payments back to the beginning of the contract.

People who enter into contracts with people lacking contractual capacity are legally bound by the agreements and their only remedies are in equity. That would generally be under an **implied-in-law contract** theory. That is explained in Chapter 9: Equitable Remedies.

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C. Contracts Violating the Statute of Frauds

The Statute of Frauds (SOF) prevents some contracts from being enforced at law unless they are in writing. When the SOF requires a contract to be in writing it is said to be "**within the statute**" and if the SOF does not require a contract to be in writing it is said to be "**outside the statute**".

Modernly the only contracts "within the statute" that are of interest are 1) contracts **conveying interests in land**, 2) contracts that **cannot be performed within a year**, and 3) contracts **guaranteeing debts** of a third party. [8]

[8] The other categories of contracts that the Statute of Frauds required to be in writing were contracts for the **sale of goods**, **pre-nuptial agreements** (contracts in anticipation of marriage), and contracts by **executors of estates**. Modernly contracts for the sale of goods are uniformly governed by the UCC, and that is heavily tested on Bar Exams. But the other two types of contracts are governed by State statutes which vary widely and are often not tested at all on Bar Exams. The California Bar Exam does not test anything, at all, about pre-nuptial agreements or the administration of estates.

1) Contracts conveying INTERESTS IN LAND

Oral contracts to sell or lease land for more than a year are not enforceable at law, with one exception, the **Part Performance Doctrine**. [9]

This application of the SOF was adopted to prevent tenants that had rented land for long periods of time from filing fraudulent claims that they had been "buying" the land rather than "renting" it. But after the SOF was adopted, a different type of fraud developed, the sale of land to gullible buyers under unenforceable oral agreements. The Part Performance Doctrine was developed by the Courts to prevent injustice when that obviously had taken place.

Past Performance Doctrine. Generally, the Part Performance Doctrine allows a Court to legally enforce (not just enforce at equity) an **oral agreement to buy real property** (not lease it) if the moving party (buyer) has 1) **taken exclusive possession**, 2) has **paid all or almost all** of the purchase price or **otherwise has made valuable improvements**, and 3) the **acts of the parties can only be explained** by one conclusion, that the land was in fact sold under an oral agreement.

> **For example:** Slick offers to sell a house to Rube for $30,000 for cash, the market value of the house, on an oral agreement. After Rube moves in Slick files an action to evict him on a claim he "rented" the house. Under these facts a Court could conclude there was, in fact, an oral sales agreement, and it may legally enforce the agreement in many States.

The Part Performance Doctrine has not been adopted by all the States the same way, and it has been codified in varying forms. Generally the Part Performance Doctrine is very **strictly applied** (if applied at all), and it has **no application to claimed oral lease agreements**.

The Past Performance Doctrine allows a Court of law to enforce an oral land sale agreement as if it had been put in writing, but if the elements cannot be proven the buyer has no legal remedy and can only seek a remedy in equity. Equitable remedies are explained in Chapter 9.

2) Contracts requiring MORE THAN A YEAR to perform

Oral contracts that, by the terms of the agreement, **cannot possibly be performed within a year from the time of contract** cannot be enforced at law. There are no exceptions to this rule, but you have to pay attention to the dates.

> **For example:** On August 15 Disney orally agrees to pay Mary $30,000 to sing at Disneyland from June 1 to August 31 the next year. The next summer Disney tells her it has changed its mind and is not going to pay her anything. Mary has no right to enforce the agreement. While it is only for a three month period, it could not have been completed until August 31, more than a year after the **time of contract**, August 15, the year before.

[9] Later in real property classes you will learn that the Statute of Frauds also requires a writing for the creation of other types of "interests in land" such as "equitable servitudes" and "remainders" but you don't need to know all about that now.

3) Contracts GUARANTEEING DEBTS of others

Oral promises to creditors (lenders) that the promisor (the "**guarantor")** will guarantee the debts of another person (a third party debtor) if the borrower fails to pay the debt are not enforceable at law. There is one important exception, the **Main Purpose Rule**. [10] The **guarantor** of a debt is also called a **benefactor** or a **co-signer**.

> **For example:** Benny says to Lender, "If you will loan $500 to Chris I will guarantee the debt." This promise is not generally enforceable at law unless it is put in writing.

A promise to guarantee the debt of a third party debtor only creates a legal contract if it is made in exchange for a promise by the creditor to either extend credit to the debtor or else to forego collection of a pre-existing debt. If the promise is made without requiring the promisee to do anything **in exchange** for the promise it is just a **gift offer** and not an enforceable contract at all.

> **For example:** Chris owes Lender money, and Lender expresses worries that he might not be paid. In response Benny tells Lender, "Don't worry. I will guarantee the debt of my friend, Chris." This doesn't create an enforceable contract at all because it asks for nothing in exchange for the promise. This is just a **gift offer**.

Also, the Statute of Frauds only requires a written contract when **guarantors promise lenders** they will "guarantee" the debts of the borrower. That means a promise that **if the borrower does not pay** the debt, the guarantor will pay it". Promises to **directly pay** for benefits conveyed to the "debtor" may create an enforceable contract even if they are oral.

> **For example:** Muffin wants to buy a diamond ring from Jim but she has bad credit. Jim tells Muffin to get a co-signer. Sugar Daddy calls Jim and says "If you sell Muffin the ring I will pay for it." That is a promise by Sugar Daddy that **he will pay** for the ring, **not a promise that he will pay if Muffin does not** pay. So that is **not the guarantee of a debt** and it does not have to be in writing.

Main Purpose Rule. An oral guarantee of a debt can be enforced at law if the **main purpose** of the guarantor is to benefit himself instead of to benefit the debtor.

> **For example:** Chris promises to repay a loan to Benny if he can get a loan from Lender. So Benny tells Lender, "If you loan Chris $500 I will guarantee the debt." This oral guarantee IS enforceable because Benny's **main purpose** is to benefit himself, not Chris.

4) WAIVER of condition

A party to an unenforceable oral contract may perform contract duties anyway, and in that case they are said to have "**waived the condition**" that the contract had to be in writing. That is explained more below.

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[10] There are actually more than one legal "rule" called the "main purpose rule", and this is only one of them.

D. Enforcement Barred by 13th Amendment

Contracts for the purchase of **unique services** cannot be enforced by an order of specific performance **against an individual** because it violates the 13th Amendment barring slavery.

However, the 13th Amendment does not apply to groups or legal entities such as corporations, associations and unions. Those can always be ordered to provide services if they are so unique no other organization can perform them.

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E. Unenforceable Non-Competition Agreements

Non-competition agreements are promises by parties that they will not enter into employment or business activities in competition against other parties. Typically these are demanded by people buying existing businesses or employers hiring employees in positions with access to trade secrets, confidential financial information or customer lists.

Non-competition agreements are **only enforceable** if they are **reasonably necessary** to protect the interests of the party demanding the agreement and **not unreasonably broad**. If they are not **necessary** or are **unreasonably broad** in scope they are **void and unenforceable**.

> **For Example:** Aerojet hires Von Braun as a rocket scientist under a contract that says Von Braun cannot work in the aerospace industry for five years after he stops working for Aerojet. This agreement IS enforceable because in his employment as a "rocket scientist" Von Braun will necessarily come into possession of highly secret information that would be damaging to Aerojet if revealed to competitors.

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F. Unenforceable Liquidated Damages Clauses

Liquidated damages clauses are contract provisions that set the remedy of a non-breaching party to a proscribed dollar amount rather than the damages actually caused by the breach or the benefits the breaching party gains as a result of the breach.

Liquidated damages clauses are only enforceable if they are BOTH **reasonable at the time of contract** AND produce a **reasonable and adequate remedy** after a breach. There are **no punitive damages** in contract law, and if a liquidated damages clause is NOT reasonable at the time of contract OR would produce an unreasonable result, it is deemed to be a punitive measure, **void and unenforceable**.

> **For Example:** Slick sells a car to Rube on a 5-year payment plan. The contract says that if Rube he is ever late making a payment the contract is void and Slick gets to keep all past payments. This is an unreasonable, unnecessary and punitive agreement because Rube might make all but the last few payments. In that case Slick's actual damages would be far less than the value of the car.

Liquidated damages clauses are never an adequate remedy for non-breaching buyers of unique property. When sellers breach an agreement to convey unique property a liquidated

damages clause is an inadequate remedy for the non-breaching buyer for the same reason an award of a money judgment is an inadequate remedy. That is explained above.

4. Enforceable Contracts

If a contract is not void, rescinded, or unenforceable because of one or more of the reasons explained above it is an **enforceable contract**. That may also be called a "**binding legal contract**", meaning that if the contract is breached the two contract parties have a **legal right** to a remedy. But for other parties to enforce a contract they must have **standing**, the **legal authority** to enforce it.

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A. Standing of Executors

When a person dies, the **executor** of the person's estate is the person legally authorized by a probate court exerting jurisdiction over the settlement of estate affairs. The **executor** has **standing** (legal authority) to enforce all **contracts** of the decedent. The executor is also responsible for **performing all remaining contractual duties** of the decedent. This is virtually never explained in contract law classes.

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B. Standing of Third Parties

If two parties enter into a contract for the purpose of benefiting a third party, that third party is called an **intended third-party beneficiary** and often has **standing** to enforce the contract against one or both of the original contract parties. This will be explained in detail in Chapter 5: Third-Party Beneficiary Contracts.

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C. Standing of Assignees

Parties to contracts can "assign" their rights to receive benefits under the contract to a third party. The person who is assigned contract rights is called an "**assignee**", and they often have standing to enforce the contract. This will be explained in detail in Chapter 6: Assignment and Delegation.

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D. Standing to Enforce Against Delegatee

Parties to contracts can "delegate" their duties to perform contractual services under the contract to a third party. The person who is delegated contract duties is called a "**delegatee**". Often contract parties have standing to enforce the contract against the delegatee. This will be explained in detail in Chapter 6: Assignment and Delegation.

Chapter 3: Contract Interpretation

Even if contracts are binding the terms and conditions must still be interpreted by the Court. The Court must piece together the communications between the parties, impute missing terms, correct drafting errors, resolve ambiguities, and interpret the stated and implied contract conditions.

1. Contract Integration

A contract often forms after a flurry of communications between the offeror and the offeree. If there is no "fully integrated written agreement" the Court must piece together the communications to establish exactly what their agreement was. This is called **contract integration**. [11]

In the process of "integrating" the various communications between the parties, the Court will generally include the terms that both parties have expressly or impliedly agreed to, and "knock out" or eliminate the terms that one or the other party has expressly objected to unless they expressly agreed to it after first objecting to it. This process of "knocking out" terms that one party or the other objected to is called the **Knock-Out Rule**.

2. Imputing Missing Terms

If parties enter into a contractual agreement without clearly specifying all the terms of the agreement, the Court must decide whether or not the unspecified terms are so important the contract is void from the beginning. This applies to both oral and written contracts.

Under the UCC most of the terms of contracts for the sale of goods can be imputed from the **past course of dealing** between the parties and **standards in the trade**. That will be explained more in Chapter 10: UCC Modifications. The common law often applies the same principal.

Under the common law some terms can also be imputed. If parties fail to specify the **time or date** when performance of contract duties is to take place, the Court will almost always presume that the parties intended for performance to take place within a **reasonable time**. If parties do not expressly say what "standard" of performance is required, the Court will generally presume performance must meet the **usual standards of the trade**.

3. Correcting Drafting Errors

If a contract is written it may contain "drafting errors". This means differences between the offer accepted by the offeree and a record of that agreement later reduced to a writing.

Drafting errors are also called **scrivener's errors**. Scrivener's errors or other deviations of a written contract from the actual agreement of the parties **have no effect** on the terms of the contract, even if the parties sign the agreement without discovering the error. Once the Court determines the written contract deviates from the intended agreement the errors will be disregarded or corrected.

[11] The term "integration" is used by the law in different contexts but it always means the same thing, piecing together different statements or documents to create an integrated statement of intent.

4. Resolving Ambiguities

Contracts are interpreted according to the **plain meaning** of the words of the offer. The offeree is required to only "assent" to the terms of the offer and is not allowed to change the terms of the offer. But under the UCC the offeree can make limited changes to the terms of the offer. That is explained in Chapter 10: UCC Modifications.

If the parties reduce their agreement to a **detailed writing** that constitutes a "**fully integrated writing**", the parties may be barred from admitting "**extrinsic evidence**" to prove that their agreement included other provisions that are not in the written contract.

A detailed writing will be deemed to be a "**fully integrated writing**" if it includes a "**merger clause**" that says something like "This is the entire agreement between the parties". A merger clause is conclusive unless the contract is clearly incomplete on its face or if the merger clause was incorporated into the contract by fraud or mistake.

If there is no merger clause, Courts will determine if the contract is "fully integrated" based on three theories, the **four corners doctrine**, the **collateral agreement doctrine** or the **credible evidence rule**. These rules only apply to written contracts and have no application to oral agreements. They are all rather similar.

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A. Four Corners Doctrine

Under the **four corners doctrine** some Courts hold that whether a writing is fully integrated must be determined only by the **plain meaning** of the words on the **face of the instrument** itself. If **no ambiguity is apparent** from the plain meaning of the contract, no extrinsic evidence may be admitted to show that the parties used terms with special meanings unless the term has special meanings in the local community, trade or industry.

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B. Collateral Agreement Doctrine

Under the **collateral agreement doctrine** other Courts look outside the written instrument to determine whether additional terms in dispute relate to collateral portions of the transaction.

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C. Credible Evidence Rule

Other courts follow the **credible evidence rule** that the actual intent of the parties should control the question of integration, and the Court may consider any credible evidence concerning the circumstances of contract formation regardless whether the contract appears complete or not.

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D. Admission of Extrinsic Evidence

If the terms of an offer or written contract are ambiguous or missing, given the plain meaning of the words of the offer or written contract, the Court will have to consider **extrinsic evidence** to determine the intent of the parties as to the ambiguous or missing terms.

The term "**extrinsic evidence**" means documents or testimony of witnesses about what the intentions of the parties were at the time of contract.

However certain types of extrinsic evidence cannot be admitted into evidence if the written contract appears to be a "fully integrated writing", and that is called the **Parol Evidence Rule**.

1) COURSE OF DEALING and TERMS OF TRADE

Extrinsic evidence of the past **course of dealing** between the parties and **terms of the trade** relevant to the contract are always admissible to show they are different from the plain meaning.

2) PAROL EVIDENCE RULE

If a written contract appears to be a **fully integrated writing** the Court generally must bar the admission of all extrinsic evidence concerning **prior or contemporaneous oral agreements** that **contradict** the terms of the written contract. This is called the "**Parol Evidence Rule**" (PER). [12] Article 2 of the UCC has a section that codifies this rule, but it is not substantially different from the common law approach.

> **For example:** Sal says, "I will sell you my boat for $10,000." Bob says, "It's a deal. That includes the sails, right?" Sal says, "No, that would be another $2,000." Bob says, "I thought you were including the sails." So they dicker over the sails, the boat, and the trailer. Several days later Sal agrees to sell the boat with certain accessories for $11,000. They execute a detailed written contract. Later Bob saying that he should only have to pay $10,000 because he accepted Sal's first offer. The PER prevents Bob from arguing that because the prior agreement was oral, and later written agreement superseded it.

The PER requires a **detailed written contract**. If there is only an oral agreement or incomplete writings the PER has no application. If a written contract has a **merger clause** it is strong evidence the parties intended for the written document to be their entire agreement.

The PER only bars evidence that conflicts with written contract terms. It does not stop the Court from considering evidence that **does not appear to contradict** stated contract terms or would **naturally not be stated** in a drafted contract.

And the PER only pertains to "prior or contemporaneous oral agreements". That means oral agreements between the parties BEFORE or WHILE the "fully written contract" was executed. Evidence of <u>subsequent</u> oral contract modifications are not barred by the PER.

[12] Be aware that the word "parol" for the Parol Evidence Rule means "is spelled differently from the word "parole" which means

The PER is **subject to several important exceptions** that might be remembered by the mnemonic DAM FOIL: **D**uress, **A**mbiguity, **M**istake, **F**raud, **O**ral condition precedent, **I**llegality, and **L**ack of consideration. Most of these exceptions are rather simple to understand.

> **For example:** Sal tells Bob, "I will sell you my sailboat for $15,000 with a one-year warranty." Bob agrees to buy it. They sign a detailed written contract typed by Sal's secretary, Debbie. Bob doesn't realize it, but the written contract says he is paying $17,000, and the boat is being sold "as is". If those terms were deliberately put in the contract by Sal, it is **fraud** on his part. And if Debbie put them in the contract by accident it is a **mistake**. So in either event the **exceptions** to the PER allow Bob to introduce evidence that the written contract does not reflect the actual agreement he had with Sal.

The PER exception that baffles many law students is **oral condition precedent**. An **oral condition precedent** is an oral agreement between the parties, before or while they sign the written contract, that the promise of one of the parties will not **ripen into a duty** to perform unless the agreed condition is satisfied.

> **For example:** Bob says, "I will buy your boat for $10,000 if I can get a loan." Sal says, "Ok. Let's write it up." This oral agreement establishes an **oral condition precedent** that Bob's **promise to pay will not ripen into a duty to pay** unless the condition that he must get a loan is satisfied. If that oral condition is not stated in their written contract Bob can still introduce evidence of it because it was an "oral condition precedent".

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E. Resolving Contradicting Provisions

If a written contract has provisions that appear to contradict each other, Courts generally will try to interpret the ambiguity in a way that **"gives effect" to all provisions**.

> **For example:** A contract has one paragraph that says a property is to be sold "as is," and another paragraph says "Seller will pay for termite repairs." The two provisions conflict. But the Court would try interpret the contract to "give effect" to both provisions.

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F. Resolution of Ambiguity against Drafter

Any ambiguity in a written contract that can not be resolved by extrinsic evidence or other rules of interpretation will generally be **interpreted against the drafter** of the document.

5. Distinguishing Bilateral and Unilateral Contracts

The distinction between bilateral and unilateral contract offers was explained in some detail in Chapter 1: Contract Formation, above.

If an offer is a general offer for a bounty or reward or otherwise unequivocally demands acceptance by performance it will be interpreted to be a **unilateral** contract offer. Otherwise it will be interpreted to be a **bilateral** contract offer inviting acceptance by exchange of a promise.

6. Distinguishing Express Conditions from Covenants

Under common law there are **two types of express contract promises**. One is called an **express condition** and the other is an **express covenant**.

Almost all express contract promises are **express conditions** except for promises that performance will be **timely**, **satisfactory**, or that a party **will not assign** the contract. Promises that contract performance will be **timely**, **satisfactory**, or **will not assign** the contract are usually considered to be "**covenants**" by the promisors and not express conditions.

Express conditions are **material conditions**. Breach of an '**express condition**' by a party is a **major breach**. In that case the non-breaching party has a **legal right** to a remedy, but the breaching party has **no legal right** to a remedy and can only obtain a remedy in equity. If an express condition fails through no fault of either party the contract becomes void. In that case the only remedy either party can have is in equity. That is explained in Chapter 9.

Breach of an express covenant by a party is a **minor breach** and the contract does not fail. In that case both parties have a **legal right** to a remedy.

This distinction between major and minor breach only applies to the common law. The UCC takes an entirely different approach that will be explained in Chapter 10: UCC Modifications.

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A. Promises of Timely Performance

Contract promises of "**timely**" performance will be considered **mere covenants** by promisors except in two circumstances when they are considered **express conditions**:

- Parties can unequivocally agree that **timely performance by the promisor is an express condition** by stating something in the contract like, "**time is of the essence**".

- And the Court will consider **timely performance by the promisor to be an express condition** if circumstances clearly show that <u>at the time of contract</u> the parties could foresee that **tardy performance by the promisor would deny the promisee the benefit of the bargain**.

The term "**benefit of the bargain**" means the **benefits a promisee expects to obtain** by entering into a contract.

1) UNEQUIVOCAL guarantees of timely performance

As stated above, **timely performance will be an express condition** if the parties **unequivocally agree** by saying something like "time is of the essence".

> **For example:** Ace promises to paint Owen's house "by September 15" and the contract says, "Time is of the essence of this agreement." That makes timely performance by Ace

an express condition. If Ace fails to finish on time he is in **major breach** regardless of why he was late.

2) IMPLIED MATERIAL CONDITIONS of timely performance

If the parties to a contract agree on a performance date but the contract does not unequivocally state timely performance is an express condition, timely performance will only be an express condition if it is **foreseeable at the time of contract** tardy performance **will deny the promisee the benefit of the bargain**.

Promises of timely performance are **MORE LIKELY to be deemed to be express conditions** of contracts that **clearly require punctuality** even if the parties do not expressly say so. The

> **For example:** Security Delivery Service promises to deliver Bar Exam booklets to the test center no later than 7:00 a.m. The contract does not expressly say "time is of the essence", but Security knows the Bar Exam starts promptly at 9:00 a.m. Security delivers the booklets a day late. That would be the breach of an express condition because it was foreseeable tardy performance would substantially deny the Bar the benefit of the bargain.

Promises of timely performance are **LESS LIKELY to be deemed to be express conditions** of contracts that are **often delayed** by events beyond the control of the parties such as contracts for **construction**, **real estate sales**, **manufacturing**, and **agricultural products**. The Court will generally hold that delays are so foreseeable in these endeavors parties would use unequivocal language in the contract if they intended for timely performance to be an express condition.

3) COVENANTS of timely performance

If a contract promises performance by a certain date it is usually a "covenant". Tardy performance is a breach of contract, but it is a minor breach. Breach of contract and its effect will be explained in Chapter 7: Breach of Contract.

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B. Promises of Satisfactory Performance

Contract promises of "**satisfactory**" performance will also be considered **mere covenants** except in two circumstances when they will be considered **express conditions**:

> First, the parties can unequivocally specify that **satisfactory performance is an express condition** by stating something in the contract like, "**the promisees have no obligation to pay for this product/service unless they are personally satisfied**".
>
> Second, the Court will consider **performance satisfactory to the promisee to be an express condition** if circumstances clearly show that <u>at the time of contract</u> the parties could foresee that **performance unsatisfactory to the promisee would deny the promisee the benefit of the bargain**.

Often this is called "**personal satisfaction**" to indicate the promisee must be satisfied "personally" rather than simply performance that would be satisfactory to an "average reasonable person".

1) UNEQUIVOCAL guarantees of personal satisfaction

As stated above, if the parties unequivocally agree performance must be "personally satisfactory" to the promisee it is an **express condition**. That may be by saying something like "**the promisee has no obligation to pay for this product/service unless personally satisfied.**" If the parties agree at the time of contract, then their agreement determines the issue.

> **For example:** Mommy takes the kids to have a Christmas picture taken. The mall photographer assures her that if she does not want to buy the picture, she does not have to pay for it. That makes the personal satisfaction of Mommy an **express condition**. If Mommy is not happy with the photo the **contract fails** and she does not have to pay. [13]

2) IMPLIED MATERIAL CONDITIONS of satisfaction

If the contract parties agree performance must be "satisfactory" but the contract does NOT unequivocally state that satisfactory performance is an express condition, the satisfaction of the promisee will NOT be considered an express condition UNLESS the circumstances at the time of contract clearly suggest the parties intended for it to be an express condition because **performance that fails to satisfy the promisee would deny the promisee the benefit of the bargain**. [14]

Promises of satisfactory performance are **MORE LIKELY to be deemed to be express conditions** of contracts that involve matters of **personal taste** rather than standards that can be judged on an objective basis. The Court will generally hold that if a performance dissatisfying to the promisee would clearly deny the promisee the benefits of the bargain, the promisee probably intended for personal satisfaction to be an express condition.

3) COVENANTS of satisfactory performance

If a contract promises "satisfaction" or "top quality service" but neither the contract nor the circumstances show that it is clearly an express condition, it will be deemed to be a "**covenant**" to provide "**satisfactory workmanship**". Substandard performance is still a breach, but it is a minor breach. To determine if the covenant has been breached, the Court will judge performance by the **standards of the trade** and whether a **reasonable person** would have been satisfied with the **workmanship**. Breach of contract and its effect will be explained in Chapter 7.

> **For example:** Ace agrees to paint Owen's house for $5,000 and promises Owen will be "completely satisfied". If Ace paints the house in a way that **meets industry standards** or else **would satisfy a reasonable person** he has not breached his promise, even if Owen is not "completely satisfied" with Ace's "**workmanship**". If Ace has done a sloppy job it is a **minor breach** of the contract.

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[13] If you have children you know all about this.

[14] These situations overlap "frustration of purpose". If the promisor knows the promisee wants to be "personally satisfied", and the performance of the promisor does NOT satisfy the promisee, the purposes of the promisee have been frustrated, AND the implied express condition has failed.

7. Implied Conditions

An implied condition is a contract condition that is **not expressly stated** in a contract offer. Rather, it is **implied by the express promises** made by the contract parties or else it is **implied by contract law**.

There are **two types** of implied conditions. **Constructive conditions** are implied by nature of the contractual promises of the parties. **Constructive conditions are never material conditions**. That means that if a constructive condition fails, the contract does not automatically fail.

All other implied contract conditions are **implied by contract law in all contracts**, and they are **always material conditions**. To distinguish these other implied conditions from "constructive conditions" and "express conditions" they are often called "**implied material conditions**".

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A. Constructive conditions

Constructive conditions are **implied conditions** concerning the **time, quality and order of contract performance** given the promises of the parties and the nature of the contract. As stated above, **constructive conditions are never material conditions**.

1) Implied TIME and QUALITY of performance

Unless the parties expressly agree otherwise a **constructive condition** of every contract is that the parties are to perform their duties within a **reasonable** period of time in a **reasonably satisfactory** manner. If a completion date is agreed on, performance must be completed by that date.

2) More TIME-CONSUMING duties FIRST

If one of the promised duties of the parties is **more time-consuming** than the other, **the more time-consuming duty must be completed first**. And the promise of the other party that is to perform the less time-consuming task is said to be **subject to the constructive condition** that it does not "**ripen**" into a duty until the other task has been completed as required. In this situation the constructive condition is a **condition precedent** because it must occur first, before the promise of the other party "**ripens**" into a duty to perform.

> **For example:** Owen agrees to pay Ace $300 to paint his fence. Since painting the fence is a **more time-consuming** task than paying for it, Ace must paint the fence first, and Owen has no duty to pay for the painting until it has been finished.

3) Express ORDER OF PERFORMANCE AGREEMENTS

Constructive conditions are implied when the parties do not expressly agree otherwise. If they expressly agree otherwise it is either an express condition or express covenant.

4) EQUALLY TIME-CONSUMING duties SIMULTANEOUSLY

Sometimes the duties of the parties **take the same amount of time to perform**, and then **neither party has a duty to perform first**. When neither party has a duty to perform first, the promise of each party is **subject to the constructive condition** that the other party must first "offer" to perform. Once a party offers to perform (this is called "tender" of performance) the duty of the other party **"ripens" into a duty to perform**. Since there is no constructive condition that either perform first, this is called a **constructive condition concurrent**.

5) Effect of FAILURE of CONSTRUCTIVE CONDITION

If parties with duties to perform first **fail to perform** they are **in breach**. Then the promises of the other parties whose promises were subject to the **constructive condition precedent** that the first parties must finish performance, **never ripen into duties** to perform. After that they have **no duty to pay** (except as explained below concerning "substantive performance") and cannot be accused of "breach" if they refuse to pay (or otherwise perform in return).

> **For example:** Mower promises to mow Farmer's field for $100. Mower's promised task is more time-consuming so Farmer has no duty to pay him until he is finished. Suppose Mower quits before he finishes mowing the field. Then the **construction condition precedent fails** and Farmer's duty to pay never ripens into a duty to pay. Mower is in breach of the contract, and Farmer can never be in breach after that because his contract promises will never ripen into duties to perform.

6) SUBSTANTIVE PERFORMANCE EXCUSES constructive conditions

Constructive conditions are **excused** if the performing party (the party providing goods and services) has **substantially performed**. The term "**substantially perform**" means a **judicial finding** that promised contract duties have been performed adequately for the promisee to substantially enjoy the benefits of the bargain. And "**excused**" means that the constructive condition is removed or terminated. Substantive performance may also be called **substantial performance**.

> **For example:** Mower promises to mow Farmer's field for $100 no later than Saturday. Farmer's promise to pay is subject to the **constructive condition precedent** that Mower must perform as promised. Suppose Mower does not finish mowing the filed until Sunday. Then the **construction condition precedent fails** and Farmer's duty to pay never ripens into a duty to pay. But suppose Mower sues Farmer for payment and the Court determines Mower has **substantially performed**. Then the **constructive condition is excused**, Farmer's **promise to pay ripens into a duty to pay**, and the Court may award a money judgment in favor of Mower.

The preceding example illustrates one of the more common misunderstandings of law students. Substantive performance is a **legal fact**, a fact for a Court to determine. If Mower is in breach (for not finishing performance as promised) Farmer cannot be in breach for refusing to pay. That is true even if a Court later finds Mower substantially performed because "substantive performance" is a legal fact for the Court to determine. This is explained more in Chapter 7: Breach of Contract.

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B. Implied Material Conditions

Implied material conditions are conditions or covenants (promises) **implied by law or circumstances** that must be satisfied **for the parties to substantially enjoy the expected benefits of the contract**.

The following **implied material conditions** are **implied by law** in every contract:

1. That the parties bargained in GOOD FAITH to create the contract;
2. Contract performance will be POSSIBLE;
3. Contract performance will be LEGAL;
4. The contract will continue to be supported by CONSIDERATION;
5. The agreed purposes of the contract will not be FRUSTRATED;
6. The parties will not HAMPER each other in PERFORMING CONTRACT DUTIES;
7. The parties will not HAMPER each other in ENJOYING CONTRACT BENEFITS;
8. The parties will ASSIST each other as necessary; and
9. The parties will SUBSTANTIALLY PERFORM CONTRACT DUTIES.

1) Effect of FAILURE OF IMPLIED CONDITION

If an **implied material condition** fails through no fault of either party the contract will become **void** or **voidable** as was explained above. And if any of these conditions are breached by a party it is a major breach. The effect of major breach will be explained in more detail in Chapter 7.

2) GOOD FAITH and breach of contract

"**Acting in good faith**" means that the parties are **not misleading** the other parties, **not actively concealing** material facts, **not concealing material facts** they have an affirmative duty to reveal, and not acting with **knowledge the other contract parties are mistaken** about material facts.

A breach of a contract, even a deliberate breach, is not an act of "bad faith".

> **For example:** Mower promises to mow Farmer's field for $100 on Saturday. After that Neighbor offers Mower $200 to mow his field on Saturday. Mower calls Farmer and tells him the deal is off unless he can match Neighbor's offer. This is NOT a "bad faith" act. Mower is not deceiving Farmer or concealing facts. It is just a breach of contract.

3) Acting to HAMPER other contract parties

It is a breach of an implied material condition for a contract party to hamper other parties' **performance of contractual duties** or **enjoyment of benefits** to the extent they are **substantially denied the expected benefits of the contract**. It is a **major breach** and the contract is rendered **voidable**.

> **For example:** Mower promises to mow Farmer's field for $100 on Saturday. On Friday Farmer irrigates the field with sprinklers. If this **substantially** hampers Mower's ability to mow the field **he can void** the contract and sue Farmer for **major breach**.

4) Duty to help other parties PERFORM

It is a breach of an implied material condition for a party to fail to help and cooperate as reasonably necessary to allow other parties to **perform contract duties** if it **substantially denies** the other party the **expected benefits** of the contract.

> **For example:** Mower promises to mow Farmer's field for $100 on Saturday. On Saturday morning the gate to the field is locked. Farmer says, "I will not let you on my land." An implied material condition of their contract is that Farmer will **take reasonable action so Mower can perform his contractual duties**. Since Farmer has refused to let Mower mow the field, **Mower can void** the contract and sue Farmer for **major breach**.

5) Duty to help other parties ENJOY BENEFITS

It is a breach of an implied material condition for a party to act or fail to act in a way that **substantially denies** other parties **expected contract benefits**. It is a **major breach** and the contract is rendered **void** or at least **voidable**.

> **For example:** County and Contractor enter into a contract (the "C-C" contract). County promises to pay Contractor $10 million to pave 10 miles of road with progress payments of $1 million after each mile is paved. Bank and Contractor enter into a contract (the "C-B" contract). Bank agrees to give Contractor a **line of credit**, and he promises to repay Bank each time he is paid by County. Contractor paves a mile of road but County breaches the C-C contract and does not make the promised progress payment. Contractor "waives the breach" and keeps paving more miles of road. County never pays him, and he never repays Bank. **Bank cannot sue Contractor for failure to repay the loan** because he has no duty to repay the loan until County pays him. **Bank cannot sue County for breaching the C-C contract** because it was not a party and was not an intended third-party beneficiary. So what is Bank's legal remedy and why? [15]

6) Duty to SUBSTANTIALLY PERFORM CONTRACT DUTIES

It is a breach of an implied material condition for a party to **fail to perform contract duties** to the extent it **substantially denies** other parties **expected contract benefits**. It is a **major breach**. [16]

> **For example:** Mower promises to mow Farmer's field for $100 on Saturday. Mower never mows the field. Since Mower has totally failed to mow the field, Farmer has been entirely denied the benefits he expected to enjoy. That is a **major breach** by Mower.

[15] The answer is that Contractor has breached the **implied material condition** of the C-B contract that he will act as reasonably necessary for Bank to substantially enjoy the expected benefits of the contract. That means Contractor had a contractual duty (to Bank) to stop work and sue County for breaching the C-C contract. When Contractor failed to do that, he breached the C-B contract, and Bank can sue him for **major breach** of their loan agreement.

[16] Some law professors do not see this as an implied material condition, but they treat it like an implied material condition. That can cause considerable confusion.

8. Waivers of Condition

The term "**waiver of condition**" means that if one or both parties to a contract "ignore" an express or implied material condition of the contract, the condition is "**excused**" so that a failure of that condition has no effect as long as the condition is "waived".

If a party performs on contract **promises that have not ripened** into duties to perform it **waives the conditions** that have prevented the promises from ripening into duties.

> **For example:** Mower promises to mow Farmer's field on Saturday for $100. Farmer does not have to pay Mower until he is finished. That is a **constructive condition precedent**. If Farmer pays Mower before he is finished he has **waived the condition**.

A party that waives a condition has a **legal right to retract** the waiver. Then the condition is "restored" and it resumes its original effect.

A waiver of condition remains **effective until it is retracted**, and the retraction is not effective until notice of the retraction is given to the other contract party.

Even though parties that waive conditions have a **legal right** to retract the waivers, a court of EQUITY may "estop" or prevent the retraction if it is necessary to prevent unjust enrichment or the frustration of reasonable expectations.

A **waiver of condition** should be distinguished from a **waiver of breach**, although they are closely related. The **waiver of a condition** means that a condition is ignored, and a **waiver of breach** means that a **major breach is treated as a minor breach** by the non-breaching party. A waiver of a breach is often called an "**election**". The "**waiver of a breach**" cannot be retracted.

9. Excuse of Conditions

Contract conditions either **shield a party that has made a contract promise** so that the **promise will not ripen into a duty** to perform unless the condition is **satisfied** or "holds" (a **condition precedent**) or else it **shields a party that has a duty** to perform so that the **duty will be discharged** if the condition is "**not satisfied**" or fails (a **condition subsequent**).

Part of "contract interpretation" is whether a contract condition is still effective or whether it has been "**excused**". If a condition is **excused**, it no longer shields the party that was previously intended to benefit from the condition. That causes **promises to ripen into duties** and **duties to continue** to be duties whether the condition is "**satisfied**" or not.

The major reasons conditions might be excused are:

1. The **condition was waived** and **retraction** of the waiver is estopped by a Court of equity;
2. The condition is excused by the **failure of a prior condition**;
3. **Major breach**, **anticipatory repudiation**, **prospective inability** and/or **prospective failure of constructive condition** excuse conditions shielding the breaching party from performance; and
4. **Substantive performance** excuses constructive conditions of prior performance.

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A. Excuse of Condition by Waiver and Estoppel

Waiver of condition was discussed above. A party that expressly or impliedly waives a condition has a **legal right to retract** the waiver at any time. BUT if retraction would cause the other party to be **detrimentally affected**, a Court of EQUITY may **estop** the retraction of the waiver. That has the same effect as if the condition were excused.

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B. Excuse of Condition by Failure of Prior Condition

The failure of one condition may cause the excuse of another condition.

> **For example:** Tom promises to paint Dick's barn by Saturday and that timely performance is an express condition. If Tom is tardy in painting the barn he is in major breach. But that condition is subject to another **implied material condition** that painting the barn is possible. If events beyond their control like floods or wildfires make painting impossible the express condition is excused by the "**failure of a prior condition**".

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C. Excuse of Condition by Major Breach

Contractual promises shielding the performance of a party that commits a **major breach** are excused, causing the promises of the breaching party to **ripen into duties** to perform. That is explained in Chapter 7: Breach of Contract.

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D. Excuse of Condition by Substantive Performance

Contractual promises shielded by **constructive conditions** are excused by a judicial finding that the performing party has **substantially performed**. That is explained in Chapter 7: Breach of Contract.

10. Option Contracts and Contract Options

Under contract law an "option" is **a legal right** to chose to do or not do something. The right to chose is usually limited to a time period called the **option period**. The person who has the right to chose is called the **option holder**, and if the option holder acts to take advantage of the option they are said to have **exercised their option**. But if the option holder does not exercise the option during the option period it will **lapse**, and after that they no longer hold an option.

There are two kinds of "options". There are **option contracts**, and there are **contract options**. While similarly named, they are two totally different ideas.

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A. Option Contracts

An **option contract** is a contract that stands alone, not just a provision within another contract. It is an agreement that one party who has made a contract offer to the other called the "**underlying offer**", **will not revoke** the underlying offer for a **stated period of time** in **exchange for consideration**. The party who pays consideration is the **option holder**.

Every option contract requires four elements: 1) an **underlying offer**, 2) **a promise** by the offeror of the underlying offer to **not revoke** the underlying offer, 3) a **stated period of time** in which the option holder can exercise the option (the "**option period**") and 4) a payment of **consideration** to the offeror of the underlying offer in exchange for the promise (the "**option price**").

An **option contract** binds the parties whether the option holder (the offeree of the underlying offer) exercises the option or not (accepts or rejects the underlying offer). If the option holder exercises the option (accepts the underlying offer) within the option period a different contract forms, the contract proposed by the underlying offer. If the option holder lets the option lapse (does not exercise within the option period) the underlying offer lapses.

> **For Example:** Seller offers to sell Blackacre to Buyer for $1 million. This is the **underlying offer**. Buyer asks for 30 days to consider the offer and seek financing and offers to pay Seller $1,000 if he will agree. This is an offer to enter into an option contract. If Seller agrees an **option contract** forms and Buyer must pay Seller $1,000. After that Buyer has 30 days to **exercise the option** (to buy Blackacre) and that is the **option period**. If Buyer exercises the option within the option period he is bound to buy Blackacre.

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B. Contract Options

A **contract option** is a provision within a contract, not a type of contract. Contracts often have provisions that give the parties "options" to do or not do something or to ask the other party to do or not do something. Those are **contract options**, and often called "option clauses".

The party that has the legal right to make the choice provided is called the **option holder**, but there may or may not be any particular **option period** in which the option must be exercised. As long as the contract containing the contract option is binding, **no separate consideration is necessary** to make contract option clauses binding.

Contract options are often subject to conditions, and they are always **express conditions**. They may be **conditions precedent** or **conditions subsequent**.

> **For Example:** Producer hires Actress under a contract to perform in his new drama on Broadway for 90 days at $5,000 a week. The contract provides that Producer has the option of extending the contract by an additional year if the play grosses more than $100,000 a week in the first six weeks. This is a **contract option**. Producer is the **option holder**. His option is subject to the **conditions precedent** that the play must gross more than $600,000 in the first six weeks.

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C. Effect of Option Offer Rejection

Under the Second Restatement of Contracts, § 37, an express rejection of a **contract offer** that is subject to an option contract does not effectively reject the offer and it remains open. There is very little case law to determine if this is a broadly adopted view or not.

> **For Example:** Sam offers to sell Blackacre to Bob for $200,000. Bob gives Sam $100 to hold the offer open for a week while Bob tries to decide whether to buy or not. Two days later Bob tells Sam, "I am not going to buy it. Your price is too high. I will only pay $190,000." Sam rejects that offer. Two days later Bob calls Sam and says, "I have changed my mind. I will buy it for $200,000 as you offered." Under the Second Restatement Bob's acceptance is effective because his rejection of Sam's offer is ineffective.

Chapter 4: Contract Modification

Modifications are **permanent** contract changes, and **waivers of condition** are **temporary** changes. Parties waiving conditions have a **legal right to retract** the waivers. **Rescissions** are contract terminations, and **novations** are rescissions followed by creation of a new contract.

A contract modification is an independent contract all by itself. It is a contractual agreement that one of the parties **agrees to do something different from the existing contract** if the other party will give or promise to give something of value **in exchange**.

> **For example:** Buyer has agreed to buy Blackacre from Seller "as is" for $200,000. Suppose Buyer agrees to pay $10,000 **in exchange** for Seller promising to repair termite damage. That is a separate agreement to modify the first agreement.

1. Modification Requires Agreement

Modification agreements must meet all the requirements of a contract, including **agreement** between the parties. This requires careful examination of the actual words of the parties.

> **For example:** Buyer and Seller have an existing agreement, and Buyer says, "I will pay you $10,000 more if you will do the termite repairs." Seller says, "I will talk to a pest exterminator." Suppose Seller does the work and Buyer refuses to pay for it. Buyer is NOT in breach because Seller never said he agreed to Buyer's offer. He just said he would "talk to a pest exterminator." That is not "assent" to Buyer's offer.

People often avoid saying the words necessary to prove commitment. When you are given quoted words you are being told this is EXACTLY what the people said, and you have to critically examine the exact words spoken. [17]

2. Supporting Consideration Required

Under the common law any agreement to modify an existing contract **must be supported by an exchange of consideration** because the modification agreement is, by itself, a separate contract.

Under the UCC this rule has been eliminated. That will be explained in Chapter 10.

A few courts have held that a good faith to modify an existing contract does not require consideration. This is not a broadly adopted rule. The general rule remains that any agreement to modify a contract must usually be supported by consideration. [18]

> **For example:** Buyer has agreed to pay Seller $200,000 for Blackacre "as is". Buyer calls Seller and says, "I hear you are in financial trouble so I will pay you $210,000 instead of $200,000." Seller says, "Very nice of you. I accept." This offer to pay $10,000 more is a

[17] Remember, semantics is the mother's milk of attorneys.
[18] This is where reading about the "Restatement of Contracts" can be very misleading. The "Restatement" is written by "legal scholars" and they have often advocated elimination of this rule. But that is not the broadly adopted law.

> **gift offer** because Buyer is not asking for anything **in exchange**. As a result the contract is **not legally modified** and Buyer's offer is not enforceable.

For a contract modification to be supported by consideration, each party must be giving something of legal value, and that depends on the exact terms of the modification agreement.

> **For example:** Buyer agrees to pay Seller $200 for his cow on Saturday. Later Buyer asks if he can delay payment until Sunday. Seller agrees. Whether this contract modification is supported by consideration depends on unstated details. Seller is "giving" something because he is giving Buyer **more time to pay**. But Seller may be giving Seller **more time to deliver the cow**. But if Seller had already delivered the cow Buyer is **not giving anything** to Seller **in exchange**, and the modification is not supported by consideration.

An agreement by one party to "take less" always lacks consideration unless they are also agreeing to "give less" or do things differently than originally promised.

> **For example:** Tom agrees to mow Dick's field for $100. But after he mows Dick says, "I will only pay you $80. Take it or leave it." Tom says, "Ok." But this agreement is not binding because Tom is effectively "giving" Dick $20 and Dick is not "giving" anything to Tom in exchange. Tom can take the $80 and still bring an action for the remaining $20.

3. Written Modification may be Required

If a contract is modified and the Statute of Frauds would have required a writing **if those new terms had been the original terms**, then the modification itself must be in writing to be enforced.

> **For example:** School and Teacher orally agree on January 1 that she will teach from September 1 to December 31 of the same year. That agreement is binding because Teacher can finish performance within a year from the date of contract. But if they later agree to extend the contract, if just for one day, the modification must be in writing because it will extend the performance period beyond a year from the original agreement.

If a contract is modified and the Statute of Frauds would NOT have required a writing **if those new terms had been the original terms**, then the modification can be oral.

> **For example:** School and Teacher agree on January 1 that she will teach from September 1 that year to May 31 of the next year. If they later orally agree Teacher will quit teaching early, on December 31, the oral modification is binding because performance will end less than a year from the original agreement.

Contract modifications also have to be in writing if original contracts require it.

4. Waivers of Condition

Wavers of condition were explained above in Chapter 3: Contract Interpretation. They do not have to be put in writing and do not have to be supported by consideration.

A **waiver of condition** is just a temporary contract change. The party that waives a condition has a **legal right to retract** the waiver at any time. But retractions are **not legally effective until notice** is given to the other party.

> **For example:** School hires Teacher under a contract that requires her to have a State teaching credential. When classes begin Teacher is waiting to receive her credential from the State. The School "waives the condition" and lets Teacher begin work. The School can **retract the waiver of condition** at any time and terminate Teacher, but the retraction is not effective until Teacher is given notice.

A Court of equity may **estop** a party from retracting a waiver of condition to prevent injustice.

5. Modification under Duress

If agreement to a contract modification results from **threats of breach** by the other party, the modification is the result of **duress** and unenforceable even if consideration is exchanged.

> **For example:** Contractor agrees to remodel Homer's bathroom. After he takes out the toilet Contractor tells Homer the toilet he must pay $1,000 more for a different toilet or the job will not be finished for weeks. Homer agrees to pay the extra money for the different toilet. The modification is supported by consideration because Contractor is giving Homer a different toilet in exchange for the additional $1,000. But it is also the result of **duress** created by Contractor. Therefore the modification is unenforceable.

6. No Application of Parole Evidence Rule

The Parol Evidence Rule never has application to contract modifications because they are never **prior or contemporaneous agreements**.

7. Accord and Satisfaction

An **accord and satisfaction** is a contractual agreement to settle a claim a contract (the "underlying contract") has been breached. The party claiming there has been a breach **agrees to abandon the claim** in exchange for something given by the accused party. The accord and satisfaction is a contractual agreement by itself, so it must be supported by consideration. That requires the **claim of breach** that is being abandoned to be a **good faith claim** with a **reasonable basis**.

Accord and satisfaction can be an oral agreement even if the contract concerned must be written.

> **For example:** Buyer agrees to pay Seller $200,000 for Blackacre. It is a real estate sales contract, so it has to be in writing to be enforceable. Buyer only pays Seller $198,000. Seller files a suit against Buyer for breach of contract. Buyer says, "I will give you my car

> if you dismiss your complaint." Seller agrees. This is a binding oral agreement even though the underlying contract has to be in writing.

An accord and satisfaction can have the same effect as a modification as shown in the above example, but it may be enforceable when an oral modification is not.

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A. Settlement of a Bogus Dispute is not Binding.

For an accord and satisfaction to be binding the underlying disputed must be a **reasonable** dispute brought in **good faith** because it is a contract agreement by itself.

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B. Accord without Satisfaction is not Binding

An accord and satisfaction is a contract agreement. The agreement is the "accord" and the exchange of consideration is the "satisfaction". If either party fails to do what they promised to do it is a **major breach**. The non-breaching party is released from the agreement and can bring an action for damages against the breaching party.

> **For example:** Seller sues Buyer for breach of contract in a real estate deal. Buyer says, "I will give you my car if you dismiss your complaint." Seller agrees. This is a binding oral agreement. But if Seller fails to deliver title to the car after Buyer has dismissed his law suit, Buyer can file a new law suit claiming Seller has breached BOTH contracts.

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C. Any Knowing Acceptance of Settlement Offer is Binding

Under the general view any **knowing** acceptance of a settlement offer is binding, even if the offeree tries to "qualify" the acceptance by stating something like "accepted under protest" or "accepted in partial payment". But an offeree who "accepts payment" is not automatically bound to the terms cited by the offeror unless they are aware of the terms. This view is followed in most but perhaps not all jurisdictions.

Under UCC § 3-311 a party that accepts a **payment** containing text that purports to settle a disputed claim or "account in full" is not usually bound to the terms of the offer unless the offer has been sent to the part of the organization that handles disputed claims, and even then the offeree is given a period of time in which to repudiate the payment. This is explained in Chapter 10.

Chapter 5: Third-Party Beneficiary Contracts

A "**third-party beneficiary contract**" is a **legally enforceable contract** entered into by two parties (a **promisor** and a **promisee**) for the **intended purpose of benefiting a third party**. This means that at least one contract party intended for the contract to benefit a third party, and the other contract party was aware of that intent. The third party the contract is intended to benefit is called an "**intended third-party beneficiary**". [19]

> **For example:** Pompous Gravesite enters buys a life insurance contract from Aetna. Pompous will pay Aetna $100 a month and in exchange Aetna promises to pay Pompous' son, Wastrel Gravesite, $500,000 when Pompous dies. If Wastrel receives this money he will be able to pay his debts. Since the purpose of the Pompous-Aetna contract is to benefit Wastrel, this is a "**third-party beneficiary contract**". Wastrel is the "**intended third-party beneficiary**". Even though Wastrel's creditors will benefit from the contract, that is not the purpose of the contract. They are just "**incidental beneficiaries**".

Life insurance policies illustrate the typical "third-party beneficiary" situation. In the example above Pompous is the "**promisee**", Aetna is the "**promisor**" and Wastrel is the "**intended third-party beneficiary**". When analyzing third-party beneficiary contract issues, expressly identify the "**promisor**", the "**promisee**", and the "**intended third-party beneficiary**".

All the rules that apply to other contracts also apply to the contract between the promisor and promisee in a third-party beneficiary contract. But **different rules** apply to the relationship between those parties and **intended third-party beneficiaries**:

1. Parties who are **not intended to be the beneficiaries** of a contract are "**incidental beneficiaries**", and they have **no standing** to enforce the contract against anybody, whether they would have benefited from it or not.
2. **Intended third-party beneficiaries** almost always have a **legal right to enforce** contracts against the promisors. This is called "**standing"**. In some jurisdictions the intended third-party beneficiaries must be "**vested**". This is explained below.
3. If promisees enter into third-party beneficiary contracts to **satisfy legal obligations**, the intended third-party beneficiaries have a **legal right to enforce** contracts against the promisees. In this case the intended third-party beneficiaries are called "**creditor beneficiaries**".
4. If promisees enter into third-party beneficiary contracts for **gratuitous purposes**, the intended third-party beneficiaries have **NO legal right to enforce** the contracts against the promisees. In this case the intended third-party beneficiaries are called "**donee beneficiaries**".
5. The promisors can raise any **defenses** against intended third-party beneficiaries that could have been raised against the promisees.
6. The promisees can raise any **defenses** against intended third-party beneficiaries that could have been raised against the promisors.

[19] Hint: It helps to draw little T-diagrams of the relationships between parties, labeling the identity of each.

1. Standing

To obtain a legal remedy for the breach of any contract, the party seeking a remedy (the movant) must have a **legal right to enforce** the contract. That is called "**standing**".

The **original parties** to a legally enforceable contract **always have standing**. That means that if either party breaches an enforceable contract, both parties have a **legal right** to bring an action award of a money judgment for **damages** caused or else for **legal restitution**. This will be explained in more detail later in Chapter 8: Contract Remedies.

In contrast, **intended third-party beneficiaries do not have "standing" unless they are "vested"**. That is explained below.

And **incidental beneficiaries**, third parties that were not intended to benefit from the contract in the first place, **have no standing** at all, even if the promisor and promisee both knew at the time of contract that their contract would serve to benefit them.

2. Vesting

Before third-party beneficiaries can enforce third-party beneficiary contracts they must be "**vested**". To be "vested" third-party beneficiaries must "**act in reliance**" on the existence of the third-party beneficiary contract.

Early common law stressed "vesting" but modernly it is of minor importance. Early Courts often required third-party beneficiaries to plead and testify they "acted in reliance" on the existence of the third-party beneficiary contract in some manner. Modernly this requirement has been almost entirely eliminated in most Courts because third-party beneficiaries obviously "act in reliance" as soon as they bring an action to enforce the third-party beneficiary contract. Consequently, **this is a pointless issue in most Courts**.

Some Courts may still require third-party beneficiaries to make some claim of "reliance" as a pleading requirement. Other than that this is a very marginal issue. But you may read some case law on this issue and it may be worth mentioning briefly on law school and Bar exams.

3. Intended Third-Party Beneficiaries

Intended third-party beneficiaries are people who were not parties to contracts that were created for the purpose of benefiting them. They are either **donee beneficiaries** or **creditor beneficiaries**.

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A. Donee Beneficiaries

If the intended **purposes** of contracts are to **bestow gifts** or other **gratuitous benefits** on third-party beneficiaries they are "**donee**" beneficiaries. **Donee beneficiaries** have **no legal right** to enforce third-party beneficiary contracts against promisees.

For example: Pompous Gravesite buys a life insurance policy from Aetna to benefit his son, Wastrel. Pompous has **gratuitous** motives so Wastrel is a **donee beneficiary**. Wastrel believes he is destined to be a millionaire so he neglects his education. Pompous later stops paying policy premiums and the policy lapses. Whether Aetna can sue Pompous for breach depends on the policy terms. But Wastrel **has no legal right to sue** Pompous for letting the policy lapse because he is a donee beneficiary.

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B. Creditor Beneficiaries

If the intended **purposes** of contracts are to **satisfy legal obligations**, third-party beneficiaries are called "**creditor**" beneficiaries. **Creditor beneficiaries** always have a **legal right** to enforce third-party beneficiary contracts against promisees.

For example: Latrina files a paternity suit against Pompous. Pompous denies being the father of her little boy, Wastrel. As an **accord and satisfaction** to settle the dispute he agrees to buy a $1 million life insurance contract from Aetna naming Wastrel as his beneficiary. Since Pompous is **satisfying a legal obligation**, Wastrel is a **creditor beneficiary**. If Pompous later stops paying the policy premiums and lets the policy lapse, he is legally liable to Wastrel because he is a creditor beneficiary.

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C. Breaches by Promisors

Intended third-party beneficiaries **always have standing** to enforce third-party beneficiary contracts **against promisors**, whether they are "donee" or "creditor" beneficiaries. They may have to satisfy the "vesting" requirement, but that is very easy to accomplish as explained above.

For example: Gravesite buys a life insurance contract from Aetna naming Wastrel as his beneficiary. Pompous dies and Aetna refuses to pay Wastrel the policy amount. Wastrel can sue Aetna for breach whether he is a "donee" or "creditor" beneficiary.

4. Defenses against Beneficiaries

Promisees and promisors can raise any defenses against third-party beneficiaries that they could have raised against each other.

For example: Pompous buys life insurance from Aetna naming Wastrel as his beneficiary. Aetna refuses to pay Wastrel claiming that Pompous made false statements about his health to get the insurance. **Bargaining in good faith** is an **implied material condition** of every contract, so **fraud** is a valid legal defense. Since Aetna could have raised the defense against Pompous it can raise the defense against Wastrel.

Chapter 6: Assignment and Delegation

The original parties to a bilateral contract are both promisors and promisees in every case. Each has given a promise in exchange for a promise. Parties can almost always "**assign their rights**" to receive contract benefits to other parties after contracts form. And they can often "**delegate their duties**" under the contract to other parties too. This is called **assignment** and **delegation**.[20]

If a contract has not been fully performed by either party the term "assignment" is often used to mean both an assignment of contract rights and an **implied delegation** of contract duties.

Assignment and **delegation** of a contract involve other parties like a **third-party beneficiary contract** but when a third-party beneficiary contract forms the contract **purpose is to benefit** the intended third-party beneficiary. In contrast, contract assignment and delegation takes place after a contract forms, and no intent to benefit third parties is required **at the time of contract**.

1. Assignment of Contract Benefits

Parties promised benefits by a contract are **promisees** as to those benefits. Promisees can convey or "subrogate" their **contract rights** to other parties. That is called "**assignment**". The parties who are assigned the rights are called "**assignees**", and the promisees who assigned their rights are called "**assignors**". For clarity you might call these "**promisee / assignors**".

When analyzing assignment issues and writing exam answers about them, it is very beneficial to identify each of the parties as being the "**promisor**", "**promisee / assignor**", "**gratuitous assignee**" or "**contractual assignee**". Assignees may also be called "**donee**" or "**creditor**" **assignees**. The "promisor" may also be called an "**obligor**". The contract that created the rights being assigned may be called a "**master contract**" for purposes of clarity.

> **For example:** County promises to pay Contractor $10 million to pave 10 miles of road. Contractor is the **promisee**. Contractor needs money for labor and materials so he assigns his rights under the **master contract** to Bank in exchange for a $9 million. Contractor is the **promisee / assignor** of the right to receive the payment, and Bank is the **assignee** of the rights. When Contractor finishes the job County will pay Bank the $10 million.

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A. The Law Favors Assignment

The law favors contract assignment to foster commerce. Most assignments of contract benefits concern **who gets paid**, and there is a substantial trade in "**commercial paper**" or which means the purchase and sale of **debt obligations**.

> **For example:** Broker gives sub-prime loans to 10,000 home buyers, each secured by a mortgage on the property purchased. Broker is the promisee of the borrowers. Broker sells the mortgages to Fannie Mae. This is an assignment, Broker is the promisee / assignor and Fannie Mae is the assignee. The borrowers are given notice of the assignment and their

[20] Hint: As with third-party beneficiary contracts, it also helps to draw little T-diagrams of the relationships between parties, labeling the identity of each, when dealing with assignment and delegation situations.

> obligation to pay Broker is replaced by an obligation to pay Fannie Mae. They don't pay Fannie Mae, they lose their homes, the economy crashes, you lose your job and end up going to law school.

Prohibitions against contract assignment are "restraints on alienation" that the law generally opposes. Therefore, promises to "not assign" contract rights are considered to be **covenants** unless contract language makes it quite clear non-assignment is intended to be an **express condition**. For a "no assignment" clause to be an **express condition** of a contract, it must say, "Any assignment of this contract is VOID," or "any assignment is VOIDABLE by the other party," or "VOID unless the other party EXPRESSLY APPROVES the assignment," or some other unequivocal statement of intent. Anything less will be interpreted to be a "covenant".

Nevertheless, **contract benefits cannot be assigned if the duties of the promisor would be substantially changed**.

> **For example:** Sears agrees to put vinyl siding on Owen's house for $30,000. Owen is the "promisee" of the siding. Owen can sell his house and assign his right to get the siding to the new owner because it is the same house. That does not change Sears' duties. But Owen cannot assign his rights to the owner of some different house and tell Sears it has to put siding on a different house.

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B. Breach of Covenant to "Not Assign"

When a "covenant not to assign" contract rights is breached, it is a breach of contract by the promisee / assignor, but the burden is on the non-breaching party, the promisor, to prove damages. And often there are no damages, so the breach has no real effect. Breach of contract is explained in more detail in Chapter 7: Breach of Contract.

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C. When Assignment becomes Effective

Assignment of contract rights requires a **clearly expressed** statement of **present intent** by promisee / assignors to convey **existing rights** to **identified assignees**. A statement of **present intent** means a statement that says, "I hereby give you…" instead of something like, "Next week I am going to give you…" When this is "effective" depends on which party you are talking about.

Promisors (obligors) are obligated to convey contract benefits to assignees **upon receiving notice** of contract assignments. It does not matter how notice is received. This is true whether or not assignees have been given notice of the assignments. If promisors are not given notice of assignments they remain obligated to convey contract benefits to promisees, and are not obligated to convey benefits to assignees.

Assignees obtain a legal right to receive contract benefits **upon notice** of contract assignments **unless they reject (disclaim) the benefits**. It does not matter how notice is received. If assignees reject (disclaim) assignments they lose their rights to master contract benefits.

Promisee / assignors lose their rights to receive contract benefits **upon receipt of notice by assignees** that do not reject them.

> **For example:** Lou loans Bob $10,000. After the contract forms Lou signs a written statement that says, "I hereby give Ann my right to receive $10,000 plus interest from Bob when his loan comes due." Suppose Lou gives the notice to Bob, but not to Ann. **Bob becomes obligated** to repay the loan to Ann when it comes due. If Bob tenders payment to Ann, **she receives notice** of the assignment at that time. If she rejects the payment, the assignment fails, and Bob is obligated to repay Lou instead of Ann.

Promisors may receive "constructive notice" via the filing of a "UCC financing statement".

Wage assignments generally must be in writing, but other assignments may be oral, even if the contract itself must be written pursuant to the Statute of Frauds.

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D. Promisee / Assignor Loses Standing

A **promisee / assignor has no remaining contract rights** after the assignment is effective. And since they have no contract rights, they have **no standing** to enforce the contracts.

> **For example:** County promises to pay Contractor $10 million to pave 10 miles of road. Contractor assigns his contract rights to Bank. Contractor has **no further legal right** to receive payment from County, and **no standing** to enforce the contract against County.

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E. Gratuitous and Contractual Assignments

Contract rights may be assigned as a **gratuitous gesture**, a **gift**, or in exchange for consideration.

1) GRATUITIOUS Assignments

When contract rights are assigned as a **gratuitous gesture** they are "**gratuitous assignments**" or "**gift assignments**", and the assignees are "**gratuitous assignees**" or perhaps "**donee assignees**".

Gratuitous assignments are merely "**gift promises**" and no contractual relationship is created between the promisee / assignor and the gratuitous assignee.

2) CONTRACTUAL Assignments

When contract rights are assigned **in exchange for consideration** they are "**contractual assignments**", and the assignees are "**contractual assignees**" or perhaps "**creditor assignees**".

Contractual assignments bind the promisee / assignors and assignees to contractual assignment agreements. For clarity these might be called "**assignment contracts**" to distinguish them from the "**master contracts**" that created the rights assigned.

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F. Revocation of Gratuitous Assignments

Contractual assignments cannot be revoked as long as the parties are bound by the terms of the **assignment contract**. But if the assignment contract fails or is rescinded, the assignment can be revoked by the promisee / assignor.

Gratuitous assignments can be revoked by the assignor at any time unless they become irrevocable. **Gratuitous assignments become irrevocable** if:

- The assignment is **stated in a writing given to the assignee**;
- The promisor (obligor) **conveys the contract benefits** to the assignee;
- The assignee and promisor **rescind** the contract and enter into a **novation**;
- The assignee **obtains a judgment** against the promisor for breach of the contract; OR
- The assignee is **given a token chose** (a symbol of ownership such as keys to a lock);

Revocation of a gratuitous assignment becomes effective when:

- The promisor (obligor) and/or the assignee are **given notice** of the revocation;
- The promisor (obligor) and/or the assignee are given notice of a **subsequent assignment** of the same contract rights to a different party; OR
- The promisee /assignor **dies**.

  For example: Ace agrees to paint Owen's house for $3,000. After the contract forms Ace tells both Owen and Ace, "I want you to pay what you owe me to Bubba as a gift for his birthday." Ace paints Owen's house but dies just as he finishes. The assignment to Bubba will **fail** because the assignment was gratuitous and Bubba did not get it in writing.

If the assignee **detrimentally relies** on the assignment, it may also be **equitably estopped**, but that is a matter of equity, not law. That is explained more in Chapter 9: Equitable Remedies.

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G. Liability of Promisee / Assignors

1) Promisee / Assignors are NOT LIABLE to Gratuitous Assignees

Promisee / assignors have no legal liability to **gratuitous assignees**. Gratuitous assignments are merely "**gift promises**" that create **no legal liability**.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace tells Owen, "I want you to pay what you owe me to Bubba as a gift for his birthday." Ace fails to paint Owen's house, and Owen refuses to pay Bubba. Bubba has **no legal right** to sue Ace because Ace simply gave Bubba **gift promise**.

2) Promisee / Assignors are LIABLE to Contractual Assignees

Promisee / assignors are legally liable to contractual assignees under terms of the "**assignment contract**" that forms between them for **five implied covenants**:

1. That the **contract rights assigned exist**;
2. That the contract rights are **not subject to unstated or hidden defenses**;
3. That assignment **documents provided are bone fide**;
4. That the promisee / assignor has the **power to assign** the rights; and
5. That the promisee / assignor **will act to prevent the rights from being defeated**.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace assigns his contract rights to Bubba in exchange for $2,800. Bubba is a **contractual assignee**. Ace gets drunk and does a very sloppy job painting Owen's house. Ace is liable for breach of contract to both Owen and Bubba.

3) Promisee / Assignors remain LIABLE to Promisors

When contracts are assigned, promisee / assignors remain legally liable to promisors whether the assignment is a "gift promise' or for consideration under an "assignment contract". This is illustrated in the example above, and it is also simply common sense. After all, if contract parties could escape liability by assigning their contract rights to some idiot named "Bubba" every contract could be broken.

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H. Promisors Liable to all Assignees

Promisors are liable to all assignees, whether they are **gratuitous** or **contractual** assignees, to the extent they would have been liable to the promisee / assignor before the assignment.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace assigns his right under the contract to Bubba. Ace paints Owen's house, but Owen refuses to pay Bubba. Owen is legally **legal liable** to Bubba whether Bubba is a gratuitous or contractual assignee.

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I. Defenses of Promisors

Assignees "step into the shoes" of the promisee so promisors can raise any defenses against assignees that could have been claimed by promisors against promisees if the contract had not been assigned, <u>at the moment the promisor was given notice of the assignment</u>.

> **For example:** Ace agrees to paint Owen's house for $3,000 on 6/1. Ace assigns his contract rights to Bubba and Owen is given notice of that on 6/10. On 6/15 Owen loans Ace $2,000. After Ace finishes painting the house Owen refuses to pay Bubba more than $1,000, citing the fact Ace owes him $2,000. Owen is in default because his claim against Ace (for $2,000) did not exist on 6/10 when he was given notice of Ace's assignment of the contract to Bubba.

However, there is an exception for **holders in due course**. A **holder in due course** is a party that is assigned contract rights under these circumstances:

- By a **negotiable instrument**;
- That is **signed** by the maker;
- And promises to pay a **certain sum of money**;
- Payable to **order of the bearer**;
- On **demand or at a specific future date**;
- That is purchased **for value**;
- Purchased in **good faith**; AND
- Purchased **without knowledge of defenses** that the contract is overdue, dishonored or has claims against it.

Under those conditions the assignee assumes many of the characteristics of a "**bone fide purchaser for value without notice**" and the promisor often cannot raise defenses of **failure of conditions**, **lack of consideration**, **breach of warranty** and some claims of **fraud**.

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J. Defenses of Promisee / Assignors

Any defenses promisee /assignors could have raised against promisors under the master contract can be raised against both promisors and assignees. In addition, promisor / assignors may have other defenses against contractual assignees under the terms of assignment contracts.

1) Master Contract Defenses of Promisee / Assignors

Promisee / assignors retain all defenses available to them under "**master contracts"**, and can raise them against both promisors and contractual assignees.

> **For example:** Ace agrees to paint Owen's house red. After the contract forms Ace assigns his rights to Bubba for consideration. Ace does not paint Owen's house because the homeowner's association outlaws it. Owen refuses to pay Bubba and sues Ace for breach of contract. Bubba also sues Ace. Ace can raise the defense of "supervening illegality" against both Owen and Bubba, just as he could have against Owen alone if he had not assigned his rights to Bubba.

2) Assignment Contract Defenses of Promisee / Assignors

Promisee / assignors can raise additional defenses against assignees under the terms of "**assignment contracts**".

> **For example:** Ace agrees to paint Owen's house. After the contract forms Ace assigns his contract rights to Bubba in exchange for Bubba's personal check. Bubba's check bounces for "insufficient funds". Because of that Ace can rescind the assignment contract and notify Owen that the assignment has been revoked.

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K. Payments by Mistake to Promisee / Assignor after Assignment

If a **promisor pays a promisee / assignor** after receiving notice of an assignment the **promisor is still liable to the assignee**. The **promisor has the burden of recovering** from the promisee / assignor that was paid by mistake.

2. Delegation of Contract Duties

Parties promising to perform contract duties are **promisors** as to those duties. When promisors arrange for other parties to perform **contract duties** for them, it is a "**delegation**". Promisors that delegate contract duties are "**promisor / delegators**" and parties delegated those duties are "**delegatees**". These are also called "**delegates**" and "**delegants**". The terms mean the same thing.

The classic "delegation" situation is a general contractor delegating tasks to "sub-contractors".

> **For example:** Contractor promises to pave 10 miles of road for County in exchange for $10 million. Contractor arranges Subcontractor to do some of the work in exchange for $4 million. Contractor has **delegated** part of the job to Subcontractor. Contractor is the **promisor / delegator** of the duty to pave the road and Subcontractor is the **delegatee**.

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A. Non-Delegable Duties

Duties cannot be delegated if

- The **contract expressly prohibits** delegation, OR
- Delegation would **materially change the benefits** the promisee would receive.

Delegation is never valid if it involves personal services of the promisor that could not be performed by an agent or employee of the promisor.

> **For example:** Celine Dion agrees to sing at Caesar's Palace six nights a week for six months. She tries to delegate her duties to an understudy. This is not a valid delegation because patrons pay Caesar's Palace to see the real "Celine Dion", not an imitator.

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B. Promisor / Delegator Remains Bound

A **promisor / delegator cannot escape liability** for **master contract duties** by delegating the contract. This, again, is just common sense. If parties could escape contract liability by delegating the duties to some "Bubba" every contract would be worthless.

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C. When Delegation is "Effective"

A delegation is effective if:

- The promisor / delegator **clearly manifests a present intent to delegate** the duties;
- The duties to be performed **currently exist**; AND
- The **delegatee agrees** to assume the duties of the promisor.

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D. Gratuitous and Contractual Delegations

Contract duties may be assumed by delegatees as **gratuitous gestures** or **for consideration**.

1) GRATUITIOUS Delegations

When contract duties are assumed by delegatees as **gratuitous gestures** they are "**gratuitous delegations**", and the delegatees are "**gratuitous delegatees**" or perhaps "**donor delegatees**".

Gratuitous delegations are merely "**gift promises**" by the delegatees and no contractual relationship is created between the promisor / delegator and the gratuitous delegatee.

2) CONTRACTUAL Delegations

When delegatees assume contract duties **in exchange for consideration** they are "**contractual delegations**", and the delegatees are "**contractual delegatees**" or perhaps "**debtor delegatees**".

Contractual delegations bind the promisor / delegator and contractual delegatee to a contractual agreement. For clarity this might be called the "**delegation contract**" to distinguish it from the "**master contract**" that created the duties being delegated.

Delegation contracts are always **third-party beneficiary contracts** because they are always formed between the promisor / delegator and the contractual delegatee **knowing the purpose of the contract is to benefit the promisee** of the **master contract**.

The intended third-party beneficiary of a delegation contract (the promisee of the master contract) has standing to enforce it against both the promisor / delegator and the contractual delegatee.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace delegates the job to Bubba in exchange for Bubba's check for $2,800. Owen is an **intended third-party beneficiary** of the delegation contract between Ace and Bubba. If Bubba's check bounces, he is in breach of the delegation contract and liable to both Ace and Owen.

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E. Revocation of Gratuitous Delegation

Contractual delegations cannot be revoked if the promisor / delegator and delegatee are bound by a **delegation contract**, but if the delegation contract fails or is rescinded the delegation can be revoked by either of them.

Gratuitous contract delegations are **revocable** by both gratuitous delegatees and promisor / delegators. Revocation is **effective upon notice** from one to the other.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Bubba tells Ace he will paint the house for free. Bubba gets bored and sloppy painting. Bubba can **revoke his gift promise** and quit any time he wants, and Ace can **revoke his delegation of duties** as well because it **a gratuitous delegation**.

If any of the parties have relied on a **gratuitous delegation**, they may be able to **estop revocation** in **equity** based on a claim of **promissory estoppel**. That is explained in Chapter 9.

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F. Gratuitous Delegatee not Liable

A gratuitous delegatee has only made a **gift promise** to assume the duties of the promisor, and is **never legally liable** to either the promisor / delegator or the promisee.

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G. Contractual Delegatee Liable to Both Delegator and Promisee

Contractual delegatees are legally liable to both the promisor / delegator and the promisee of the master contract under the terms of the delegation contract.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace delegates the work to Bubba for $2,500. If Bubba fails to paint the house properly he is liable to both Ace and Owen.

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H. Promisees Not Liable to Delegatees

Under common law **promisees are not liable to** delegatees. They are only liable to promisors.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace subcontracts the paint work to Bubba, promising to pay him 90% of what he gets from Owen. Bubba paints Owen's house, but Owen doesn't pay Ace and Bubba gets nothing. Owen is **not legal liable** to Bubba. Owen is only liable to Ace.

But there is **a limited modern exception** to this rule. Broadly adopted statutes now provide protections for some delegatees. They can file and serve liens against the properties of promisees that are improved by the labor and materials delegatees provide. Statutes vary by State but these are often called **mechanic's liens**, **material men's liens**, or **workman's liens**. These warn the promisees to not pay the promisor / delegator without assuring the contractual delegatees have

been paid. Delegatees have a right to recover amounts they are owed directly by promisors directly from promisees, **even if promisees have not breached the master agreement**.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace subcontracts the paint work to Bubba, promising to pay him 90% of what he gets from Owen. **Bubba serves a workman's lien on Owen** warning him that when the house is finished Owen should not pay Ace without confirming that Bubba has been paid. If Owen pays Ace, and Ace heads to Mexico, Bubba has the right to bring an action against Owen's house to recover the money he is owed by Ace.

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I. Promisees Remain Bound

Promisees remain liable to promisors under the **master contract**.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace subcontracts the paint work to Bubba. Bubba paints Owen's house, but Owen doesn't pay Ace. Owen is liable to Ace the same as if the contract had not been delegated to Bubba.

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J. Promisor / Delegators Liable to Contractual Delegatees

Promisor / delegatees are legally liable to contractual delegatees under the terms of the **delegation contract**. If contractual delegatees perform as promised, promisor / delegatees are liable to them under the terms of the delegation contract.

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K. Defenses of Promisors and Promisees Unchanged

The **defenses** of both promisees and promisors are **unchanged by delegation**.

> **For example:** Ace agrees to paint Owen's house for $3,000. After the contract forms Ace subcontracts the paint work to Bubba. Ace and Owen can still raise any defense against each other that they could have raised if the contract had not been delegated.

3. "Assignment of Contract"

The term "**assignment of benefits**" must be carefully distinguished from the similar terms, "**assignment of contract**" or "**contract assignment**". A "**contract assignment**" by a party that has not yet fully performed contract duties **implies both assignment and delegation**.

> **For example:** Ace agrees to paint Owen's house. After the contract forms Ace "**assigns the contract**" to Bubba. That implies Bubba has assumed Ace's duty to paint the house in exchange for the right to receive payment from Owen. Ace is both a promisee / assignor AND a promisor / delegator. Bubba is both an assignee and a delegatee.

Chapter 7: Breach of Contract

A **breach of contract** is:

- A **breach of existing contract duties** by a contract party; OR
- An **anticipatory repudiation** of future contract duties that is **not cured** or **retracted**.

A breach of contract can either be a **major breach** or a **minor breach**.

Only enforceable contracts can be breached, so breaches of agreements cannot be "contract breaches" if the:

- Agreements are **not contracts** at all;
- Contracts are **void ab initio**;
- Contracts are **failed**, voided by subsequent failure of condition;
- Contracts are **legally rescinded** (voided) by the parties; or
- Contracts are **unenforceable**.

When an agreement or understanding is breached, but it is not a breach of an enforceable contract, the parties have no legal right to a remedy and can only seek a remedy in equity. That will be explained in Chapter 9: Equitable Remedies.

1. Breach of Existing Contract Duties

A contract duty that does not exist cannot be breached. Some duties exist from the moment a contract forms such as the duty of good faith bargaining. But contract promises **subject to conditions precedent** do not **ripen** into duties until and unless the conditions are **satisfied**.

Contract promises are often subject to the **constructive condition precedent** that the other party must perform as promised first. Contract promises may be subject to other conditions precedent. Until those conditions are satisfied, promises do not ripen into duties and cannot be "breached".

> **For example:** Ace agrees to paint Owen's house by September 1. Owen's promise to pay is subject to the **constructive condition precedent** that Ace must properly finish painting the house by September 1. If Ace is tardy he has breached the contract, and Owen's promise to pay does not ripen into a duty to pay. If Owen refuses to pay, **he is not in breach** of any duty because his promise to pay never became a duty.

After contract promises ripen into duties to perform, promisors have a **duty to perform in accordance with** all contract **conditions** and **covenants**. Consequently, a breach of an existing contract duty is always a breach of:

- An **express condition** by a party;
- An **implied material condition** by a party; OR
- Some other **express or implied covenant** by a party.

If a contract party **repudiates a contract promise** that has not yet ripened into a duty, it is an **anticipatory repudiation**, not a breach of an existing duty. Anticipatory repudiation is explained in the next section.

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A. Breach of Express Conditions always Major Breach

If an **express condition fails** because of a party's acts or failures to act, it is always a **major breach**, and that determines the remedies of both the breaching and non-breaching party. It does not matter what effect the breach has on the non-breaching party.

If an express condition fails through no fault of either party the contract fails (becomes void), but neither party is in breach. In that case the parties have no legal remedies and must seek a remedy in equity. That is explained in Chapter 9: Equitable Remedies.

Most express contract promises are express conditions. But promises of **timely performance**, **satisfactory performance**, or that the **contract will not be assigned** are often considered to be "mere covenants".

> **For example:** Ace promises to paint Owen's house with "Kelly-Moore paint". Instead, Ace paints the house with "Sherwin-Williams" paint. That is a **breach of an express condition** of the contract by Ace, so it is a **major breach**. It does not matter why Ace used a different paint or whether Owen is better or worse off.

If timely performance is an express condition of a contract, tardy performance is a **major breach**, regardless of the effect it has on the other party.

> **For example:** Ace promises to paint Owen's house no later than September 1 and they agree "time is of the essence". Ace does not finish painting until September 2. That is a **breach of an express condition** of the contract by Ace, so it is a **major breach**. It does not matter what effect it has on Owen.

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B. Breach of Implied Material Conditions always Major Breach

Implied material conditions are conditions **implied by law or circumstances** that must be satisfied **for the parties to substantially enjoy the expected benefits of the contract**. The breach of an implied material condition is always a **major breach**.

As explained above, express conditions are **defined by the parties**, and every breach of an express condition is a major breach whether it has a serious effect on the non-breaching party or not. But implied material conditions are "material" only because of the **serious effect failure has on the parties**. A breach of an implied material condition is always a **major breach** because **if it did not substantially deny expected contract benefits** to the non-breaching party, it **would not be considered to be a breach of an implied material condition**.

The **implied material conditions implied by law** in every contract were explained above in Chapter 3: Contract Interpretation. They are:

1. That the parties bargained in GOOD FAITH to create the contract;
2. Contract performance will be POSSIBLE;
3. Contract performance will be LEGAL;
4. The contract will continue to be supported by CONSIDERATION;
5. The agreed purposes of the contract will not be FRUSTRATED;
6. The parties will not HAMPER each other in PERFORMING CONTRACT DUTIES;
7. The parties will not HAMPER each other in ENJOYING CONTRACT BENEFITS;
8. The parties will ASSIST each other as necessary; and
9. The parties will SUBSTANTIALLY PERFORM CONTRACT PROMISES.

If any of these implied material conditions fail through no fault of either party the contract fails (becomes void), but neither party is in breach. In that case the parties have no legal remedies and must seek a remedy in equity. That is explained in Chapter 9: Equitable Remedies.

1) Duty to help other parties PERFORM

Each contract party has a **duty to help and cooperate** as necessary for other parties to perform contract duties.

> **For example:** Mower promises to mow Farmer's field for $100. When Mower arrives the gate to the field is locked. If Farmer does not unlock the gate he has breached the **implied material condition** that he will help Mower perform and is in **major breach**.

2) Duty to SUBSTANTIALLY PERFORM

An implied covenant of every contract is that parties will perform as **a reasonable person would find satisfactory** even if there are no express conditions of time or quality of performance. Any failure to perform in a reasonable manner is a **breach** of contract, but if a breaching party **substantially performs** it is a minor breach. Substantial performance means the non-breaching party has not been **substantially denied expected contract benefits**. A **failure to substantially perform** is a **major breach**.

> **For example:** Ungrateful Satan agrees to perform a rock concert for Promoter at the arena on September 1. They do not agree "time is of the essence", so timely performance is **not an express condition**. Ungrateful Satan shows up too late to perform. Since that is not reasonably satisfactory, it is breaches an implied covenant. And since Promoter is **substantially denied expected contract benefits** it is a **major breach**, the breach of an **implied material condition**.

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C. Breaches of Express and Implied Covenants always Minor Breach

Covenants are express or implied promises that are **not express conditions** and if breached are at least **substantially performed**. Breaches of covenants are always **minor breaches**. [21]

[21] There is considerable confusion and lack of clarity in the field of law regarding implied material conditions. They are often referred to without definition or explanation. That only causes confusion. It is clearly a major breach of

Three types of **express contract promises** generally considered **covenants** rather than express conditions are:

- Promises of **timely performance**;
- Promises of **satisfactory performance;** and
- Promises to **not assign** contracts.

Any of these can be express conditions, but for them to be express conditions the parties must either make it **unequivocally clear** in the language of the contract they are express conditions or else circumstances at the time of contract (not at the time of breach or because of the effects of a breach) make it clear the parties **intended** for them to be express conditions.

> **For example:** The Ungrateful Satan agrees to perform a rock concert for Promoter at the local arena at 7:00 p.m. on September 1. They do not agree "time is of the essence", so timely performance is **not an express condition**. The Ungrateful Satan shows up late, but the concert is a success anyway. The tardy performance was the breach of an express covenant but it **did not substantially deny expected contract benefits** to Promoter. Therefore it was a **minor breach**.

2. Anticipatory Repudiation

An **anticipatory repudiation** is a **statement** or other **indication** that a contract party **will probably not perform contract promises** that have not yet ripened into contract duties.

There are three levels of uncertainty whether contract parties will perform future duties:

- If there is a **possibility** performance will not occur, the other party may request **reasonable assurances**;
- If there is a **likelihood** performance will not occur it is a **prospective failure**; AND
- If there is **almost certainty** performance will not occur it is **anticipatory breach.**

Anticipatory repudiation is always a **major breach unless** it is **cured**, **retracted**, or **waived**. But if cured, retracted or waived, it is not a major breach, and may not even be a minor breach.

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A. Request for Reasonable Assurances

If there is a **reasonable possibility** a contract party will fail to perform future contract duties the other party may request **reasonable assurances**.

"Reasonable assurances" means a bank guarantee, a performance bond, placement of property in an escrow account, provision of a deed of trust or some similar financial guarantee that the party performing services will be compensated when they finish the job.

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contract for a party to fail to substantially perform contract duties. So by implication the duty to substantially perform is a material condition of every contract, and that makes it an "implied material condition".

Under the common law there is **no legal right** to demand or receive reasonable assurances, but if a request for reasonable assurances is not honored it supports a claim of **prospective failure of constructive condition** or **anticipatory breach**. Those in turn provide legal rights.

> **For example:** Tom agrees to build a house for Dick. During construction Tom hears Dick has financial problems. Tom can ask Dick for **reasonable assurances** in the form of a **performance bond** from a third party like a bonding company. If Dick does not respond Tom may stop work on a claim of prospective failure or anticipatory breach.

A right to request and receive reasonable assurances is specifically provided for under the UCC. The UCC will be explained later in Chapter 10: UCC Modifications.

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B. Prospective Failure

Some jurisdictions recognize "**prospective failure**" as a "middle ground" between reasonable uncertainty supporting a demand for **reasonable assurances**, and **anticipatory repudiation**, an almost certainly, when there is just a likelihood a contract party will fail to perform future contract duties. It is also called "**prospective inability**" to perform or a "**prospective failure of constructive condition**". When a party deliberately does something making its future performance unlikely this may be called a "**voluntary disablement**".

Jurisdictions that do not recognize **prospective failure** treat these situations the same as anticipatory repudiation.

If a request for reasonable assurances is made and not honored it supports a **claim of prospective failure**. That suspends a party's **duty to perform** and **excuses constructive conditions precedent**, so the performing party can stop work and wait for the other party to perform first.

> **For example:** Mower promises to mow Farmer's field in exchange for $100 to be paid on Saturday. Farmer has no duty to pay Mower until he has finished performance. But if Farmer says, "I might not be able to pay you on time," it creates a **likelihood** Farmer will not perform his future duty. That is a **prospective failure** and Mower can stop work and demand Farmer to pay him in advance. Farmer still has until Saturday to pay.

If **parties change position in reaction** to **prospective failure** it **discharges** duties in most Courts.

> **For example:** Tom agrees to buy Dick's cow on Saturday, but the cow gets sick. That raises a substantial risk of prospective failure. If Tom buys Harry's cow in response he will be **discharged** from his duty to buy Dick's cow on Saturday in most Courts.

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C. Anticipatory Repudiation

If there is almost certainty a contract party will fail to perform future contract duties it is an "**anticipatory repudiation**" in all jurisdictions. It may also be called "**anticipatory breach**". Jurisdictions that do not recognize **prospective failure** consider serious likelihood of failure and failure to give reasonable assurances to be anticipatory repudiation.

Anticipatory repudiation excuses all conditions precedent and the party's promise to perform in the future ripens into a duty to perform immediately. Simultaneously, **anticipatory repudiation suspends** the performing party's **duty of performance**, the same as with **prospective failure**.

If the party with a duty to perform in the future does not perform immediately it is a **major contract breach**, and the other party's duty to perform is **discharged**.

> **For example:** Mower promises to mow Farmer's field in exchange for $100 to be paid on Saturday. Mower starts mowing, but on Friday Farmer says, "I will not be able to pay you tomorrow." Since that creates **almost certainty** Farmer will not perform his future duty, it is an **anticipatory repudiation** and Mower may stop work and demand that Farmer pay him immediately. Farmer cannot wait until Saturday to pay. [22]

Anticipatory repudiation is often a major breach but that is not exactly true as explained below.

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D. Cure and Retraction of Anticipatory Repudiation

Anticipatory repudiation can be **cured** or **retracted**, and in that case there is **no breach** of the contract. But if the other party substantially changes position in reaction to the anticipatory repudiation before cure or retraction is attempted it is a **major breach**.

1) CURE of anticipatory repudiation

After anticipatory repudiation a party may **cure** by immediately performing **all contract duties**.

> **For example:** Mower promises to mow Farmer's field for $100 to be paid on Saturday. After Mower starts mowing Farmer says, "I will not be able to pay you." Mower may stop work and demand that Farmer pay him immediately. If Farmer does pay him immediately he has **fully performed all his duties**. That **cures** the anticipatory repudiation, the contract remains in place, and Mower is still bound to finish the job.

2) RETRACTION of anticipatory repudiation

A party that has anticipatorily repudiated a contract may **retract** the repudiation **before the other party has reacted**. In that case the repudiation is retracted.

Some jurisdictions distinguish between a "**hard reaction**" and a "**soft response**". A "soft response" is less than a strong objection the contract has been breached. It may be a request for reasonable assurances. After an anticipatory repudiation the other party **may always request reasonable assurances**, and failure to give assurances is an anticipatory repudiation.

The **retraction** of a statement of anticipatory repudiation may consist of nothing more than **continuation of performance**.

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[22] Note that the difference between **prospective failure** and **anticipatory repudiation** may hinge on the difference between the words "**might not**" and "**will not**".

3) SUBSTANTIAL REACTION prevents cure or retraction

If a non-breaching party **substantially reacts or changes position in response** to anticipatory repudiation the breaching party **cannot cure or retract** and it is a **major breach**. A "substantial reaction" includes **unconditional refusal to perform** contract duties, **declaring breach**, **engaging other parties** to perform the same services, etc.

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E. Waiver of Anticipatory Repudiation

An anticipatory repudiation may be "waived" by the non-breaching party. The term "waiver" is not technically correct. The correct term is an **election**. The non-breaching party may "elect" to treat an anticipatory repudiation as a **minor breach** rather than a **major breach**.

> **For example:** Ace promises to paint Owen's house with "Kelly-Moore paint". Owen discovers Ace is painting the house with "Sherwin-Williams" paint instead. That is a **major breach** because it violates an **express condition**. Owen doesn't say anything and lets Ace continue. That is an "election" to treat Ace's major breach as a minor breach.

Refusing a tender of performance waives anticipatory repudiation and terminates the contract.

> **For example:** Mower promises to mow Farmer's field on Saturday. But on Friday Mower says, "I can't mow your field tomorrow, but I can do it today." This is an anticipatory repudiation that **excuses all conditions**, making Mower's promise to mow a present duty to mow. And he simultaneously **offers to cure** his breach by mowing immediately. If Farmer refuses Mower's offer to do the work immediately it waives the anticipatory repudiation and terminates the contract.

Rescission by the non-breaching party also waives anticipatory repudiation and terminates the contract.

> **For example:** Mower promises to mow Farmer's field on Saturday. But on Friday Mower says, "I can't mow your field tomorrow." In response Farmer says, "Then the deal is off." That acts as a rescission and waiver of the anticipatory repudiation.

3. Major Breach of Contract

A **major breach** of contract is:

- The **breach of an express condition** by a party;
- The **breach of an implied material condition** by a party; OR
- An **anticipatory repudiation** that is **not cured**, **retracted** or **waived** by the non-breaching party.

A major breach may also be called a **material failure** or a **breach of material condition**.

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A. Effect of Major Breach

Whether there has been a **major breach** of a contract or not is a matter for judicial determination. If a Court determines there has been a **major breach** it has two effects:

- First, the breaching party's **contract promises immediately ripen into duties** to perform. In other words, any **conditions precedent** that may prevent the breaching party's promises from ripening into duties are **excused**, and the breaching party has a duty to perform all contract promises as if those conditions have been satisfied.
- Second, **all remaining duties of the non-breaching party are discharged**. They have no duty to perform any remaining contract promises.

This allows the non-breaching party to **immediately sue for damages** rather than wait until contract performance is supposed to be finished. The breaching party is left with **no legal rights**, and can only plead for a remedy in equity.

> **For example:** Garth promises to restring Wayne's guitar. In exchange Wayne promises to tune up Garth's car. Garth also promises Wayne that if the car gets over 20 miles to the gallon after the tune-up he will pay Wayne a $200 bonus. Garth totally fails to restring the guitar. That is a **major breach**, and Garth is liable to Wayne for the expense of having someone else restring the guitar. Plus it **excuses** the mileage condition and Garth owes Wayne the $200 bonus. Wayne's duty to tune up the car is **discharged**.

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B. Waiver of Major Breach

As explained above in regard to anticipatory repudiation, the non-breaching party can **waive the breach** by not objecting and allowing the breaching party to continue performance. This is actually an **election** to treat the major breach as a minor breach as explained earlier.

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C. Remedy of Non-Breaching Party

When there is major breach of a contract the non-breaching party has a **legal right to award of a money judgment** against the breaching party, **and is excused of all remaining contract duties**.

> **For example:** Ace promises to paint Owen's house with "Kelly-Moore paint" for $3,000. Instead, Ace paints the house with "Sherwin-Williams" paint. That is a major breach because it breaches an **express condition**. Owen is excused from any legal duty to pay Ace at all.

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D. Remedy of Breaching Party

When there is major breach of a contract the breaching party has no legal right to a remedy. The breaching party can only plead for a remedy in equity. That is explained in more detail in Chapter 9: Equitable Remedies.

4. Minor Breach of Contract

A minor breach is the breach of any **express or implied covenant**. It can also be defined as:

- The breach of an express contract promise that is **not an express condition**; OR
- The breach of an implied contract promise that is **substantially performed**.

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A. Effect of Minor Breach

Whether there has been a **minor breach** of a contract or not is a matter for judicial determination. If a Court determines there has been a **minor breach** all remaining **constructive conditions precedent are excused** and the parties have a **duty to perform all remaining contract promises**.

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B. Remedy of Non-Breaching Party

When there is a minor breach of a contract the non-breaching party has a **legal right** to an **award of damages** or else an **offset for damages** caused by the breach. The calculation of damages is explained in more detail in Chapter 8: Contract Remedies

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C. Remedy of Breaching Party

When there is minor breach of a contract the breaching party has a legal right to **receive all promised contract benefits**.

> **For example:** Mower promises to mow Farmer's field on Friday for $100. Mower does not mow it until Saturday. Farmer refuses to pay. Mower sues Farmer for payment. If Mower proves timely performance was not an **express condition** and that his tardy performance **did not substantially deny Farmer expected contract benefits**, the Court will find Mower's breach was **minor**. That finding **excuses constructive conditions** so Farmer's promise to pay ripens into a duty to pay. If Farmer can prove the breach caused him any damages, he has a right to an offset in that amount. The Court will then issue a money judgment in favor of Mower for $100 less the offset for damages.

5. Breach of Divisible Contracts

Contracts divided into discrete phases, installments or steps such that breach of one part does not necessarily cause breach of the whole contract are called **divisible** or **installment** contracts.

Minor breaches of divisible contracts are treated like minor breaches in any other contract, but major breaches are treated as breaches **only as to that phase or part** in isolation. This concept has somewhat different application in certain situations.

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A. Breach of Installment Contracts for Goods

Contracts for the sale of goods are governed by Article 2 of the UCC. That will be explained in more detail in Chapter 10: UCC Modifications. But if a contract for a sale of goods provides for **delivery in installments**, a breach as to any one delivery does not cause the entire contract to fail.

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B. Breach of Divisible Employment Contracts

If an employment contract for a set period of time provides for a series of periodic payments, the contract is a divisible contract. A defaulting employee has a right to payment for the full periods worked, even if they do not complete performance in the remaining contract periods.

> **For example:** Teacher Tom contracts to teach school for a nine month "school year" at a rate of $3,000 a month. Tom quits after three months. He has a right to be paid for the three months he worked even though his breach as to remaining months is a major breach.

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C. Breach of Divisible Construction Contracts

A construction contract that provides for progress payments at specific milestones may be treated as a divisible contract, but if a major breach of any one phase substantially denies the non-breaching party the expected contract benefits of the remaining phases, it is a **major breach of the entire contract**.

> **For example:** Contractor agrees to pave 10 miles of highway, and State promises to pay $1 million for each mile of highway completed. Contractor only paves the miles of highway that are easy to complete and refuses to pave the rest. That is a **major breach** of the entire contract because a highway with gaps is worthless. State is **discharged** from any duty to pay Contractor, and Contractor is liable for State's cost to complete the project.

6. Breach of Real Estate Contracts

Breaches of real estate contracts combine "contract" issues with "real property" issues.

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A. Duty to Disclose

Under broadly adopted modern law sellers of interests in real property have an **affirmative duty to disclose** all known material conditions negatively affecting the value. This is an implied material condition of every real estate contract. If a contract forms **without full disclosure** by the seller, the seller is in major breach and the **buyer can void the contract ab initio**.

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B. Use of Escrow Accounts

Real estate sales use an **escrow account** managed by an independent **escrow officer** and there is an agreed-upon date for the conveyance of title called the "**escrow date**". Parties have **no duty to perform prior to the escrow date**. But if a party fails to act reasonably before the escrow date the other party may request **reasonable assurances**.

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C. Timely Performance Seldom a Material Condition

Real estate sales are so **prone to delays** that timely performance is not a material condition unless the parties expressly and unequivocally state it is an express condition.

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D. Duty to Deliver Marketable Title

A seller of real property impliedly promises to deliver **marketable title**. That means title to the property that a **reasonably prudent business person** would consider **free from reasonable doubt in both law and fact**. The title actually delivered must comprise **the entire geographical area promised**, existing usage must **not violate existing zoning** requirements, and there must be **no undisclosed claims or encumbrances**.

Title that is not marketable is often said to be "clouded" or that there is a "cloud on the title".

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E. Simultaneous Performance is Concurrent Condition

The promise of a buyer to pay for real property is **subject to the condition precedent** that the seller must first tender (offer to deliver) **marketable title**. That means the buyer's promise to pay does not ripen into a duty to pay until the seller of the property tenders title.

At the same time the promise of a seller to deliver marketable title is **subject to the condition precedent** that the buyer must first tender (offers to pay) the purchase price.

Therefore the promises to perform ripen into duties to perform simultaneously with performance itself, so simultaneous performance is a **concurrent condition precedent**. That is why these transactions use an **escrow holder** to facilitate the simultaneous conveyance.

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F. No Breach Unless Performance is Tendered

Since neither party to a real estate contract has any duty to perform until after the other party tenders performance, there can be no breach of contract (other than anticipatory repudiation) unless **one party tenders** performance **on or after the escrow date** and the other party fails to respond in kind.

> **For example:** Buyer agrees to buy Blackacre from Seller for $1 million with September 1 as the escrow date. Seller arrives at the escrow company on September 1 to discover Buyer has not deposited the required funds. Seller refuses to sign the deed over to Buyer. Neither party is in breach. Buyer is not in breach because he had no duty to pay until Seller tendered an executed deed, and Seller is not in breach because he had no duty to execute the deed until Buyer tendered payment.

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G. Equal Dignity Rule Requires Written Broker Agreements

Some States require real estate broker contracts to be in writing or they are not enforceable at law. This is called the **equal dignity rule**.

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H. Effect of Breach on Broker Commissions

Under the general view real estate sellers are liable for broker commissions even if buyers breach purchase agreements and fail to pay for the properties they agreed to buy. Under this view the real estate broker only promises to find a buyer that is **ready, willing and able to buy** the property being sold. Once the broker has done that the seller is liable for the broker's commission even if the buyer later breaches the contract.

However, a growing minority of courts hold sellers are NOT liable for broker's commissions if buyers breach purchase agreements. Under this view sellers have no duty to pay brokers until sales are complete. The sellers' promises to pay commissions are considered subject to **constructive conditions precedent** that buyers must first complete the purchases. If that does not happen the condition is not satisfied and the sellers have no duty to pay commissions. (See *Tristram's Landing, Inc. v. Wait* (Mass., 1975) 327 N.E.2d 727.)

Under this growing view brokers must recover commissions from the breaching buyers on the grounds that they were **intended third-party beneficiaries** of the real estate sales contracts that were breached by the buyers.

Chapter 8: Contract Remedies

Legally enforceable contracts give the parties a **legal right** to remedies. If there is no legally enforceable contract, the only possible remedy of the parties is in equity. That is explained in Chapter 9: Equitable Remedies.

Further, **parties that commit major breaches have no legal right to a remedy** and must also seek a remedy in equity.

So discussion of "contract remedies" only applies to **non-breaching parties** and **breaching parties that have committed minor breaches**.

The possible legal remedies are:

- Awards of **money judgments**;
- **Eviction** (removal of people or objects from land);
- **Legal Replevin** (repossession of chattel);
- **Foreclosure**; AND
- **Legal rescission** and **restitution**.

Of these, contract classes focus almost entirely on the award of money judgments, and the other legal remedies are hardly ever mentioned.

It is important to understand that there are **no punitive damage awards in contract law**. While "fraud" and "duress" are reason for voiding a contract, it is not a basis for awarding punitive damages unless the movant (plaintiff or cross-complainant) pleads in tort.

1. The Role of a Jury

In a breach of contract action the parties have a **right to a jury trial**. The jury is the "**finder of fact**". The right to a jury can be waived and often is waived by the parties. In that case the judge is the finder of fact, and that is called a "**bench trial**".

The first thing to be determined by a finder of fact is whether there was, in fact, an enforceable contract. If not, the parties have no legal remedies and the only remedies are in equity. Equitable remedies are determined by the judge alone, not a jury. They are explained more in Chapter 9.

If the finder of fact determines there was an enforceable contract the remaining issues are whether **there was a breach**, the **damages** caused, if any, whether a party should be **awarded a money judgment**, and if so, the appropriate **amount** of that judgment.

2. Awards of Money Judgments

The legal remedy that is the focus of most discussion in contracts classes in law school is the **award of a money judgment**. A money judgment (in contract law) results when the finder of fact determines there **was a legally enforceable contract**, that it **was breached**, and that one of the parties has a right to receive an award of **damages** or **restitution**.

In that case the Court issues a "judgment" in favor of one part, the **judgment creditor**, for a certain amount of money against the other party, the **judgment debtor**.

The judgment creditor is not always the non-breaching party, the judgment debtor is not always the breaching party, and the money judgment is not always an award of "damages". So don't leap to conclude that a "money judgment" means an "award of damages to the non-breaching party".

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A. The Basis for the Judgment

How the "amount" of the judgment is measured depends on whether the judgment creditor is the breaching party or the non-breaching party.

1) Judgments to NON-BREACHING parties

A non-breaching party may have a right to award of a money judgment whether there has been a **major or minor breach**, and the amount of the judgment is measured by either **damages** OR **legal restitution**

Damages are monetary losses a breach of contract causes the non-breaching party. **Legal restitution** to a non-breaching party is either the monetary benefit a breaching party received under the contract, or else the benefit they would gain by breach, depending on situation. Non-breaching parties have a **legal right to** receive the larger of **damages** or **legal restitution**.

2) Judgments to BREACHING parties

A breaching party only has a right to a remedy if there is a **minor breach**. If there has been a major breach they have no legal right to any remedy and can only seek a remedy in equity.

A money judgment issued to a **breaching party** is only measured by **legal restitution**. **Legal restitution** to a breaching party is the monetary benefit the non-breaching party gained under the contract.

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B. Collection on the Judgment

Whether money judgments are measured by damages or restitution, and whether they are issued by Courts of law or equity, they all give the same remedy. A judgment is not a Court "order", and the judgment debtor is not "ordered to pay" the judgment creditor. Rather it is a "judgment" that says the judgment creditor has the **right to collect** a certain amount from the judgment debtor <u>if he can.</u>

The **judgment creditor** has the burden of **collecting on the judgment**. If the judgment debtor pays the judgment, the problem is solved. Otherwise the judgment creditor must follow the collection rules of the particular State. Generally the judgment creditors record judgments with county recorders to create liens on all real property owned by **judgment debtors**. Judgment creditors may also have the County Sheriff seize personal property of judgment debtors.

A Court of law never helps the judgment creditor collect on the judgment. The burden of collection is entirely on the judgment creditor. If a Court helps a party collect on a judgment, the Court is acting in **equity**, not in law.

Limits protect judgment debtors from being impoverished. Judgment creditors cannot take everything judgment debtors own. These protections vary by State. For example, a judgment debtor may be allowed to keep an auto value less than a certain amount. Judgment debtors who have no assets to be seized are "judgment proof". You cannot pull their gold teeth!

Judgment creditors can have the County Sheriff sell the real and personal property seized from judgment debtors in "Sheriff's sales" to "satisfy" judgments. If sales raise more money than judgment debtors owe (after expenses of the sale) the excess is returned to the judgment debtors.

A large portion of money judgments never get collected. If the judgment is large it is often better for the judgment debtor to declare bankruptcy or disappear. Then the judgment is worthless. [23]

3. Damages

A money judgment measured by "damages" can only be awarded to a non-breaching party. And non-breaching parties can demand a money judgment measured by "legal restitution" instead, if they wish. So the term "award of money damages" should only be used to refer to a money judgment award to a non-breaching party (against the breaching party) measured by the amount of damages caused by the breach of contract.

The **purpose** of awarding **damages** is **compensate** the non-breaching party so that they are put in the same position they would have been in if the contract had not been breached.

Damages are **calculated** as the sum of four distinct types of "damage" caused by a breach of contract. They are:

- **Expectation** damages;
- **Reliance** damages;
- **Incidental** damages; AND
- **Consequential** damages.

In most situations one or more of these categories of "damage" have no application.

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A. Expectation Damages

Expectation damages are the monetary value of the **contract benefits expected** by the non-breaching party over the **benefits actually received** because the contract was breached. The purpose of expectation damages is to compensate non-breaching parties for the loss of benefits caused by the breach.

[23] I have been told that over 75% of all judgments are never collected. I don't know if that is true. After all, studies show 93.254% of all statistics are just made up out of thin air like this one. And four out of five doctors agree. Nevertheless, winning a million dollar judgment is meaningless if nothing can be collected.

Actual calculation of expectation damages depends on whether the non-breaching party was:

- Denied promised property or services;
- Denied payment for property; OR
- Denied payment for services performed.

1) Expectation damages for PROPERTY or SERVICES not provided

If parties are denied property or services because of a breach their **expectation damages** are the **value of expected benefits lost** because of the breach. Usually this is the same **amount they would have to spend to rectify the breach**.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace paints the house so badly it would cost Owen $1,000 to correct the mistakes. Owen's **expectation damages** are the $1,000 he would have to spend to put him in the same position he expected.

But sometimes the expected benefits lost because of a breach are less than the cost of rectifying it.

> **For example:** Builder promised to build a house for Owen for $300,000. He builds the house facing the wrong direction. The error does not cause the house to have any less market value, but lifting the house and turning it the right direction would cost $25,000. Since Owen ended up with a house worth the same amount that he expected, he has no **expectation damages**, even though it would cost him $25,000 to correct the breach.

One of the "expected benefits" of a contract may be the right to use property. If **tardy performance** causes **"loss of use"** for a period of time, expectation damages are based on the **imputed rental value** of the property for the period of time it could not be used because of the breach.

> **For example:** Builder promised to build a house for Owen by August 1. He finishes a month late. If the house would have had a rental value of $2,000 a month, Owen must be paid $2,000 to compensate him for "loss of use". Those are his expectation damages.

2) Expectation damages when PROPERTY not paid for

If parties are not paid for property they <u>have conveyed</u> their expectation damages are the **amount they were promised**. If they are denied payment for property they <u>promised to convey</u> their expectation damages are the **amount they were promised less the market value of the property** at the time of the breach.

> **For example:** Buyer agrees to pay Seller $1 million for Blackacre. Later Buyer refuses to pay. If Seller has <u>already conveyed</u> the land to Buyer, Seller's expectation damages are the amount promised, $1 million. If Seller <u>has not conveyed</u> the land to Buyer, Seller's expectation damages are $1 million less the market value of Blackacre at the time of Buyer's breach.

3) Expectation damages when SERVICES not paid for

If parties are not paid for services they have already performed their expectation damages are the **amount they were promised**. If parties are refused payment for services not yet performed their expectation damages are the **amount they were promised less the costs they would have incurred** in providing the services. This is effectively "**lost profits**" caused by the breach.

> **For example:** Builder agrees to build a house for Owen for $300,000. Builder expects to incur costs (permits, labor and materials) of $250,000. If Owen repudiates the contract after Builder completes performance, Builder's **expectation damages** are the amount he was promised, $300,000. If Owen repudiates the contract before Builder completes performance, Builder's **expectation damages** are the amount he was promised, $300,000, less the costs he would have incurred, $50,000, which is equal to his **lost profits**.

4) Parties may have NO DAMAGES

A party may have NO EXPECTATION DAMAGES in some situations.

> **For example:** Ace agrees to paint Owen's house with "Kelly-Moore" paint for $3,000. Ace paints the with "Sherwin-Williams paint", breaching an express covenant of the contract. **If the paint used is of the same or better quality** Owen has not suffered any loss of benefits and has no **expectation damages**.

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B. Reliance Damages

Reliance damages are the **out-of-pocket expenditures** by the non-breaching party before the breach in reliance on the belief the breaching party would properly perform less the value of the expenditures to the non-breaching party after the breach.

> **For example:** Traveler books a trip to China with Agency. For the trip Traveler pays $100 for a visa from the Chinese consulate and buys new luggage for $300. Agency cancels the trip. Traveler's **reliance damages** are the cost of the visa and luggage, less the value those items have to Traveler after the breach. Since Traveler has no use for the visa but can use the same luggage for other trips, her reliance damages just the cost of the visa.

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C. Incidental Damages

Incidental damages are fairly minor **out-of-pocket expenditures** after the breach, caused by the breach, but not the sort of "direct and natural" expenses that would be expected by the breach. They are usually storage charges, shipping costs, rental fees and things of that nature.

If a breach causes a loss of use and replacement property is rented in the meantime, expectation damages can be awarded for the loss use or incidental damages can be awarded for the costs of the replacement, but there is no basis for awarding the sum of the two amounts.

> **For example:** Builder promised to build a house for Owen by August 1. He finishes the job a month late, and Owen has to rent another house to live in during the delay. Suppose the imputed rental value of the home Builder promised Owen was $2,000 a month and the cost of the rental house was also $2,000 a month. Owen can claim **expectation damages** of $2,000 for not being able to use the house he was promised, or he can claim **incidental damages** of $2,000 for the cost of renting another house to live in, but he has no right to be awarded the sum of the two amounts because then he would receive twice the amount of benefit he actually lost.

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D. Consequential Damages

Consequential damages are lost profits on collateral contract commitments that fail because a contract is breached. Under *Hadley v. Baxendale* and its progeny the non-breaching party has no right to consequential damages unless the **breaching party knew or could "contemplate" at the time of contract** that a breach would cause a loss of profits on collateral agreements.

> **For example:** Owen tells Ace that he has sold the house to Byer for $200,000, and that he has to have the house painted or the deal with Byer will fall through. Ace agrees to paint Owen's house. Ace fails to paint the house, and as result Byer voids his contract with Owen. Owen is forced to sell the house to Smith for $190,000. Ace is liable for Owen's loss of $10,000 because he **knew** that if he breached the painting contract Owen would lose profits on the sales contract.

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E. "General" and "Special" Damages

Sometimes the terms "general" and "special" damages are used in contract law. **This is just a bad idea and it should be avoided**.

The term "**general damages**" is used to describe the **sum of expectation, reliance** and **incidental damages**. The term "**special damages**" is used to describe **consequential damages** alone.

Using these terms causes confusion with the same terms in tort law, and is no good reason to use these terms in contract law.

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F. Damage Amounts Must be Proven with Certainty

A **non-breaching party has the burden** of proving, with a preponderance of the evidence, the **amount** of damages they claim they have suffered with **reasonable certainty**. To do this often requires the testimony of **expert witnesses**.

Damages based on speculation and unsupported claims cannot be awarded.

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G. Damages Must be Caused by Breach

A **non-breaching party has the burden** of proving the damages they have suffered were **caused by the breach**. This means that the damages must be a **direct and natural result** of the breach.

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H. Damages Must be Unavoidable

A **non-breaching party has the burden** of proving the damages they have suffered were **unavoidable**. This means that the non-breaching party could not have avoided suffering the damages claimed after the breach took place.

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I. The "Duty to Mitigate"

The requirement of the non-breaching party to prove the damages claimed were **caused by the breach** and **could not have been avoided** is often called the "**Duty to Mitigate.**" This simply means that in certain circumstances the non-breaching party must act to prevent a breach from causing damages, but in other circumstances there is no "duty" to act at all.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace fails to paint the house at all. Owen seeks written estimates from three other contractors and the lowest bid is $4,000. Owen has **no duty to paint the house** or "mitigate" his damages. He simply has to convince the Court that **if he had painted the house** it would have cost him $1,000 more than he **expected to pay** Ace.

Under the UCC a non-breaching buyer who has been sent non-conforming goods may act to "cover" by buying identical goods elsewhere, but there is no "duty" to do that and the buyer does not have to "cover" at all. This is explained more in Chapter 10: UCC Modifications.

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J. The "Four C's"

The requirement that damages are **Certain**, were **Caused** by the breach, **Could not** be avoided, and were **Contemplated** at the time of contract may be called the "Four C's".

> **For example:** Ace agrees to paint Owen's house. After that Owen offers the house for sale for $300,000. Ace paints the house poorly, and Owen is only able to sell the house for $200,000. Owen claims Ace cost him $100,000 because he could have sold the house for a higher price but for the poor paint job. His claim will fail for four reasons. First, Owen **could have corrected** the paint job before selling, so he **failed to mitigate**. Because of that he cannot prove the paint job **caused his loss**. Because of that he cannot prove his loss **with certainty**. And finally Ace **could not contemplate** Owen planned to sell the house <u>at the time of contract.</u>

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K. Consequential Damages Require Sale before Breach

The preceding rules that consequential damages must be **contemplated** (foreseeable) at the time of contract, **proven with certainty** at the time of breach, **caused** by the breach and **unavoidable** effectively combine to require contract property to be **sold before the breach** (i.e. pre-sold) or else consequential damages cannot be proven.

> **For example:** Owen asks Ace to paint his house because he plans to sell it for $200,000. Ace agrees to paint Owen's house by August 1. Ace is tardy painting the house, and Owen is delayed in selling the house. Owen ends up selling the house to Smith for $190,000. Ace is NOT liable for damages of $10,000 because Owen did not sell the house before the breach. Since he did not have the house sold before the breach, he cannot prove with certainty that the breach caused him to suffer any loss at all.

4. Legal Restitution

The amount of a money judgment may be based on legal restitution rather than damages. And this is the only legal remedy of a breaching party. The **purpose** and **measure** of "legal restitution" depends on whether it is awarded to the non-breaching party or the breaching party.

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A. Restitution to Non-Breaching Party

A non-breaching party has a legal right to award of a money judgment measured by restitution as an alternative to damages whether the breach is major or minor. Restitution to a non-breaching party is measured by the amount of benefit the breaching party has received as a result of EITHER **the contract** OR **the breaching the contract**. In any case it cannot be more than the contract amount.

The **purpose** of legal restitution to a non-breaching party in either case is to **prevent the breaching party from reaping an unjust enrichment by breaching the contract**.

> **For example:** Builder agrees to build a house for Owen for $300,000. He expects his costs (permits, labor and materials) to be $250,000. After Builder has spent $200,000 (on permits, labor and materials) Owen repudiates the contract. Builder has **expectation damages** of $50,000 (his lost profit) and **reliance damages** of $200,000, his out-of-pocket expenditures. Therefore Builder's **total damages** are $250,000. But suppose Builder can prove it would only cost Owen $20,000 to finish the house. That means that Owen has received $280,000 worth of benefits under the contract (he can have a house worth $300,000 by just spending $20,000 more). **Owen would reap an unjust enrichment** from breaching the contract if Builder was limited to damages alone, so Builder has a right to demand **legal restitution** instead.

Sometimes restitution is the non-breaching party's only possible remedy.

> **For example:** Ace agrees to paint Owen's house for $3,000 using "Kelly-Moore" paint. Ace finds he can get an equivalent quality of "Sherwin-Williams" paint on sale and save $200. Ace paints the house with the cheaper paint to increase his profits. This is a **major**

breach because he has violated an **express condition** of the contract to reap an **unjust enrichment**. But Owen cannot prove he suffered any damages because the paint used by Ace is of the same quality. But Owen has a legal right to award of a money judgment in **legal restitution** for $200, the **unjust benefit** that Ace would otherwise enjoy as a result of his breach, so that Ace does not benefit from breaching the contract.

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B. Restitution to Breaching Party

The breaching party never has any legal right to award of "damages". But breaching partiers **always have a legal right** to an award of a money judgment measured by legal restitution in the case of **minor breach**. The breaching party has **no legal right** to any remedy at all in the case of **major breach**.

Restitution to a breaching party is measured by **the amount of benefit the non-breaching party has received a result of the contract**, but not more than the contract amount.

The **purpose** of restitution to a breaching party is to **prevent frustration of reasonable expectations**, thereby **protecting the public interest** in commerce. Therefore, legal restitution to the breaching parties is **measured by the amount they expected to benefit** less an offset for the amount of damages caused by beach of the contract.

In other words, legal restitution to breaching parties that have substantially performed is measured by **the contract benefits promised less an offset for damages**, if any, caused by the breach.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace does a sloppy job and Owen pays another painter, Paul, $300 to touch it up. Owen refuses to pay Ace. Since Ace substantially performed he has a **right to legal restitution** for the contract amount, $3,000, less an **offset for damages** of $300 for his sloppy work. The Court will issue a **money judgment** to Ace against Owen in the amount of $2,700.

5. Implied-in-Fact Contract Remedies

Implied-in-fact contracts were explained briefly above, and they are as legally binding as any other enforceable contract. A common situation involves a party who knowingly receives benefits without expressly promising to pay for them, and subsequently refuses to pay for the benefits claiming no contract existed. In that case refusal to pay is a breach of contract, and the performing party has a **legal right** to award of a money judgment. In most cases they are awarded a judgment for the amount they **expected to be paid**, their expectation damages.

6. Liquidated Damages

The enforceability of liquidated damage agreements has been explained above. These agreements that the remedy of a non-breaching party are limited to a fixed monetary amount will not be enforced by a Court unless they were BOTH **reasonable to begin with** AND **produce a reasonable remedy** after a breach has occurred.

7. Judgment Interest

Once money judgments are awarded they begin to accrue "**legal interest**" from the date of issue until the judgment is "satisfied" or paid. The term "**legal interest**" is the interest rate and calculation method set forth in State statutes for interest accruing on judgments.

If money judgments are based on **sums certain**, judgment creditors generally have a right to award of "**pre-judgment interest**" on the judgment amounts from the dates the amounts were first owed, rather than from the dates judgments are issued. The term "**sum certain**" means the judgment amount was determinable with certainty at the time of the breach.

Pre-judgment interest is awarded to prevent parties from reaping an unjust enrichment by unjustly refusing to pay amounts owed.

> **For example:** Ace agrees to paint Owen's house for $3,000. Ace finishes painting on July 1, but Owen refuses to pay claiming the house is not painted properly. One year later the Court determines Ace performed properly and Owen's claim was without basis. The Court issues a **money judgment** to Ace against Owen in the amount of $3,000. [24] But since Ace was denied the use of the money for a year (and Owen has enjoyed the use of it), the Court may also award Ace pre-judgment interest beginning from July 1.

A Court cannot award pre-judgment interest if the amount of the judgment is uncertain in amount until it is issued.

8. Other Legal Remedies

Besides awards of money judgments the other possible legal remedies are **eviction/ejectment**, **legal replevin**, **foreclosure**, and **legal rescission**.

These are legal remedies because parties have a **legal right** to them. But they are seldom discussed in law school contract classes. Eviction, legal replevin and foreclosure are strictly controlled by State statutes, the statutes proscribe the exact steps that must be taken, and there is little more you need to know about them.

There is seldom a right to a jury trial in these actions, but there may be exceptions. For example, in eviction actions tenants may deny breaching their duties (e.g. to pay rent, avoid waste, etc.) and there may be a right to have a jury determine that key fact. This is rather rare and of little interest.

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A. Eviction and Ejectment

Eviction is the **legal right** of property owners to have people or objects removed from their land. When tenants are being removed from the land the remedy is always called **eviction**. When objects such as abandoned cars are being removed the remedy may be called **ejectment** rather than eviction.

[24] Note that here the amount of damages suffered by Ace is $3,000, and that is equal to legal restitution (the benefit Owen reaps from breach). So in this case there is no difference in the amounts.

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B. Legal Replevin

Legal replevin is the **legal right** of the owner of a security interest in **chattel** (a creditor) to take possession (repossess). Usually they are required to sell it to satisfy debts the owed against it, and any excess sales proceeds must generally be returned to the **debtor**.

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C. Foreclosure

Foreclosure is the **legal right** of the owner of a security interest in **real property** to take possession of it. Usually they are required to sell it to satisfy debts the owed against it, and any excess sales proceeds must generally be returned to the **debtor**.

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D. Legal Rescission and Restitution

Legal rescission was explained earlier. It is just the **legal right** of a contract party to void the contract. When a party has a legal right to rescind a contract, they usually have a right to **legal restitution** as well.

> **For example:** Dell sells Rube a computer with a guarantee that if he is not happy he can return it and get his money back at any time in the first month. Rube discovers the computer is defective, sends it back and demands his money back. This is **legal rescission** and he has a **legal right to restitution** as well because that was part of the agreement.

9. Adequacy of Legal Remedies

Legal remedies are considered to be adequate remedies and the exclusive remedies of the parties even if they can never be collected. The ability of a judgment creditor to collect on a judgment against a judgment debtor is seldom of any concern to the Court.

The one exceptional situation when award of a money judgment is considered to be an inadequate remedy is when a party has **failed to convey unique property or services** to the other party. In this situation the Court (the judge, not a jury) has **discretion** to issue an **order of specific performance**, an order of the Court that a party is to convey the promised property or services to the other.

This is an **equitable** remedy, not a legal remedy, in that parties have **no legal right** and are **not entitled** to an award of specific performance. This is explained more in Chapter 9.

Chapter 9: Equitable Remedies

If promises or agreements do not create enforceable contracts the parties have **no legal rights** to a remedy, and the only possible remedies for the parties are in equity. This may be because **no contract was ever intended** (e.g. "gift offers"), because **a contract offer was revoked** (e.g. revocation of unilateral contract offers), because any contract that was intended was **void ab initio** (e.g. "mutual mistake"), perhaps because contracts that did form were voided by a **failure of condition** or **legal rescission**, or when there has been **retraction of a waiver of condition**.

Further, parties that commit **major breaches** have **no legal rights** to remedies.

The parties in a breach of contract action do have a legal right to have a jury decide these issues, whether a contract existed at all, whether it was enforceable, whether it was breached, and whether the breach was a major or minor breach. But after deciding those issues the jury would have no further involvement in deciding whether or not to grant equitable remedies. That decision is entirely up to the judge alone, although his decision may be in response to a jury's finding.

Even if a jury does determine there was a legally enforceable contract and recommends award of a money judgment to one of the parties, the judge has discretion to decide it **would not be an adequate legal remedy**. This is most likely if a seller of **unique property** or **services** has breached the contract. In that case the judge may grant an **order of specific performance** instead.

Parties seeking remedies are called "movants" and the other parties are "respondents".

1. Equitable Jurisdiction

The authority of a Court (i.e. the judge) to provide an equitable remedy is called **equitable jurisdiction**. The Court has no equitable jurisdiction and no power to provide an equitable remedy if the movant seeking a remedy has a right to adequate legal remedies. Therefore, movants that plead for equitable remedies have the **burden of proving** they have **no adequate legal remedies**. This is **threshold issue** in every situation.

Often it is said that movants must also prove they are facing **irreparable harm**. This is usually redundant because if they had an "adequate legal remedy" the harm they face would not be compensable and not "irreparable".

It is also often said that movants must prove the "**balance of equity**" favors them. This simply means that the equitable arguments in favor the movant must outweigh the arguments in favor of the respondent. Among these considerations is whether the remedy sought by the movant would be **overly burdensome** for the Court to supervise.

If equitable jurisdiction is established, the **Court has discretion** to provide a remedy, but only to the **extent necessary** to either **prevent an unjust result** or **protect the public interest**.

And even if equitable jurisdiction is established, the decision whether to grant or refuse an equitable remedy is **at the discretion of the Court**. That means the judge has discretion whether to grant or deny equity.

Conversely, it is important to understand that **nobody has a right to equity**. That means that nobody is "**entitled**" to receive an equitable remedy. If you are ever asked if a party is "entitled" to receive specific performance the answer is simply "no".

Generally whatever the judge decides concerning an equitable plea will be upheld on appeal. But in some situations equitable remedies may be so obviously justified that granting or denying equity may be reversed on appeal for "**abuse of discretion**". But that is very rare.

Likewise, Courts only have discretion to provide equitable relief **to the extent it is necessary**. The Court (judge) does not have authority to provide an equitable remedy exceeding the amount necessary.

2. Equitable Causes of Action

Judges are not above the law or a law unto themselves, so a judge (Court) who grants an equitable remedy must establish a rationale supporting the action. There are about five recognized **equitable causes of action** or "**equitable theories**" that authorize a Court of equity to provide an equitable remedy. These are simply "reasons" or "rationales" that justifies granting equitable remedies.

The three associated with contract law scenarios are:

- **Implied-in-law contract**;
- **Promissory estoppel**; AND
- **Detrimental reliance**.

Professors and legal writers are more likely to use the term "cause of action" in terms of actions at law and are more likely to use the term "equitable theories" in terms of actions in equity but in both cases they are referring to reasons why a Court would be authorized to provide a remedy.

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A. Implied-in-Law Contract

Implied-in-law contract is an equitable theory that always justifies granting equitable remedies to parties that have committed **major breaches**, parties to contracts that were **void ab initio**, parties to **failed contracts**, parties to **rescinded contracts**, and parties to contracts that are **unenforceable**.

"Implied-in-law contract" is not a legal contract at all, and has nothing to do with "law" either. It is just a reason "why a court can grant equitable relief".

Some professors and legal writers refer to implied-in-law contracts as "quasi-contracts" and "fictional contracts". That just adds to the confusion. In fact, the term "quasi-contract" is often used to mean completely different ideas.

Implied-in-law contract is the applicable equitable theory when movants (parties seeking equitable remedies) have **acted to confer benefits on the other parties** with a **reasonable belief they would be compensated** in exchange. It does not matter if the "other parties" actually received any benefit from the "actions" or not.

The reason a Court would grant a remedy in this situation is to **prevent the frustration of reasonable expectations** and thereby **protect the public interest** in a smoothly operating commercial system.

There is no basis to grant a remedy based on implied-in-law contract if the movant had no **reasonable expectation of compensation**, so parties that act as **volunteers** have no right to be paid for their efforts.

> **For example:** Mary Mission feeds Derelict Dick believing that she will be rewarded by God. Dick dies and it turns out he was very wealthy. Mary Mission has no basis to plead for repayment in equity because she was a **volunteer**.

The **award of a money judgment** is almost always the remedy granted by a Court of equity based on **implied-in-law contract** theory. The **measure** of the judgment is the amount necessary to prevent frustration of reasonable expectations. That is called **equitable restitution**.

> **For example:** Vic has a stroke and collapses in a coma. EMS rushes him to the hospital in its ambulance. Vic is dead on arrival. EMS bills Vic's estate for the expense of the ambulance. Vic's executor refuses to pay the bill because Vic never agreed to it, Vic never "knowingly accepted" the services of EMS, and Vic did not benefit from the services of EMS. The Court will issue a money judgment to EMS for the amount it expected to be paid based on **implied-in-law contract** because EMS **acted to confer benefits** on Vic with a **reasonable belief it would be compensated**. After all, it would **harm the public interest** if ambulance services did not get paid.

Professors and legal writers often say the purpose of implied-in-law contract is to prevent "unjust enrichment". This is wrong. No "injustice" ever needs to be found. As the above example illustrates parties required to pay for services often do nothing "wrong" and are not "enriched".

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B. Promissory Estoppel

Promissory estoppel is an equitable theory that may justify granting equitable remedies to parties that have **reasonably relied** on **promises**, **assurances** or **waivers of condition** by other parties ("respondents") that have revoked or breached the promises or waivers.

When a Court grants relief based on a plea of promissory estoppel the **purpose** may be to **prevent unjust enrichment** by the respondent or else to **prevent frustration of the reasonable expectations** of the movant, depending on circumstances.

An **injunctive order** "**estopping**" a party from breaching a promise (the "respondent") is most often the remedy granted by a Court of equity based on **promissory estoppel** theory.

> **For example:** Seller agrees to sell Blackacre to Buyer for $300,000 under the terms of a written contract with close of escrow scheduled for May 1. The parties agree that "time is of the essence". On April 25 Buyer orally asks Seller to give him another week, until May 8, to arrange financing. Seller agrees. On April 30 Seller calls Buyer and says he is

retracting his "waiver of condition", that their agreement was not enforceable because it was not in writing and not supported by consideration. The next day he tenders marketable title and declares Buyer in major breach. Buyer has no legal remedy because he is in major breach. So he may plead equity and ask the court to "**estop**" Seller from retracting his agreement to extend the close date to May 8.

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C. Detrimental Reliance

Detrimental reliance is an equitable theory that may justify granting equitable remedies to parties that have **reasonably relied** on **promises** or **assurances** by respondents, **misrepresentations of fact** by respondents, or else when respondents have **deliberately withheld the true facts** from the movants for the purpose of deceiving them.

In contract law settings, detrimental reliance most often arises out of promises or agreements that cannot be enforced as contracts, and in that scenario it is very similar to a plea of promissory estoppel. In these situations **both promissory estoppel** and **detrimental reliance** could be argued.

The Court may issue a money judgment to compensate a movant that has been harmed by detrimentally relying on the promises or representations of the respondent. In that case the remedy is generally called **equitable restitution**. In other cases the Court may issue an **injunctive order** "**estopping**" the respondent from acting in some manner that threatens to harm the movant.

3. Illegal Contract Remedies

Contracts that are for known illegal purposes from the beginning are void ab initio and no remedy can be obtained in equity because the parties will be considered to be equally guilty. That is called "**in pari delicto**". Both parties are considered to have **unclean hands**, and the Court leaves the parties "as it found them." The term "unclean hands" will be explained below.

If one or both parties to a contract reasonably believe it is legal at the time of execution, or at least did not intend to commit an act of "moral turpitude" a Court of equity may provide **restitution** to a movant to prevent unjust enrichment or frustration of reasonable expectations. In this case the movant is **not in pari delicto**.

> **For Example:** Tom buys a winning million dollar lottery ticket from Dick for $1 without knowledge that this is an "illegal" transaction because Dick lacks the necessary licenses from the Lottery Commission. The Court will not award the million dollars to Tom because the contract established by the ticket sale was illegal. But it may order Dick to return Tom's $1 because Tom was **not in pari delicto**.

4. Remedies for Revocation of Unilateral Contract Offers

The remedies various Courts have created for situations when unilateral contract offers are revoked after offerees have started performance were explained above. Two of them are equitable.

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A. Revocation Barred by Promissory Estoppel

Some Courts hold that offerors are equitably barred from revoking unilateral contract offers after they learn offerees have begun performance by **promissory estoppel**.

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B. Award of Equitable Restitution

Some Courts allow offerors to revoke unilateral contract offers at any time, but award offerees **equitable restitution** to prevent unjust enrichment or frustration of reasonable expectations.

> **For example:** Tom makes a unilateral offer to pay Dick $1,000 if and only if Dick paints Tom's remote mountain cabin. Dick starts painting the cabin. Then Tom says, "I revoke my offer. I have decided to not paint my cabin after all." If Tom knew Dick had begun performance, some Courts would **equitably estop** him from revoking. Other Courts would allow him to revoke but require him to pay Dick **equitable restitution** whether he was aware Dick had begun performance or not.

5. Equitable Restitution

"Equitable restitution" is used to describe all **money judgments** issued by Courts of **equity**. While "restitution" suggests the Court is "restoring" parties to their original positions that may not be true. Equitable restitution may be awarded to **prevent unjust enrichment** or to **prevent frustration of reasonable expectations**. When Courts issue money judgments based on **implied-in-law contracts** movants are put in better positions than before they acted, and respondents are put in worse positions. Movants are rewarded for actions respondents did not ask for, agree to pay for, or willingly accept, and they may not have even benefited from the movants' efforts.

If Courts of equity issue orders of **specific performance** or **injunctive orders** to "estop" respondents from acting in some manner based on theories of **promissory estoppel** or **detrimental reliance**, it generally is not called "**equitable restitution**".

Awards of equitable restitution may be called "quantum meruit" reimbursement, but that term is used inconsistently. Everyone who says "quantum meruit" clearly knows what they mean, but if you read the literature carefully you find that the term is used to mean very divergent ideas.

Movants awarded money judgments in equitable restitution become **judgment creditors** the same as movants awarded judgments at law for damages and legal restitution. They have the same burden to collect as any other judgment creditor, as was explained in Chapter 8: Contract Remedies. The fact that a judgment is issued for "equitable" reasons makes no difference.

6. Specific Performance

A Court may provide an equitable remedy even though parties have an enforceable contract if a contract for **unique property** or **services** is breached by the seller. In these situations an award of money damages is not usually an adequate remedy. Therefore, the Court may order **specific performance**. Specific performance means an **order of the Court directing a respondent to convey property possession and title** to the movant or possibly to **perform unique services**.

Land has historically been viewed as unique in almost all situations. But there have been a few exceptions when the dispute was over condominiums or building lots with virtually identical characteristics.

> **For example:** Tom agrees to sell Blackacre to Dick for $1 million. If Tom breaches by refusing to convey title, a Court will often award Dick **specific performance** because land is generally viewed as unique. The Court may order the land to be conveyed to Dick. But if Dick breaches by refusing to pay the Court will NOT award specific performance. There is nothing "unique" about the money Dick promised to pay. The Court would just issue Tom a money judgment for the damages he can prove. His "expectation damages" would be **$1 million less the market value of the land at the time of the breach**. He would also get reimbursed for reliance and incidental damages.

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A. Specific Performance must be Feasible

The Court usually will not award specific performance if it would enmesh the Court in a long and difficult process of monitoring performance.

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B. Mutual Performance must be Assured

The Court usually will not award specific performance if there are no **reasonable assurances** there will be **mutual performance**. This may be called "**mutuality of remedy**". It means that the Court may deny specific performance to a movant if there is a reasonable possibility that the movant will not perform contract duties promised in exchange.

> **For example:** Tom promises to sell Blackacre to Dick for $1 million on credit. Tom breaches by refusing to convey title. A Court usually will not award Dick specific performance (ordering title to be conveyed to Dick) unless there are **reasonable assurances** Dick will, in fact, pay Tom the $1 million he is owed.

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C. No Specific Performance of Personal Services by Natural Persons

The Court cannot order specific performance of "personal" services by a natural person. That means services by an individual as opposed to an organization. The reason is that it violates the 13th Amendment prohibition of slavery (involuntary servitude).

> **For example:** Tom agrees to sing at Dick's supper club for one year for $30,000. Tom breaches and refuses to sing. The Court cannot order Tom to sing. Dick can hire another singer and sue Tom for expenses he incurs as a result. And if Tom gets a job singing for a competing nightclub nearby he may also get an injunction to stop him so Tom does not **reap an unjust enrichment** from breaching the contract.

The 13th Amendment does not apply to legal entities that are not individuals. So if corporations, associations and business organizations breach agreements to provide unique goods and services, they may be ordered to provide them.

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D. Specific Performance must be Possible

The Court cannot order specific performance if it is impossible for the respondent to comply as would be the case if the property in dispute is **sold to a third party** who is a **bone fide purchaser for value without notice** (BFPVW).

A **bone fide purchaser for value without notice** is a third party that **pays fair value** for property **without knowledge** other parties have claims against it. Under broadly adopted law it is **not possible to recover** property that has been transferred to a BFPVW.

7. Equitable Defenses

There are two (and only two) defenses to a plea for equity. They are **unclean hands** and **laches.**

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A. Unclean Hands

Courts will not award equitable remedies to parties with "**unclean hands**". That means **Courts will not help parties benefit from their own wrongdoing** such as using deceit, concealment, duress and unconscionable contract provisions to benefit at the expense of an innocent party.

In every case consider whether the "promise" the movant seeks to enforce was the result of **good faith bargaining** or from deceit or threats to breach existing duties.

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B. Laches

Laches means that a Court of equity will not provide a remedy to parties that have **unreasonably delayed taking action** to the **prejudice** of opposing parties.

> **For example:** Bevis breaches his contract with Butthead. Butthead does not sue Bevis for four years. Suppose he has no legal remedy because the Statute of Limitations has run out. Butthead must plead equity because he has no legal remedy. But Bevis will plead **laches** and argue Butthead **unreasonably delayed** seeking a remedy, causing him **prejudice**.

Laches can be pled as an equitable defense by a party that **has no legal defense**.

Chapter 10: UCC MODIFICATIONS

The common law applies to all contracts, but the Uniform Commercial Code (UCC) **modifies** some common law rules. You must understand the common law rule first in order to understand how the UCC modifies some of them. Never assume the UCC totally replaces common law.

This Chapter primarily explains UCC Article 2, **contracts** for the **sale of goods** with only slight mention of Articles 1 and 3 at the end.

This Chapter explains the Article 2 provisions that are most commonly tested. BUT you should read all sections of the UCC that might be tested on your exams.

There is a slight inconsistency between word usage in the common law and the UCC. Under common law the word "**discharged**" is used to mean a party is released from a duty, and the word "**excused**" is used to mean a promise is released from a condition. Under The UCC the word "**excused**" is used to mean **a party is released from a duty**.

1. UCC Definitions and Application

UCC Article 2 governs **contracts for the sale of goods**. **Goods** are **moveable things**. They are **chattel**, objects that are being sold and delivered.

The UCC applies to ALL contracts for the sale of goods, and it does not matter who is selling them or the dollar value of the sale.

> **For example:** Tom agrees to sell his stereo to Dick for $100. The UCC applies to this transaction because a "stereo" is a **moveable** object.

Article 2 does not apply if the contract is to pay someone to make goods. That is just a contract for labor services. And Article 2 does not apply if the contract is to buy intellectual property (e.g. songs, song rights, architectural designs) even if the property is recorded on tape or in the form of blueprints. **If the "thing" sold could be transmitted electronically it is not a good**.

> **For example:** Tom downloads a song to his Ipod. It is not a "good".

Article 2 only applies to **sales** of objects. Do not think or say that it applies to "transactions." Many "transactions" are not "sales" or even "contracts".

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A. Goods are Movable Objects

"**Goods"** are things that are **moveable** at the time they are "identifiable" to the contract. That means **when the seller is going to deliver** them to the buyer. They don't have to be moveable at the time of contract. They have to be moveable **at the time of performance**.

The key identifier of a good is that will be delivered to the purchaser. By definition (UCC § 2-105) unborn animals (e.g. a farmer selling calves before they are born) and growing crops are goods. The money used to buy goods and investment securities are not goods.

The UCC applies to a sale of things **attached to the land** if the **land is not also being sold** and the good is:

1. A **structure** (or its materials, bricks, boards, etc.), **gravel**, **minerals**, **oil** or **gas** IF the **seller is going to sever** it from the land before delivery (but not if the buyer removes); or

2. A **standing crop** or **timber** no matter who removes it. (see UCC § 2-107)

   For example: Tom agrees to sell his standing wheat crop to Dick. The UCC applies no matter who harvests the crop. But if Tom agrees to sell gravel from his land to Dick, the UCC only applies if Tom is the one that removes the gravel.

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B. Combined Contracts – Main Purpose Rule

The UCC governs all provisions of contracts for the **sale of goods AND services** if the **main purpose** of the contract is to sell the goods and not the services. This is **Main Purpose Rule**. The determination of the "main purpose" depends on **which costs more**.

> **For example:** Tom pays Dick $600 for an air conditioner and $50 for installation. The air conditioner costs more than the installation so the **main purpose** of the contract is a sale of goods and not services. Therefore Article 2 governs the whole contract.

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C. Merchants

UCC Article 2 has some special rules for **merchants**. Some rules apply to contracts involving EVERY merchant and others only apply when BOTH parties are merchants.

A **merchant** is a person who **deals** in the goods that are the subject of the contract or **hold themselves out by occupation** to be experts in the trading of those goods. (UCC § 2-104)

A party is not a merchant just because they run some "business". They must be **substantially occupied** in buying and/or selling the goods of the contract OR **have "expertise"** in trading the goods OR be **represented by an agent** who has "expertise" in trading the goods of the contract.

> **For example:** Tom, an avid coin collector, buys a rare coin from Dick's Coin Shop. Dick is a merchant because he **deals** in coins. Tom is an **expert** because he is an "avid collector," implying he is has "**expertise**" in the trading of these goods.

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D. Conforming Shipments

Under UCC Article 2 a shipment of goods that conforms to the terms of the contract agreement is called a **conforming** shipment. (UCC § 2-106) That means the goods shipped are of the **type and quality** promised, in the **quantity** promised, and delivered on or before the **date promised**

Conversely, a shipment of goods that is not the **type and quality of goods** promised, LESS than the **quantity** promised, or delivered AFTER the **date promised** is called a **non-conforming** shipment.

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E. Accepting versus Receiving Shipments

Under UCC Article 2 "receiving" a shipment should be distinguished from the idea of "accepting" the shipment. A party that receives a shipment of goods has a **reasonable time** in which to inspect the shipment to determine if it should be **accepted** as a conforming. (UCC ¶ 2-513) If it is not a non-conforming shipment, it can be rejected, and is not **accepted**.

If a shipment is **not rejected** as a non-conforming shipment **within a reasonable period of time after receipt**, or if the buyer says the goods are acceptable, or else the buyer acts in a manner inconsistent with the seller's ownership, it will be deemed to have been **accepted**. (UCC § 2-606) Once a shipment is accepted it cannot later be rejected as being a non-conforming shipment.

The period of time that is **reasonable for inspection** will vary with the situation.

2. Article 2 Contract Formation

UCC Article 2 drastically changes common law rules governing the **formation** of contracts. However, many common law rules are retained, either expressly or impliedly. For example, the UCC retains and expressly states that contract parties have an affirmative duty to act in **good faith**. Contract **offers still required a manifestation of present intent** to enter into a contract. And the **mailbox rules** are not changed.

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A. Offer Gap Fillers

Under UCC Article 2 contract **offers do not have to state terms as completely and with as much certainty** as under the common law. The UCC establishes "**gap filler**" provisions that allow the Court to presume missing contract terms.

The only term that **must be stated** in a contract offer is the **quantity** of goods being offered for purchase or sale, and there are **two exceptions** to that rule, requirement and output contracts. Those are explained below.

1) Gap fillers based on EXTRINSIC EVIDENCE

Missing contract terms can be presumed by using extrinsic evidence about the **course of dealing** between the parties and **industry practices**.

The UCC adopts a the **parol evidence rule** but expressly allows parties to present additional evidence demonstrating a **course of dealing** and **usage of trade** terms along with evidence of

consistent additional terms (UCC § 2-202.) The **course of performance** between the parties is given considerable weight in determining the terms of the agreement (UCC § 2-208.)

2) REQUIREMENTS contracts

A **requirements contract offer** is one that offers to buy or sell "**all needed amounts**" by the buyer **during a stated period of time**. The "quantity" of the contract is the amount actually needed by the buyer during the stated period, but not more than **reasonably proportionate** to amounts previously needed (UCC § 2-306.)

A valid requirements contract offer must bind the buyer to purchase **ALL amounts needed** from the seller and cannot be just for amounts "ordered" or "wanted".

3) OUTPUT contracts

An **output contract offer** is one that offers to buy or sell "all output" produced by the seller **during a stated period of time**. The "quantity" of the contract is the amount actually produced by the seller during the stated period, but not more than **reasonably proportionate** to amounts previously produced (UCC § 2-306.)

4) TIME of performance

The time period in which goods are to be delivered is the "**contract period**". Unless the parties otherwise specify all goods ordered are to be delivered in **one shipment** within a **reasonable period** of time given the **course of dealing** between the parties and **standards of the trade**.

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B. Merchant's Firm Offers

Under UCC Article 2 a **signed, written assurance** of a **firm offer** by a **merchant**, a statement the offer will not be revoked, creates an **option offer** that cannot be revoked for either the **time stated** or a **reasonable time** where no time is specified, but **not more than three months** no matter what time is stated (UCC § 2-205.) Unlike the common law, **no consideration** is necessary.

If the offeror signs a form with such an assurance on a form supplied by the offeree, this assurance must be separately signed (e.g. buyer says, "I want you to make me an offer using my own form" and then gives the seller his own pre-printed form which says the offer is "firm".)

The time limits stated by UCC § 2-205 only define the time for which the offer cannot be revoked. They do not define the time at which the offer will automatically lapse. If the offer states a time frame for which the offer is firm, it is reasonable to accept within that stated time, so the offer will not lapse for the time stated, if one is stated. Otherwise the offer lapses at the end of a reasonable period of time, the same time at which the offer could be revoked anyway.

> **For example:** SaveCo advertises three artichokes for a dollar, but it sells out. SaveCo gives Dick a written, signed "rain check" that says he can come in and buy artichokes at that price "any time in the next year". The rain check is a firm offer that cannot be revoked for a **reasonable time** of **not more than three months.** SaveCo can revoke the offer after

three months, even though it says it is good for a year. But if the store does not expressly revoke the offer, Dick can accept it at any time for the next year because the offer itself defines that as a reasonable period in which he can accept. After a year the offer automatically lapses.

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C. Offer Acceptance Indicated by Shipment

UCC Article 2 allows acceptance in any reasonable manner unless the offer unambiguously indicates acceptance must be by a specific means. (UCC § 2-206) **Any shipment or promise to ship** is an acceptance of a buyer's offer, **whether the shipment is conforming or non-conforming**, unless the seller **expressly states** the shipment is being sent **as an "accommodation"**. That means a shipment of different goods to "accommodate" the buyer because the goods could not be sent as ordered. An accommodation shipment is an implied counter-offer.

> **For example:** Buyer sends Seller a fax ordering 100 lamps. Seller ships Buyer 50 lamps with a statement it is an "accommodation". This is a counter-offer. Buyer can reject them or accept them. But Seller is not in breach for sending a "non-conforming" shipment.

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D. Acceptance of Offer with Varying Terms

The UCC **abandons the mirror image rule**. Acceptances are binding even if they state varying terms. (UCC § 2-207) The common law concept of **rejection and counteroffer** are not eliminated, but a response is not a rejection and counteroffer unless it **demands assent** to the varying terms.

> **For example:** Buyer orders 100 lamps with a 90-day warranty. Seller responds, "We will only send you the lamps without warranty." That is a rejection and counter-offer.

Whether a response is an acceptance with varying terms or a rejection and counter offer demands **careful study of the exact words** of the response. When examinations give you QUOTED WORDS pay close attention to whether offerees say they "will provide", "would provide", "can provide" or "could provide" the goods ordered.

If parties say they "will" fill an order they have promised to ship, and that accepts the order, regardless of what else they say unless the rest of their response is clearly an assertive demand for assent to different terms. If they say they "can" fill an order they have not promised to ship, so that is a counter-offer, regardless of what else they say.

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E. Inclusion of Varying Terms

Under UCC Article 2, if an offer is accepted with varying terms, the **varying terms are excluded** and do not become part of the contract UNLESS **all** of the following conditions are satisfied:

- Both **parties are** merchants;
- The offer **did not expressly prohibit** addition of **new terms**;
- The varying terms **do not materially alter** the contract; AND
- The offeror **does not promptly object** to the new terms. (See UCC § 2-207)

An acceptance citing a **different price or quantity** is **always a materially altered term**, so it never becomes part of the agreement.

A varying term is always a **material alteration** if it reduces the legal rights of the offeror (e.g. required **binding** arbitration, waiver of merchantability, waiver of implied warranties.) An acceptance demanding "**arbitration** of disputes" is NOT a materially altered term if it only demands "**non-binding**" arbitration.

Varying terms that do not become part of the agreement are considered to be "proposals for modification". **If the other party agrees to the different terms**, the contract is modified to include the different terms. This is explained more below.

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F. Contracts Proven by Behavior

Under the UCC a contract will be proven to exist if there is **any evidence of agreement** to form a contract, either express or implied by behavior of the parties, **unless** there is **no reasonably certain basis for providing a remedy**. (UCC § 2-204).

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G. Battle of the Forms

The rules for "Battle of the Forms", "Last Shot Doctrine" and "Knock Out Rule" are the same under the UCC as they are under the common law as it was explained earlier.

3. Written Evidence Often Needed

Under UCC § 2-201 a contract for sale of goods worth **$500 or more** is not legally enforceable unless there is a **sufficient writing signed by the party** against whom the contract is to be enforced. [25] A "sufficient writing signed by the party" is one that is sufficiently clear to show there was a contract, authenticated by a signature, letterhead, logo or some other marking **sufficient to "authenticate" the identity of the sender** as the "party to be bound".

The UCC refers to its requirement for written evidence as a "Statute of Frauds" but it supersedes and drastically changes the original "Statute of Frauds". The original Statute of Frauds actually required certain **contracts** to be in writing. In contrast UCC § 2-201 only requires **sufficient writing by the party to be bound** to establish that there had been a contract.

[25] The UCC increased the amount necessary to require a writing to $5,000 in 2005, but most States have not yet adopted the higher limit by statute. For exams you may generally say $500.

Between <u>two merchants</u> a **sales confirmation stating quantity** (and otherwise sufficiently detailed to show a sales contract exists), sent from one merchant to the other, is a <u>sufficient writing</u> to **bind the receiving party** if that party **knows of its contents** and **does not object** in 10 days. This is a <u>different standard</u> between two merchants, NOT an exception that <u>no writing</u> is needed.

> **For example:** Dick sends Tom this message, "This is to confirm your telephone order for turtle doves." Even if **both are merchants** and Tom **does not object** this still is NOT a sufficient "writing" because Dick <u>didn't say how many</u> turtle doves Tom ordered.

There are **three exceptions** when UCC § 2-201 <u>does not require any writing</u> at all.

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A. Exception for Special Made Goods

A contract for **specially made goods <u>unsuitable for general sale</u>** does not required a writing, regardless of the size of the contract. The term "special made goods" means made by the seller according to specifications provided by the buyer. This is a very important exception to remember.

> **For example:** Tom orders $600,000 worth of bumper stickers that say "Tom for President." No writing is needed because these are special made goods.

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B. Exception for Contracts Admitted in Pleadings

If parties admit in pleadings or discovery that contracts existed, the contracts are binding without any writings. This exception is important in the real world but seldom tested in law school.

> **For example:** Tom sues Dick claiming breach of a $50,000 oral contract for goods. No writing is needed if Dick's attorney files an answer **admitting** the contract existed.

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C. Exception for Goods or Payment Accepted

If parties **accept either a shipment of goods or payment** the requirement of a writing is eliminated <u>as to that part of the contract.</u> "Accepting" a shipment as opposed to merely "receiving" it was explained above. The fact that part performance of an oral contract is accepted does not bind the parties to the remaining part of the oral contract.

> **For example:** Tom orally agrees to buy 100 barrels of oil from Dick at $50 a barrel (do the math - $5,000). Dick ships 90 barrels of oil, and Tom accepts delivery. Then the price of oil drops. Tom refuses to accept the last 10 barrels, says he does not want the first 90 barrels either, and refuses to pay anything at all. Tom must pay $4,500 for the oil he accepted even though the contract was "oral" because **he accepted delivery** of that part of the shipment. Tom does not have to accept or pay for the remaining 10 barrels because the contract was **not supported by a writing** and he **did not accept** that part of the shipment.

4. Modification without Consideration

Under the Article 2 contracts for the sale of goods can **always be modified by agreement of the parties without any consideration** (UCC § 2-209.) [26] The common law rule requiring consideration is completely abandoned.

The UCC does not change the common law rules requiring the need for modifications to be in writing. If a contract **expressly requires modifications to be in writing**, then oral modifications are not enforceable. And if contracts, as modified, would have needed to be in writing under UCC § 2-201 originally, then the modifications must be evidenced by a sufficient writing.

> **For example:** Dick orally orders goods from Tom for $300. Then Dick calls Tom and says, "I want to double the order." Tom orally agrees. The modification is not binding because it increases the contract to over $500 and makes a writing needed.

But if modification "takes the contract out of the statute" no writing is needed.

> **For example:** Dick orders goods from Tom for $600 under a written contract. Then Dick calls Tom and says, "I want to cut the order in half." Tom orally agrees. The modified agreement is legally binding because now the contract is for less than $500.

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A. Unenforceable Modification Acts as Waiver of Condition

Under UCC § 2-209 a contract modification that is not binding because it is not in writing may act as a waiver of condition which is **legally effective until it is retracted** by the waiving party. **Retraction** of a waiver of condition **requires actual notice** to the other party.

> **For example:** Dick orders goods from Tom for $600 to be delivered May 1 under a written contract. Tom calls Dick and says, "I need until May 5 to deliver." Dick agrees. The oral agreement is legally binding as a waiver of condition until and unless Dick gives Tom notice he is retracting his waiver.

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B. Equitable Estoppel May Bar Retraction of Waiver

Under UCC § 2-209 the retraction of a waiver of condition by a party may be **estopped** by the Court as **necessary to prevent an injustice**. This generally requires that the other party has changed position in reliance on the waiver.

[26] It should go without saying that no contract can be modified, under the UCC or common law, unless the parties both agree to the modification, and the agreement is the result of fair dealing between them in good faith.

5. Assignment and Delegation

The UCC does not substantially change common law rules for assignment and delegation. "Assignment" of an executory contract implies **delegation** unless there is a contrary agreement. Express provisions prohibiting "assignment" usually bar delegation too. Delegation gives the other party a right to demand **reasonable assurances**. (UCC § 2-210)

6. Risk of Loss and Loss in Transit

Unless parties otherwise agree, if **goods are damaged in transit** through no fault of either party, before the buyer assumes the risks of loss, the buyer can entirely or partially rescind the contract. (UCC § 2-613)

The risk of loss unconditionally passes to buyers who are **merchants** upon **receipt** of the goods and to buyers who are **not merchants** upon **tender of possession** (offer of delivery or possession). (UCC § 2-509.) However, risk of loss can pass to the buyer at an earlier time as follows:

- If the contract **requires or authorizes the seller to ship the goods** to the buyer by carrier (e.g. by rail), and the seller is not required to deliver the goods <u>at</u> (note this says "at" and not just "to") a particular destination, the **risk of loss** of goods in transit passes to the seller **the moment they are delivered to the carrier** even if the seller retains a security interest in the goods. (UCC § 2-509.)

- If the contract requires the seller to deliver the goods at a particular location and the carrier tenders the goods to the buyer at that location the risk of loss passes to the buyer **the moment they are tendered by the carrier**. (UCC § 2-509.)

- If goods are held by a **bailee** (e.g. bonded warehouse) for delivery without being moved, the risk of loss passes to the buyer **upon receipt of documents giving right of possession** (e.g. negotiable warehouse receipt, title documents, notice of right to take possession). (UCC § 2-509.)

7. Failure of Supply

Unless the parties otherwise agree, if **supply conditions** that were basic assumptions of the contract cause delay or make delivery impracticable (note this does not say "impossible"), sellers are discharged from their duty to perform. (UCC § 2-615.) They must reasonably notify buyers of their inability to deliver as promised.

If sellers can deliver part of the goods promised to buyers they must allocate production and deliveries to the <u>current</u> promisees (customers) and can allocate a portion to <u>regular</u> customers and to the seller's own needs.

Buyers who receive notice sellers will be unable to perform due to failure of supply, and who would be substantially impaired as a result, must give <u>written</u> notice of intent to **terminate** the contract or **modify** it by agreeing to take the allocation offered by the seller within 30 days or the contract lapses with respect to any deliveries affected. (UCC § 2-606.)

8. Breach of Contract

The UCC does not substantially change the duties of buyers to pay for goods from the common law. Most UCC changes regarding "breach of contract" concern breaches by sellers.

Under UCC Article 2 any **non-conforming shipment** by a seller to a buyer is a **breach of contract** by the seller, and all breaches of contract by sellers are treated in the same manner. (UCC § 2-601) This is called the **Perfect Tender Rule**.

The UCC completely abandons the common law concepts of "major" and "minor" breach. Never discuss "major" or "minor" breach in a UCC situation because there is no such thing.

The duty of the seller of goods in every contract is to deliver the **goods** ordered, in **merchantable condition** (sellable), in the **quantity ordered**, in **one allotment** (unless otherwise agreed), **on or before the delivery date** agreed, or if no date was agreed **within a reasonable period** of time.

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A. Right to Demand Assurances

Under UCC § 2-609 both buyers and sellers have a **right** to demand **reasonable assurances** if there is a **reasonable basis** to think the other party will not perform. This is slightly different from common law because it gives a "right" to demand assurances.

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B. Breach of Divisible Contracts

Divisible contracts were explained earlier in Chapter 7. A divisible contract for the sale of goods is called an **installment contract**, meaning goods are **delivered in installments**.

A breach as to any one installment shipment of an installment contract is a breach as to that installment. But the entire contract is not breached. (UCC § 2-612) The parties remain bound to the remainder of the contract. The non-breaching party has a right to demand assurances as to the remainder of the contract.

> **For example:** Dick orders 12,000 widgets from Tom, to be delivered 1,000 each month with payment on delivery. When Tom's third shipment arrives Dick fails to pay for it. That is a breach as to that shipment. Tom is still bound to deliver the remainder of the contract shipments, but he has a right to demand reasonable assurances.

9. Right of Seller to Cure Breach

If a buyer of goods objects that a shipment is non-conforming, the buyer must tell the seller and give **sufficient information for the seller to cure** the breach. (UCC § 2-605) The seller then has a **right to cure the breach** under UCC § 2-508 by giving the buyer timely notice of **intent to cure** and delivering a conforming shipment within the **contract period**.

If the seller sent a non-conforming shipment to the buyer with **reasonable belief** that it would be **acceptable for the buyer's needs**, the seller has a right to a **reasonable amount of extra time** beyond the contract period in which to cure the breach. (UCC § 2-508)

> **For example:** Tom agrees to ship 100 cases of wieners to Dick by Saturday. Tom ships 99 cases wieners on Friday. If Dick objects that the shipment is **non-conforming** (because it is "short") Tom can tell Dick he will "cure" by sending another case overnight. If one more case of wieners arrives by Saturday Tom has "cured" the breach. If Tom does not deliver the additional case on time he does not get any more time to cure because **it is not reasonable to think 99 cases are "acceptable" to a person who ordered 100 cases.**

10. Buyer's Right to Reject Goods

If a buyer receives a non-conforming shipment, and the breach is not cured by the seller, the buyer can **reject the whole** shipment, **accept the whole** shipment, or **accept some commercial units** of the shipment (e.g. accept certain boxes, car loads, pallets, barrels, etc. less than the whole shipment) and **reject the rest**. (UCC § 2-601) Rejection must be done within a **reasonable** time after delivery. (UCC § 2-602)

> **For example:** Tom orders 1000 light bulbs from Dick. When the shipment arrives all but 999 light bulbs are unbroken. Tom can reject the entire shipment because it does not conform to the order. [27]

A buyer can reject any entire shipment of an **installment contract** that is non-conforming.

> **For example:** Tom orders 10,000 light bulbs from Dick to be delivered 1000 each week. In the third shipment only 999 light bulbs are unbroken. Tom can reject the entire shipment but is still bound to the rest of the contract.

11. Buyer's Duty as to Rejected Goods

If are rejected by a buyer, the buyer has a duty to follow instructions from the seller, but if the seller gives no other instructions the buyer has a duty to immediately **sell the** goods for the seller's account if they are perishable or will quickly lose value. (UCC § 2-603) Otherwise the buyer can **store the goods** for the seller's account, **reship** the goods to the seller, or **sell them** for the seller's account. (UCC § 2-604)

[27] The common practice is to ship extra goods so that if some break there will still be enough unbroken items delivered to meet the contract specifications.

The buyer has a right to reimbursement for all expenses and the right to a commission on all rejected goods that are sold.

12. Non-Breaching Buyer's Right to Damages

Non-breaching buyers are those who receive **non-conforming shipments**, buyers in contracts sellers have **anticipatorily repudiated**, or buyers that **do not receive** the goods promised.

Non-breaching buyers can **cover** by immediately buying conforming goods, but there is **no duty to cover**. If buyers cover they have a right to award of money judgments for damages based on the **excess of the cover price over the contract price**. (UCC § 2-712)

Non-breaching buyers that do not cover have a right to a money judgment for damages for the **excess of market price at the time of breach over contract price**. (UCC § 2-713)

Non-breaching buyers who **accept** non-conforming shipments have a right to award of damages for the **excess of the value of goods promised over the value of goods delivered**. (UCC § 2-714)

Non-breaching buyers also have a right to **rescind** the contract.

Non-breaching buyers also have a right to **incidental and consequential damages**, including damages for personal injury or property damage caused by a breach of warranty. (UCC § 2-715)

Salvage sales. If non-breaching buyers receive non-conforming shipments that the sellers fail to take back, the non-breaching buyers may recover against their damages by selling the goods at a **salvage sale**. This is done in much the same way that a non-breaching seller might conduct a salvage sale, as explained below. Non-breaching buyers must give breaching sellers notice of rejection and an opportunity to recover their goods. If they do not do so, non-breaching buyers may give notice of intent to sell the goods as salvage. Salvage sales must be conducted in a reasonable manner, and the proceeds are applied against the non-breaching buyer's damages. If salvage proceeds exceed the non-breaching buyers' damages, the excess belongs to the breaching sellers.

13. Non-Breaching Seller's Right to Damages

Non-breaching sellers are those who deliver conforming shipments **accepted by an insolvent buyer** or **wrongfully rejected**, sellers in contracts buyers have **anticipatorily repudiated**, or sellers that **do not received payments** promised.

If buyers repudiate contracts or fail to give reasonable assurances sellers may **withhold delivery**, **stop delivery**, **cancel** the contract, **resell contract goods**, and otherwise **recover damages**. (UCC § 2-703)

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A. Insolvent Buyers

Sellers that discover buyers are **insolvent** may **refuse delivery** except for cash payment, including payment for all previous deliveries under the contract, and **reclaim possession of all goods**

delivered and not paid for in the prior ten (10) days. If buyers have misrepresented their solvency in writing in the prior three months, sellers can **reclaim possession of all goods delivered** that have not been paid for. (UCC § 2-702.)

The right to reclaim goods sold to insolvent buyers is subject to defenses that may be raised by **bone fide purchasers for value without knowledge** and **holders in due course**.

If sellers successful recover goods they have **no other remedies** against the buyers.

Seller may also stop delivery of goods in the possession of a carrier or bailee if they discover buyers are insolvent or if buyers repudiate the contract. (UCC § 2-705.) To stop delivery carriers and bailees must be given notice to stop delivery before the goods are delivered and before buyers have been given negotiable instruments of title or acknowledgements that effectively transfer rights of possession to buyers.

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B. Awards of Damages to Non-Breaching Sellers

Under the UCC non-breaching sellers have a right to award of a money judgment for damages that can be calculated four different ways:

- The excess of contract price over the net proceeds of **salvage sale**;
- The excess of contract price over **market price at the time of breach**;
- Lost profits; OR
- The contract price less proceeds of sale.

1) Damages determined by salvage sale

Non-breaching sellers may **sell goods** that have been wrongfully rejected, withheld from delivery for cause, and recovered from insolvent buyers at a **public or private salvage sale**. Sellers must give **prior notice** of any salvage sale to breaching buyers unless the **goods are perishable** or otherwise likely to **quickly lose value** AND they are sold at a **public sale**. (UCC § 2-706)

If salvage sale proceeds exceed the contract amount and incidental expenses breaching buyers have a **right to reimbursement of security interests** in the goods. The **remaining profits** belong to the non-breaching sellers. In this case the non-breaching seller suffers no damages.

If salvage sale proceeds do not fully reimburse non-breaching sellers for the contract amount plus incidental expenses they may **recover damages for the shortfall** from breaching buyers **if they gave them required notice of the salvage sale**.

2) Damages determined by market price

Non-breaching sellers that do not sell goods at a salvage sale still have a right to recover damages from breaching buyers for wrongfully rejected goods or repudiation measured by the **excess of contract price over market price** at the time and place goods are tendered, **plus incidental expenses**, and **less expenses saved because of the breach**. (UCC § 2-708(1))

This is only feasible if there is a way of determining "market price".

3) Damages equal to lost profits

If award of damages based on the excess of contract price over market price produces an inadequate remedy, the non-breaching sellers have a right to recover damages from breaching buyers equal to **lost profits** that would have been made on the sale, **plus incidental expenses less payments** made by the breaching buyers and **less proceeds of resale** of the goods if any. (UCC § 2-708(2))

This may be called a "**lost volume**" situation.

4) Damages equal to contract price

If a buyer refuses to pay the contract price or refuses to accept a conforming shipment the non-breaching seller has a right to award of a money judgment for damages equal to the **contract price** of **goods accepted**, conforming **goods lost or damaged**, and otherwise **goods that cannot be reasonably sold at salvage**. (UCC § 2-709)

This may be called an "**action on the price**".

14. Article 3: Accord and Satisfaction

The UCC does not substantially change the common law concept of accord and satisfaction. However, UCC § 3-311 makes a slight revision. Under that provision a negotiable instrument (e.g. a bank check) tendered by a debtor in full satisfaction of a creditor's claim (e.g. marked "this check is tendered in full payment of all claims") will not discharge the claim, if:

- The claimant, if it is an organization, proves it sent a conspicuous statement to the party tendering payment (i.e. the debtor) instructing them to send all communications and payments in satisfaction of disputed debts to a designated person, office or place, and the debtor did not send the tendered payment to that person, office or place; OR
- The claimant, whether an organization or not, proves that within 90 days after receiving a payment tendered "in full payment" of a disputed claim it tendered repayment of the amount back to the debtor.

  For example: Tom owes $20,000 on his credit card. He disputes his bill and sends the finance company a check for $2.00 with the written statement, "I offer this amount in full settlement of my account." If he has previously been told to send disputed bill payments to a particular office (e.g. the office of the attorneys for the company), and does not send this check to that office, it is generally without effect. If he sends the check to the correct office and it is cashed the company still has 90 days to return his money.

Nevertheless, if a debtor tenders an instrument to a claimant or an agent of the claimant with direct responsibility over a disputed claim in full payment of the claim, and the debtor can prove the claimant or agent knew the instrument was tendered in full payment of a claim within a reasonable time before collection of the instrument was initiated, and the claimant or agent proceeded to collect on the instrument anyway, then the claim is discharged.

For example: Tom disputes a claim by his credit card company that he owes $20,000, and he has been dealing with Maria, an agent of the company. He tells Maria he is going to make a settlement offer, and he sends her a check for $5,000 marked “in full settlement”. Since Maria is aware Tom’s check is being submitted in an attempt to settle the dispute, the check will become a binding accord and satisfaction if she cashes it, and the company cannot reverse that after the fact.

Chapter 11: Conclusion

This outline is intended to provide a simple and summarized explanation of the black letter law and bright line rules of **CONTRACTS** and **Article 2 of the UCC**.

Black letter law means statutes and basic rules of broad theoretical application. And **bright line rules** are those decisional rules or logical guidelines created by the Courts for the determination of close cases.

To make the explanation here simple and avoid unnecessary confusion some of the details and minor splits of authority have been ignored or avoided in this outline. But the foregoing reflects about ninety percent of everything you should know to succeed in law school, and more than enough explanation of the rules of law for you to pass any bar examination.

Among the materials that have been excluded from this outline are legal theories that have been widely abandoned, extreme minority views, rare exceptions, fact-bound cases, history of the law's development, most cases, highly unusual situations and dwelling on subtle distinctions. These issues and concepts are either unnecessary for your legal education, OR your professor will direct them to your attention.

Each professor of law, in every subject, holds a keen interest in narrow areas of the law of personal interest. Frequently this interest is based on their own legal education or their experiences in the Courts. When your professor expounds on an area of law given summary treatment in this outline it will be necessary for you to consult authoritative reference materials such as hornbooks to gain a greater understanding.

If your professor is adamant about some theoretical concept (e.g. "valid" contracts versus "unenforceable" contracts, conditions "excused" versus duties "discharged") note that proclivity and modify your explanation of the law as necessary to humor those proclivities. But, you will find the bar examiners far less interested in such marginal issues and much more concerned with the breadth of your knowledge of the rules of law set forth herein.

Other than those cases where a professor demands further knowledge in a narrow area, the foregoing should be entirely sufficient to impart an adequate **understanding** of the **law of contracts**. However, mere **understanding is NOT ENOUGH** for you to succeed. Law school and the bar examinations require **both understanding** and ability to **explain the application** of the **law to the facts and facts to the law**.

This outline is NOT written for the purpose of explaining to you how you should explain the law on your examinations. You are urged to consult Nailing the Bar's **"How to Write Contracts & UCC Law School and Bar Exams"**. Information about that publication is available inside the back cover of this outline.

Tim Tyler, Ph.D.
Attorney at Law
Sacramento, California

Index

E

F

G

H

I

J

K

L

M

N

O

P

Q

R

S

T

U

V

W

Y

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