Topic 10: Contract Law

Overview

- ***Introductory Video***:

VOCABULARY & CONCEPTS

QUESTIONS & ANSWERS

1. What is a contract?

A contract is a legally enforceable promise or an exchange of promises. To be enforceable, the contract must meet certain elements. There must be an offer, acceptance of that offer, and then an intended exchange of value between the parties. These elements demonstrate a "meeting of the minds" between the parties. That is, the parties have a common understanding of the material terms of the agreement. A contract doesn't have to be a formal, written document. It can be a verbal agreement or it can arise through the conduct of the parties. Those who make a contract do not have to use the word contract or even recognize that they have made a legally enforceable promise. Each state develops its own contract law. Contract law provides confidence and promotes productivity by making private agreements between individuals legally enforceable. Plainly stated, it helps make buyer and seller willing to do business together.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/what-is-a-contract/

2. What are the sources of contract law?

States create their own contract law. They pass statutes and allow courts to develop common law. In doing so, state legislators and judges rely upon model laws in developing the statutory and common law. These model laws are known as the Restatement of Contracts and the Uniform Commercial Code. These model laws influence judges who interpret contract law and legislators draft statutes that resemble (or copy exactly) these model laws. As such, you can study model laws to acquire a broad understanding of how contract law works. You can then look to the specific laws of your state to determine the exact law that applies to a given situation.

- *Restatement of Contract* - The Restatement of Contracts (Restatement) is a model law that deals primarily with contracts that do not involve the sale of goods. Or rather, where goods are not the

primary subject of the contract. Most state common law generally tracks closely the provisions of the Restatement.

- *Article 2 of the Uniform Commercial Code* - Article 2 of the Uniform Commercial Code (UCC) governs contracts for the sale of goods. It has been uniformly accepted by nearly every state in the United States. A sale of goods includes any manufactured product, crops, timber, livestock, attachments to land, exchanged currencies, mined minerals, etc. It does not include intellectual property, securities, non-commodity currencies, and un-mined minerals.

To be subject to the provision of the UCC, goods must be the primary purpose of the contract. If services are the primary purpose of the agreement, then the incidental inclusion of goods is not covered by the UCC or corresponding state statutes.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/influential-sources-contract-law/

3. What are unilateral and bilateral contracts?

Contracts are divided into unilateral and bilateral contracts based upon the duty of performance and how an offer to contract is accepted.

- *Bilateral Contract* - A Bilateral contract consists of two promises between individuals that forms a contract. Specifically, one party makes a promise to another party that she will do something (or forgo doing something) in exchange for the other party's promise to do something (or promise to forgo doing something). For example, Eric promises to wash Julia's car if she promises to pay him $20. The both activities will occur at some point in the future, so you have two promises of future performance.

- *Unilateral Contract* - A Unilateral contract is an agreement with only one promise. That is, one party promises a future action if the other party performs whatever is requested of her. The promising party does not want a return promise. As such, a contract is formed or comes into exists once the other party begins to perform the requested services. Suppose Eric tells Julia that he will pay her $20 if she washes his car. Eric does not want a promise to wash the car. Julia can accept Eric's offer by beginning to wash his car. Julia is not obligated to wash the car unless or until she begins doing so. Further Eric is not obligated to pay Julia until she begins washing the car.

The common characteristic between unilateral and bilateral contracts is that it entails a promise of performance and a demand from the offeree.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/unilateral-and-bilateral-contracts/

4. What are express, implied-in-fact, and implied-in-law contracts?

- *Express Contract* - An express contract arises from interactions in which parties actually discuss the agreement and the promised terms. The contract does not have to be formal or in writing, but it requires that the parties express their intentions in an agreement.

- *Implied-in-Fact Contract* - An implied-in-fact contract arises from the conduct of the parties, rather than from words. That is, the parties interact in a manner that constitutes a legally enforceable contract. This means that all of the elements of an enforceable contract can be inferred from the actions of the parties. For example, Ellen asks Albert, an attorney, for professional advice. Ellen knows that Albert is an attorney and charges for his advice. Asking Albert for his professional advice implies a promise from Ellen to pay the going rate for that advice. This is true even though Ellen and Albert did not make an express promise to pay for it.

- *Implied-in-Law or Quasi-Contracts* - A implied-in-law contract is a contractual relationship ordered by the court. That is, the court deems the interactions between parties to be a contract under the law. This court action is generally taken to avoid an unjust result, such as when one party is unjustly enriched at the expense of another. The court will hold that the law implies a duty on the first party to pay the second, even though the elements to find a legally enforceable contract between the two parties is absent.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/express-vs-implied-contracts/

5. What are valid, enforceable, void, and voidable contracts?

There are several common characteristics of contracts that dictate whether a contract actually exists and whether it is enforceable in a court of law. The following vocabulary is important for characterizing these aspects of a contract.

- *Valid and Invalid* - A contract is valid when all of the essential elements to forming a legal contract are present. Conversely, a contract is invalid (or rather, there is no contract) if any of the essential elements of a contract are missing. The elements to forming a valid contract (offer, acceptance, and consideration) are discussed further below.

- *Enforceable and Unenforceable Contract* - An enforceable contract is one that can be enforced in court of law. That is, the law allows for enforcement of the contract. An enforceable contract must always be valid. A valid contract may, however, be unenforceable. That is, even though all of the essential elements of a contract are present, a court will not enforce the contract. For example, an oral contract may be valid, but the court will not enforce it because that specific type of contract is required to be in writing under the state's law. Contracts that are required to be in writing are discussed further below.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/enforceable-vs-valid-contracts/

- *Void and Voidable Contracts* - An otherwise valid contract may be void pursuant to the law. That is, state law identifies certain types of contracts that are deemed void from the outset. These include contracts that violate public policy or have an illegal purpose. For example, a contract to purchase illegal drugs is void. A voidable contract is an agreement where either one or both parties has the right to make the contract void. That is, the contract is valid and enforceable until one party elects to void it. For example, a party to a contract who is below the legal age of mental capacity may void the contract at any point before she reaches the age of mental capacity.

Various situations where contracts are deemed valid, enforceable, void, or voidable are discussed further below.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/voidability-of-a-contract/

CONTRACT FORMATION

6. What elements are required to form a valid contract?

As previously discussed, a contract is a specific promise to another and also a specific demand of that person. The demand could be a promise of future action (bilateral contract) or immediate performance of an act (unilateral contract). The promise and demand is an **"offer"**. Meeting with the offeror's demand is known as "**acceptance**". Both parties must give or exchange something of value with the other. The thing of value is known as "**consideration**". Consideration is the promise to give, or actual giving, of a requested benefit or the incurring of a legal detriment (i.e., doing something one doesn't have to do.). Both parties must be of a legal age and sound mind, and the purpose of the agreement cannot be illegal or against public policy.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/requirements-to-form-a-contract/

7. What constitutes an Offer to contract?

The following elements must be present to establish a valid offer to contract.

- *Offeror and Offeree* - An offer to contract must contains a specific promise from the the person making the promise (Offeror) and a specific demand of the individual receiving the offer (Offeree).

- *Intent to Make an Offer* - The offeror must intend to make the offer. Whether there is an intent to make an offer is judged from the position of the offeree. If a reasonable person in the position of

the offeree would believe the offeror's words or actions to constitute an offer, then it is an offer. This is an objective, rather than subjective, standard for determining whether the intent to make an offer exists.

- *Definite Terms* - An offer to contract must be sufficient definite. That is, the terms of the offer must be sufficiently specific to allow the offeree to understand and accept the offer. For example, simply stating that you will purchase an item "for a reasonable price" is not sufficient to constitute a definite offer. Most advertisements, catalogs, and web page price quotes are considered to indefinite to form the basis for a contract. To be sufficient definite, the advertisement must be specific about the quantity of goods being offered and who is the intended offeree. Under the UCC, some contracts for the sale of goods can leave open non-quantity terms to be decided at a future time.

Remember, the above elements do not have to be in writing or formal. Further, the parties do not have to realize that their words or actions constitute a valid contract; rather, each element is judgment by an objective standard. That is, how would a reasonable person perceive the actions potentially constituting an offer.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/what-is-a-valid-offer/

8. When does an offer to contract terminate?

An offer to contract terminates at the following times or under the following conditions:

- *Specific Provision* - An offer may include a specific provision detailing how long an offer will stay open and the conditions under which it terminates.
- *Lapse of Time* - Unless the offer states otherwise, an offer terminates after a reasonable period of time. A reasonable period of time will vary depending upon the type of contract. For example, an offer to sell bananas will terminate more quickly than an offer to sell cement.
- *Offeree's Rejection* - An offer terminates if the offeree receives the offer and rejects it. Once the offeree rejects the offer, she cannot come back later and accept the offer. Any attempt to do so may constitute a new offer to the original offeror.
- *Counter Offer* - If an offeree makes a counter offer or counter proposal in response to an offer, the original offer terminates. This is the case with negotiations. If a party attempts to negotiate new or additional material terms to the offer, the original offer terminates. Attempting to offer ancillary or non-material terms may not terminate the offer.
- *Revocation by Offeror* - Generally, the offeror may revoke an offer at any time before the offeree accepts it. If the offeree has already accepted the offer, then a valid contract exists and an attempt to revoke the offer may constitute breach of the contract. There are certain offers, known as "firm offers", that state that the offer cannot be revoked for a certain period. This type of offer is a form of contract in itself.
- *Destroy Subject Matter of Contract* - An offer terminates if, before the offer is accepted, the

property that is the subject of the offer is destroyed. If the offer has already been accepted, this could serve to void the contract.

- *Death or Mental Incapacity* - If the offeror dies or loses mental capacity at any time before an offer is accepted, then the offer is revoked. The offer does not become effective again if the offeror regains mental capacity.

- *Illegality* - An offer terminates if the subject of the offer (the activity of product) becomes illegal. If the offer has been accepted, the subject matter becoming illegal will void the contract.

Note that some of the methods of contract termination are voluntary, while others others are a result of circumstances beyond the control of the parties.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/terminating-an-offer/

9. What is Acceptance of an offer?

Acceptance of a contract is the assent of the offeree to the demands contained in the offeror's offer. Acceptance of the contract varies depending upon whether the contract is unilateral or bilateral. An offeree accepts a bilateral contract by making the return promise demanded by the offeror. An offeree accepts a unilateral contact by undertaking the performance demanded by the offeror.

- *Mirror Image Rule (Restatement)* - The mirror image rule states that the acceptance of an offer must be exactly as demanded by the offeror. That is, the acceptance must "mirror" the offer. If the offeree adds new terms to the acceptance, it is not really an acceptance. Acceptance with different or additional terms constitutes a counteroffer. The mirror image rule applies in most contracts not involving the sale of goods.

  - ***Practice Question***:

  - ***Resource Video***: http://thebusinessprofessor.com/mirror-image-rule/

- *Exception to Mirror Image (UCC)* - The mirror image rule does not apply to sales of goods under the UCC. The UCC recognizes that a contract is formed if the acceptance of the offer is unequivocal. That is, if it is obvious the parties agree on the primary or material terms of the agreement, then an acceptance that changes or adds additional terms is a valid acceptance. The effect of different or additional terms depends on whether the parties are merchants. If either party is not a merchant, then any additional or different terms are deemed suggestions for addition and do not become part of the contract. If both parties are merchants, the additional terms become a part of the contract unless: they materially alter the contract, acceptance is conditioned on the specific terms of the offer, or the offeror specifically rejects the additional or different terms.

  - ***Practice Question***:

- ***Resource Video***:

- *Silence with Regard to Offer* - Failing to reply to an offer is not acceptance in most cases. This is true even if the offer says silence will be considered acceptance. There are exceptions to this rule. If the relationship between the parties is such that it is not expected that the offeree reply, then silence by the offeree may constitute acceptance. Another example would be where the offeree readily understands that silence or a failure to respond means acceptance of the offer. This generally only arises in situations where the offeror and offeree have a history of prior dealings. In the case of contracts between merchants under the UCC, silence may constitute acceptance of an offer. In some instances, a merchant is required to expressly reject goods that are delivered; otherwise, her silence constitutes acceptance of the contract.

  - ***Discussion***:
  - ***Practice Question***:
  - ***Resource Video***: http://thebusinessprofessor.com/silence-is-not-acceptance-of-an-offer/

- *Mailbox Rule* - The mailbox rule is a default rule that applies when the offeror does not place specific requirements on the manner of acceptance. Under this rule, the offeree accepts the offer when it is sent to the offeror. This could include dropping it in the mail or sending it with a courier. This may also include providing notice of acceptance via email or other electronic communication (regardless of whether the offeror actually checks or reads the email). As such, if an offer is made to multiple offerees, the first offeree to accept in any manner (including by dropping the acceptance in the mail) has a binding contract.

  - ***Discussion***:
  - ***Practice Question***:
  - ***Resource Video***: http://thebusinessprofessor.com/mailbox-rule-for-contracts/

10. What is Consideration in the context of contract formation?

Consideration is anything of value. The Restatement and UCC require that a valid contract concern an exchange of value between the offeror and offeree. The value should be the inducement or incentive for the other party entering into the agreement. That is must be the subject of the bargain between the parties. When the existence of consideration is not clear, the court will examine the transaction as a whole.

- *Types of Consideration* - The amount or value of the consideration present does not matter. It need not be money. It could even be a promise to refraining from doing something. A promise to make a gift is not binding because the party receiving the gift gives no value in return for the promise. An agreement not to sue the other party may be sufficient consideration when reasonable grounds exist to make a lawsuit possible. Consideration for a prior agreement is not valid, except in very limited circumstances. Under the UCC, a preexisting obligation can constitute valid consideration. The offeror must be a purchaser of $500 or more in goods, and must offer to pay more than an additional $500. This exception exists to protect certain business

arrangement from failing. The UCC a also allows a promise to keep an offer open (a "firm offer") without additional consideration beyond the original offer.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/what-is-consideration/

- *Exception to Consideration Requirement* - A doctrine known as "promissory estoppel" may serve as a substitute for consideration to make an agreement into a valid contract. Promissory estoppel is an equitable doctrine. If the offeree relies on the offeror's promise to her detriment, the doctrine of promissory estoppel may make the contract valid despite the absence of consideration. For example, Tina says that she will give Sam her car to drive across the country from Georgia to California. Sam relies on Tina's promise and to his detriment by spending his money fixing up Tina's car to make certain it is reliable drive cross country. If Tina tries to back out of making the promised gift, a court may enforce the promise as an enforceable contract. OPTION and FIRM OFFERS,

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/promissory-estoppel/

ENFORCEABLE, VOID, & VOIDABLE AGREEMENTS

11. What is mental capacity to contract?

To enter into a contract a person must have mental capacity sufficient to understand the nature and consequences of her actions. If mental capacity is absent, the contract is voidable by the person lacking capacity. There are three classes of persons commonly understood to lack capacity to be bound by contractual promises:

- *Minors* - A minor is someone below the statutory age of mental capacity within a jurisdiction. Generally, a person must be 18 years old or older to have the requisite mental capacity to contract. As such, a minor who enters into a contract can void the contract at any time prior to reaching the age of majority. The exception to this rule is when the contract involves goods or services necessary for the child's survival. This could include food, water, shelter, etc. In the case of necessities, the child will be obligated to pay the reasonable value of the goods or services received. If the child fails to disaffirm the contract by this time, she thereby ratifies the contract and is bound going forward.

- *Intoxicated Person* - An intoxicated person may lack the mental capacity necessary to contract. Generally, this will require extreme intoxication. If the intoxicated person enters into a contract, she must disaffirm the contract within a reasonable time of regaining capacity and learning of the contract. If she fails to do so within a reasonable time, she has ratified the contract and will be bound.

- *Mentally Incompetent Person* - A mentally incompetent person generally lacks the ability to enter into a contract. If the mental incompetency is temporary, the individual must disaffirm any contract entered into during incapacity within a reasonable time of regaining capacity. If the personal is permanently incapacitated, the contract is either void or voidable at the insistence of a legally appointed guardian.

Each state may pass additional situations in which it deems an individual mentally incompetent to enter into contractual relations.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/mental-capacity-to-contract/

12. What is the requirement that a contract have a lawful purpose?

A contract must have a lawful purpose to be enforceable. That is, the contract cannot violate or cause others to violate the law or public policy.

- *Crimes and Torts* - Contracts that require commission of a crime or tort or violate accepted standards are void. If a contract has both legal and illegal provisions, court will often enforce the legal provisions and refuse to enforce the illegal ones.

- *Unconscionable Contracts* - An unconscionable contract has terms that are extremely unfair or one-sided in favor of a party with greater bargaining power. The terms of the agreement are said to "shock the conscience. Such a contract may be void as against public policy if the circumstances indicate that a reasonable person would not have entered into the agreement without the existence of an undue hardship. In some situations the undue hardship must have been brought on by the party unduly benefited by the contract.

- *Contracts that Restrain Trade* - Contracts that restrain trade may be illegal and thus void. This is true for contracts that create a monopoly, fix prices, and divide up markets. This is generally the area of anti-trust law. A court may also find a contract void if it serves to frustrate economic activity in a manner not covered by antitrust law. For example, a contract that intentional interferes with contractual relations or unfairly competes may be void. For example, a contract that directly prohibits competitive business activity is a "Covenants Not to Compete". This type of contract restricts an individual from carrying on a trade or practice. These contracts are held to be void when they are unduly burdensome in their restrictions regarding the time and geographic locations for doing business. A covenant not to compete that has a limited time frame (3-6 months) and a limited jurisdiction (up to 50 miles) is generally enforceable if there is good reason for the restriction.

States are free to pass statutes or develop common law that protects the public interest. A contract that runs afoul of what is deemed necessary for the public good may also be void.

- ***Discussion***:
- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/lawful-purpose-for-contracts/

13. What common situations give rise to a voidable contract?

- *Fraud* - Fraud involves an intentional misstatement of the material (important) fact that induces one to rely justifiably to his or her injury. If a person is defrauded into entering a contract, the defrauded party may void the contract upon learning of the fraud. Voiding the contract is at the option of the defrauded party, as she may wish to remain in the contract. The party committing fraud may not void the contract. If the defrauded party fails to void the contract, she is deemed to have ratified it and is bound.

- *Misrepresentation* - Misrepresentation is a material misstatement of fact that induces one to rely on the statement. The difference with misrepresentation and fraud is that misrepresentation does not involve the intent to mislead. As in the case a fraud, a party who enters a contract as a result of a material misrepresentation may void the contract upon learning of the false representation. The misrepresenting party may not void the contract. Failure to void the contract upon learning of the misrepresentation is deemed to ratify the agreement.

- *Duress* - Duress means the use or threat of force to convince a person to act according to one's wishes. If a party enters into a contract due to the physical or economic duress imposed by the other party, the contract is voidable at any time by the party subject to duress.

- *Undue Influence* - Undue influence arises when one party unfairly takes advantage of another party by using a position of trust, influence, or confident. For example, a psychiatrist who enters into a contract with her patient that is not related to medical services may be deemed to have exercised undue influence. The influence party may have been pressured to enter into the agreement or felt unduly obligated to enter into the agreement for fear of destroying the doctor-client relationship.

- *Mutual Mistake* - A mistake by both parties regarding material facts to the contract may make a contract voidable. In such a situation, either party may void the contract upon learning of the mutual mistake. The test for whether the mistake of fact is material is to ask whether a reasonable person would have entered into the agreement if the true facts were known. A mutual mistake of law may make a contract voidable if it caused the parties to not have a "meeting of the minds" with regard to the core aspects of the contract. If no meeting of the minds exists, then there is never a valid agreement between the parties.

- *Unilateral Mistake* - Generally, unilateral mistake by one party to the contract does not make the contract voidable. A unilateral mistake about the basic assumptions of the contract will only make the contract voidable when the non-mistaken party knew or had reason to know of the other party's mistake. In such a case, the effect of enforcing the contract against the mistaken party must be unconscionable and the non-mistaken party would not suffer a substantial hardship by voiding the contract. If the non-mistaken party did not know about the other party's mistake, then the standard for voiding the contract is even higher. In such a case, the contract must not yet have been performed or the parties must be easily restored to their pre-performance positions. The mistake must be substantial, and the mistake must directly relate to some computational or clerical error in the construction of the terms of the agreement. No defense exists if the mistaken party knowingly assumed the risk of the mistake; is grossly negligent in making the mistake; violates a legal duty; fails to act within her duty of good faith and fair dealing; or intentionally fails to read the contract.

- ***Discussion***:

- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/voidable-contract-scenarios/

14. When is a contract required to be in writing?

Some valid contracts are required to be in writing to be enforceable by a court of law. The requirement that a contract be in writing is generally dependent upon the subject matter of the agreement. A statute requiring that a contract be in writing is known as a "Statute of Frauds". These statutes are designed to prevent fraud in the formation of contracts. Most statutes do not require that the entire contract be in a formal writing; rather, there must be sufficient writing (in any form) to demonstrate the core aspects of the agreement.

The following types of contract are generally required to be in writing in all jurisdictions:

- *Sale of an Interest in Land* - Contracts concerning the transfer of an interest in land must be in writing to be enforceable. An "interest in land" includes contracts for mortgages, mining rights, easements, etc. Note: A construction agreement is not a transfer in an interest in land.
- *Collateral Promise to Pay Another's Debt* - Debt Surety or Guarantee agreements are required to be in writing to be enforcement. These instruments document when one person promises to repay the debt of another. This includes situations where business owners guarantee the debts of their business.
- *Cannot Be Performed within One Year* - A contract must be in writing to be enforceable if the duties under the contract cannot possibly be performed within one year after its making. The ability to carry out the contract must be impossible to a certainty. For example, an oral contract for services that lasts for twenty months or a lease of longer than one year are generally not enforceable.
- S*ale of Goods of $500 or More* - Sales of goods fall under the provisions of the UCC. The UCC requires that any contract for the sale of goods for $500 or more must be in writing to be enforceable. Modifications to any such agreement must also be in writing.

States may establish other contracts that are required to be in writing to be enforced in that jurisdiction. For example, most states require insurance policies to be written.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Videos***: http://thebusinessprofessor.com/statute-of-frauds-explained/

15. What type of writing is required to satisfy the statute of frauds?

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16. What exceptions exist to the requirement that a contract be in writing to be enforceable?

Jurisdictions recognize a number of exceptions to the requirement that certain contracts be in writing to be enforceable. Common exceptions to the writing requirement are as follows:

- *Admission Under Oath* - If a party admits under oath (such as in a deposition or in a court proceeding), the contract may then be deemed enforceable.

- *Part Performance* - A court may deem an oral contract enforceable if the parties (or one party) has partly performed the contract. This principle generally applies to oral agreements to sell or transfer real property (land). For example, if the buyer has paid part of the purchase price and taken possession of the land, then the court may hold the oral agreement enforceable. This would generally entail a court order to complete the contract performance by signing a deed legally transferring the property.

- *Promissory Estoppel* - As explained early, the equitable doctrine of promissory estoppel applies in situations where one party relies on another party's promise to their detriment. It arises in a situation where a party believes that their exchange of promises is a legally enforceable contract. That party puts herself in a position where she would suffer a loss if the other party does not perform. For example, Tom promises Jane that he will sell her land to build a house. Jane, relying on the promise, hires individuals to begin grading the land and laying a foundation for the house. Later, Tom refuses to transfer a deed to Jane and claims that the contract is not enforceable because it was not in writing. Jane has spent significant money and time under the belief that the contract was enforceable. As such, a court will probably hold the contract to be enforceable under the doctrine of promissory estoppel.

- *Rules Involving Goods* - The UCC provides several exceptions to the rule that contract for the sale of goods for $500 or more must be in writing. For example:

    - *Specialty Goods* - If a manufacturer agrees to manufacture specialty goods for a client. Once the manufacturer begins production of the goods, the contract may be enforceable without a written agreement.

    - *Partial or Complete Performance* - If goods have been accepted and payment for the goods has been made, the parties cannot later claim that the contract was unenforceable and demand return of the money or property. This may also be true for partial payment or delivery of a portion or installment of the goods.

    - *Contract Between Merchants* - An oral contract between merchants in which one party delivers goods and the other party either delivers goods or send written notice confirming the terms of the agreement and the other party does not object to that notice within 10 days.

The justification for the above exceptions to the statute of frauds is that each situations provides an additional level of proof regarding the existence of a contract. It reduces the need for a writing to prove that the contract exists and its terms.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/exceptions-to-statute-of-frauds/

INDIVIDUALS WITH RIGHTS UNDER THE CONTRACT

17. Who are the beneficiaries of the contract?

The parties to the contract are the primary beneficiaries. In general, individuals who are not parties to a contract have no rights to sue to enforce the contract or to get damages for a breach of contract. There is, however, exceptions to this rule. It is possible for third parties to have rights in a contract. A third-party beneficiary may have rights under a contract if the original parties to the contract intend for the agreement to benefit the third party and that intent is demonstrated in the agreement. This may happen at the time of the contract, or a third party may also acquire rights in an already executed contract if one party to the contract validly transfers those rights to the third party. The extent of the third party's rights is determined by their status as either a donee beneficiary or creditor beneficiary.

- *Donee Beneficiary* - A donee beneficiary is a third party who receives contractual rights as a gift from the promisee. If a promisee makes a contract for the benefit of a donee beneficiary and the promisor fails to perform, the third-party may not bring an action against the promisee (individual transferring the contract), but may bring an action against the promisor (individual obligated under the contract). Since the transfer to the beneficiary is a gift, there are no grounds for recourse against the promisee.

- *Creditor Beneficiary* - A creditor beneficiary is a third party who receives contractual rights from the promises as satisfaction of a debt. When a promisor fails to perform under the subject contract, the creditor beneficiary can bring an action against the promisee and the promisor. The promisee may also bring an action against the promisor, as her rights have been harmed by the promisor's failure to perform.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/third-party-beneficiaries/

18. What is assignment and delegation of contracts?

Assignment is the transfer by one party of her right to receive performance from the other party to the contract. Delegation is the transfer by one party of her duties to perform under a contract.

- *Methods of Assignment or Delegation* - The rights under a contract can be assigned or the duties delegated through agreement between the assignor and assignee. Assignments/delegations can be a gift or an exchange for other value. In general, unless the contract deems otherwise, obligees may assign their rights or delegate their duties under the contract to third parties. The assignor/ delegator must give notice to the other party immediately upon assignment/delegation.

- *Writing Requirement* - Assignments and delegations of common law contracts do not have to be in writing. Assignments of contracts for the sale of goods must be in writing if the original contract was subject to the statute of frauds.

- Non-Assignable/Delegable Contracts: Unless the agreement limits assignment of rights, most contracts are assignable. Delegation if duties pursuant to contract is more limited. The following contracts are not capable of delegation:

- *Material Changes of Responsibility* - A contract that materially alters the obligor's duties under the agreement is not transferable. For example, an assignment that greatly varies a party's delivery requirements cannot be assigned. Doing so may detriment the obligor who has to meet a new (and possibly more taxing) delivery schedule.

- *Increases Burden or Risk* - Generally, any contract that materially increases the other party's burden, risk, or ability to receive return performance is not delegable. For example, requirement contracts cannot be assigned because the producer's duty depends on the individual output requirements of the purchaser.

- *Special Skills* - A party to a contract cannot delegate performance of duties under a contract when performance depends on the character, skill, or training of that party. For example, one singer cannot transfer her obligations under a contract to another singer if the other party depended upon the skill of that particular vocalist.

- *Multiple Assignments* - A party can partially assign a contract or assign the same contract to multiple parties. Different jurisdictions follow different rules regarding the priority of the assignees. Some jurisdictions allow that the first assignee of a contract who gives notice to the obligor has priority over other assignees. Other jurisdictions follow the rule that the first assignee to receive assignment of a contract has priority to performance by the obligor. Still other jurisdictions follow the rule that the first assignee has priority, unless a later assignee:

  - *Purchaser in Good Faith for Value* - If an assignee pays value for the assignment in good faith without notice of a prior assignment (and the prior assignee did not receive the assignment in good faith and for value).

  - *Court Action* - If an assignee receives a judgment against the obligor, if a court adjudicates the matter, it may be vested with the authority to establish priority of ownership in the payments.

  - *Novations* - If the assignee executes a novation, then the novation establishes priority. A novation is a new contract between individuals that replaces a party to the contract or obligations or rights under the agreement.

  - *Written Assignment* - If an assignee receives a written assignment capable of transfer. Some agreements, such as assignments that are subject to the statute of frauds, are only capable of being assigned *via* a valid writing. If a prior assignment does not satisfy the statute of frauds, a subsequent transfer could take precedent. It is important to review the specific rules applicable to the specific jurisdiction when determining one's rights under an assigned contract.

- *Revoking an Assignment* - A gratuitous (gift) assignment cannot be revoked if the assignment is made pursuant to a written document signed by the assignor. If no writing exists, revoking a gratuitous assignment is extremely easy (because no physical transfer has taken place). It can be revoked by an assignor later assigning the same right (the last assignment controls), the death or incapacity of the assignor, or by the delivery of notification of revocation to the assignee or obligor.

- *Modification after Assignment* - Generally, a contract cannot be modified after assignment. As previously discussed, once a contract has vested, the parties generally cannot modify the contract in a way that impairs the assignee's rights. If, however, a modification does not affect the assignee's rights, then it may be modified. In some cases, the assignee can effectively alter the contract by disclaiming her rights under the agreement. There is an exception in commercial

contracts that allows for modifications or substitutions in accordance with commercially acceptable standards. This allows for slight modifications that are within the expectations of the parties.

- *Continued Delegator Responsibilities* - The party delegating the contract is still potentially liable under the contract if the delegatee fails to perform. If, however, the delegatee and the obligee under the contract enter into a novation, then the delegator is relieved of responsibility. If the delegator expresses her intent to repudiate the contract upon assignment to the delegatee, then there is an implied novation if the obligee does not object.

- *Is the delegatee liable under the contract if no novation takes place?* It depends. The delegatee will be liable under the contract if she expressly or impliedly accepts responsibility for performance. In this case both the delegating party and the delegatee may be liable on the contract.

Most of the above rules regarding assignment and delegation are capable of modification in a contract between the parties.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/assignment-of-a-contract/

RELIEF FROM DUTIES UNDER A CONTRACT

19. When is a party relieved from their obligations under a contract?

Parties to a contract have duties or obligations under the contract. There are generally three options to relieve these obligations:

- *Perform* - An individual is relieved from her duties under a contract once she has fully or substantially performed those duties. The individual is "discharged" from the contract.

- *Release from Contract* - An individual may be released from a contract by the other party. Alternatively, the person may be released if the contract becomes void.

- *Breach* - Once a party to a contract breaches that contract, she and the other party no longer have duties to perform. If the contract is enforceable, the other party then has the ability to enforce the contract against the other party by seeking damages.

Performance of the contract and release eliminate a person's liability under the contract. Breach exposes the breaching party to damages or losses suffered for the breach. None of these options relieve a party form tort liability if their actions with regard to the contract give rise to potential tort liability.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/duty-of-performance/

CONTRACTUAL PERFORMANCE

20. What are executed and executory contracts?

An executed contract is one in which the parties have performed their duties under the contract. An executory contract where the parties have not yet performed their obligations under the agreement.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Document***: http://thebusinessprofessor.com/executory-vs-executed-contracts/

21. What is performance of a contract?

As stated above, performance of a contract relieves a person from further duties under the contract. Complete performance by a party means that the contracting party has fulfilled every duty required by the contract. A completely performing party is entitled to a complete performance by the other party. Substantial performance of a contract means less than a complete performance, but is sufficient to avoid a claim of breach of contract. More specifically, it means that a party has performed all material elements of the contract. There are, however, non-material aspects left uncompleted. The other party may be entitled to seek offset or recovery from the substantially performing the party for the aspects of the contract not completed. For example, Doug enters into a contract to build a house for Ellen. He builds the house, but fails to paint the interior the color described in the contract. This contract is substantially performed and does not give rise to an action for breach. Ellen may, however, recover or offset the cots of painting the walls when paying Doug. Any performance that is not complete or substantial performance is a a material breach. A level of performance below what is reasonably acceptable. The materially breaching party cannot sue the other party for performance and is liable for damages to the other party for the breach.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/performance-substantial-performance-breach/

22. What is performance of a divisible contract?

A divisible contract is one that has multiple parts or is divided up into segments. Each segment exists and can be completed independently. That is, each segment has duties that require completion. An installment contract is an example of a divisible contract. Each installment has duties or obligations required to be completed. Performance of one segment does not relieve a party from the obligation to perform the other segments. Further, breach of one segment does not excuse performance by the parties of the other segments.

- ***Discussion***:

- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/what-is-a-divisible-contract/

RELIEF FROM DUTIES UNDER THE CONTRACT

23. What situations relieve individuals from performing her duties under a contract?

A individual is relieved from her duty to perform a contract in the following scenarios:

- *Void Contract* - If a contract becomes void, both parties are relieved from their duty of performance.
- *Breach by Other Party* - If the other party material breaches the contract, the non-breaching party is relieved from the obligation to further perform the agreement.
- *Failure of a Condition* - A contract may contain any number of conditions that may materialize (or fail to materialize), which relieves the parties' obligation to perform under the contract.
- *Impossibility, Impracticability, of Frustration of Purpose* - Parties to a contract may be relieved from their obligation to perform if performance becomes impossible, commercially impracticable, or the underlying purpose of the contract is frustrated.
- *Waiver or Release* - The parties may, on their own volition, decide to relieve the other party from their obligations to perform by signing a waiver or release.

Any of the above situations may release one or both parties from their duties of performance.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/discharge-from-contract/

24. What are conditions upon the duty to perform a contract?

Conditions are facts or situations that must materialize (or fail to materialize) for either or both to have the duty to perform a contract. Conditions are generally divided as follows:

- *Condition Precedent* - A condition precedent is where something must take place or a situation must arise prior to or before a party has a duty to perform. For example, Eric agrees to sell Fran one of his playoff seat tickets if the Atlanta Braves make it to the playoffs. The obligation to sell Fran a ticket only arises upon the occurrence of a specific event.
- *Condition Subsequent* - A condition subsequent excuses contractual performance if some future event takes place or situation arises. For example, Frank agrees to cut Gina's grass today if it does not rain. If it rains, Frank is relieved from the obligation to cut the grass. Likewise, Gina is relieved from her duty to pay Frank.

A condition may be expressed between the parties or implied from the nature of the agreement. That is,

the parties affirmatively discuss or include the conditions in the agreement or the language or nature of the contract may imply certain conditions on performance. The contract may also contain conditions that must take place concurrently before either party has a duty to perform. This is often the case when the contract requires simultaneous performance. Most point-of-sale purchases involve an implied concurrent condition of performance. For example, I give the cashier money and she sells me the groceries.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/conditions-under-contract-precedent-and-subsequent/

25. What are the conditions regarding payment, delivery, and tender of performance?

To "**Tender Performance**" means an offer or attempt to perform the agreement. Often a party's offer or attempt to perform is sufficient to satisfy the condition of performance an obligate the other parties performance. That is, a party cannot avoid her obligation under the contract by failing to accept the other party's tender of performance. For example, unless a contract states otherwise, the default rules under the UCC and Restatement place conditions on the delivery of services and the delivery of a product by a party to a contract. The UCC states the buyer tendering payment to the seller of a good is a condition that must be satisfied before the seller has the duty to deliver the good. The Restatement, in contrast, requires that a service provider must tender performance before the other party has a duty to pay for those services. In either case, rejecting a party's tender of performance can constitute a breach of contract if the tender of performance conforms to the requirements of the contract.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/tendering-performance-of-contract/

26. What are impossibility, impracticability, and a supervening frustration of purpose of a contract?

Impossibility of performance and commercial impracticability may excuse a party's performance of a contract. Further, it will relieve the party from liability for the non-performance.

- *Impossibility of Performance* - A party may be excused from her duty to perform under a contract if performance becomes impossible. For example, a party may be relieved from her duty to sell a product if the product is destroyed before she can sell it to the buyer. Impossibility of performance will only excuse a party's performance if the impossibility is not the fault of the non-performing party. Further, impossibility will not excuse liability for non-performance if the contract expressly contemplated the risk of conditions making performance impossible and specifically placed those risks upon the non-performing party. Events that make a contract impossible include:
    - Illegality of the subject matter;

- The subject of the contract (property) is destroyed;
- One of the parties to the contract dies or becomes physically or mentally disabled;
- Natural forces interrupt the contract (tornado, earthquake, severe storms, flooding, etc.);
- Performance would cause substantial risk of physical harm to one party.

The justification for the above exemptions regards the unexpected nature of the interruption in contractual performance. The interruption is not specifically attributable to any party and, therefore, should not unduly burden either of the parties.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/impossibility-and-impracticability/

- *Commercial Impracticability* - Commercial impracticability is where performance of a contract by a party has become unfeasibly difficult or costly to perform. The difference between impracticability and impossibility is that impracticability is still physically possible – it simply results in a substantial hardship to the performing party. Impracticability will excuse performance where the excused party did not have control over (or was not at fault for) the condition that made performance impracticable. Further, the excused party must not have expressly or impliedly assumed the risk of the duties becoming impracticable. Generally, impracticability is only found in extreme circumstances. Such instances include major price swings due to government action or international relations. In any event, impracticability generally requires the relieved party to suffer some form of unreasonable burden, risk, or expense.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/impossibility-and-impracticability/

- *Supervening Frustration of Purpose* - This is when circumstances arise that fundamentally frustrate a party's reason or purpose for entering a contract. The doctrine is similar to impracticability, but it does not relate to a party's hardship; rather it focuses on her expectation and purpose in entering the agreement. For a frustrating circumstance to relieve or excuse an obligation under a contract, the party cannot have assumed the risk of the circumstance (in the contract), be at fault for the occurrence or the non-occurrence of the event or circumstance, and the occurrence or non-occurrence must have been a basic assumption on which the contract was made. For example, John signs up for piano playing lessons from Tara. John suffers a horrible accident that causes him to lose dexterity in his hands. This is a frustration of purpose that was unforeseeable and substantially frustrates the purpose of learning to play the piano. As such, John will be excused from performance of the contract. Suffering an economic loss is not a frustration of purpose.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/frustrating-purpose-in-a-contract/

27. What is Waiver or Release from a contract?

A waiver and a release serve to excuse one or both parties' duty of performance.

- *Waiver* - When a party intentionally relinquishes a right to enforce the contract. A waiver is generally employed after a party fails to perform.
- *Release* - When one party is relieved from her promise of performance. A release generally occurs before a contracting party has to perform.

Waiver and release are often used synonymously to refer to a single document that simultaneously relieves a party from their duty to perform and excuses a non-performance or breach.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/waiver-or-release-from-contract/

BREACH OF CONTRACT

28. What is a breach of contract?

A party who is not relieved from performance and fails to perform her obligations under a contract is said to breach the contract. Breach entails a failure to perform material duties in accordance with the agreement. This can include a complete lack of performance, partial performance, or performance that fails to meet the demanded standard.

29. What methods exist for resolving a breach of a contract?

There are several remedies or solutions available for a breach of contract:

- *Negotiated Settlement* - The parties may work out a satisfactory solution to most breaches of contract is resolved by the parties themselves through voluntary negotiated settlements.
- *Arbitration* - The parties may agree to submit their dispute to a neutral third party or parties to resolve the dispute.
- *Litigation* - The parties seek to enforce their contract rights in a court of law.

30. What remedies exist for breach of a contract?

A breach of contract action may result in any number of damages:

- *Compensatory Damages* - Compensatory damages are court-awarded damages to put the plaintiff in the same position as if the contract had been performed. It includes lost profits on the contract and cost of getting a substitute performance.

- *Consequential Damages* - These are court-awarded damages arising from unusual losses which the parties knew would result from breach of the contract.

- *Liquidated Damages* - Liquidated damages are damages specified in the contract in the event of non-performance by either party. Liquidated damages are appropriate where real damages for breach of contract or likely to be uncertain, parties sometimes specific in the contract what the damages should be in the event of breach. Courts will enforce these "liquidated" damages unless they seem to penalize the defendant instead of merely compensating the plaintiff for uncertain losses.

- *Nominal Damages* - Nominal damages include a small amount awarded by the court to the plaintiff for a breach of contract, which causes no financial injury o the plaintiff.

- *Specific Performance* - Specific performance is court-ordered, equitable remedy when the subject matter of the contract is unique. A court order for specific performance directs a party to perform their duties under the contract. Specific performance is not available for service obligations.

- *Rescission* - Rescission is an equitable remedy that requires each party to return the consideration given the other. This remedy is often used in fraud or misrepresentation cases. It is

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/damages-in-a-breach-of-contract-action/

31. What is efficient breach?

Efficient breach is where a party makes a conscious decision to breach a contract by balancing the costs of complying versus fulfilling the contractual obligation.

- ***Discussion***: Should this simply be an economic consideration or is there a moral consideration involved?

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/breach-damages-and-remedies-in-contract/

INTERPRETING A CONTRACT

32. What rules or standards do courts apply when interpreting contracts?

Courts in different jurisdictions may employ unique standards when interpreting the meaning of contract terms. Common approaches include:

- *Plain Meaning* - The majority of jurisdictions interpret contract provisions based upon their "plain meaning." That is, if a contract term is unambiguous, then the court will apply the meaning commonly applied to the term or provision.

- *Reasonable Person* - Other jurisdictions interpret contract provisions based upon how a "reasonable person" in those circumstances would interpret the contract. This is known as the "objective standard."

- *Subjective Intent* - Some jurisdictions will look to any outside evidence to determine the subjective intent of the parties.

Some other common approaches to interpreting contract provisions are as follows:

- *Express Terms* - Afford the greatest weight to the contract's express terms;

- *Implied Terms* - Look to implied terms originating from the course of dealing, course of performance, or trade usage;

- *Specific Terms* - Give greater weight to specific terms above general terms;

- *Actively Negotiated Terms* - Terms that are actually negotiated between the parties are given greater weight than standard terms or boilerplate;

- *Totality of Circumstances* - The court will take into consideration the overall circumstances of the agreement;

- *Contract Purpose* - The purpose of the contract, if ascertainable, should be considered in interpreting the intentions of the parties;

- *All Writings* - Interpret all parts of the contract as a whole (including when the contract consists of multiple writings);

- *Context* - Words are given their prevailing meaning in the context of the contract;

- *Trade Terms & Course of dealing* - Specific trade terms are to be interpreted in accordance with their meaning in the trade. The parties' intentions are interpreted consistently and in accordance with course of performance, dealing, and trade usage; and

- *Interpret Against Drafter* - Ambiguous terms may be interpreted against the drafter.

Jurisdictions may employ any combination of these approaches when interpreting provisions or giving weight to conflicting terms.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/role-of-state-in-interpreting-contract/

33. What is the Parol Evidence Rule?

This rule or doctrine controls whether parties may introduce to the court interpreting the contract evidence of their agreement that is not included within the written document. This rule either allows or disallows a party from introducing that evidence to the court to modify or add terms to a contract. The purpose of this rule is to prevent confusion in the interpretation of the contract and fraud by any party against another.

- *Prior Communications* - The parol evidence rule primarily serves to exclude any evidence of prior negotiations (either before or contemporaneous with the signing of the contract) that have the effect of altering the express terms of the agreement. Information or communications contemporaneous with execution of the contract may be admissible in interpreting the contract, but are not admissible if they expressly contradict unambiguous, contract terms.

- *Final Agreement* - For the parol evidence rule to apply, the contract must be the final agreement between the parties. This means the contract is an "**Integration**". If the party is determined to be a final expression of the parties' agreement, then the parol evidence rule is effective to limit what information outside of the writing the parties can introduce to the court in interpreting the agreement.

- *Integration Clause* - For the parol evidence rule to apply, the courts must interpret a contract to be the complete and final agreement between the parties. The best way to make certain that the contract is deemed a complete and final expression of the parties' intent is to include an "integration clause." An integration clause, also called a "merger clause," is a provision in a contract that says that the contract is a complete and final understanding of all the terms of the agreement. In other words, these clauses state that the contract is intended to be a complete integration. Some merger clauses will specifically state that any outside information or communications contemporaneous with the execution of the contract or prior thereto should not be considered a part of the contract. Other, more specific clauses, will specifically reference outside information, documents, or communications and state whether the terms of those items are included in the final agreement. These clauses are usually conclusive unless a contract defense applies (such as fraud, duress, etc.).

An agreement may appear on its face as simply a partial understanding of the agreement between the parties. In such as case, the contract is not an integration.

- ***Discussion***:

- ***Practice Question***:

- ***Resource Video***: http://thebusinessprofessor.com/parole-evidence-rule/

34. What is a complete integration and partial integration?

If a court determines that the document is an integration, it can either be completely integrated or partially integrated.

- *Complete Integration* - A complete integration is when the contract contains all of the facts or information regarding the parties' agreement. If the court determines that a contract is a complete integration, the parol evidence rule limits all prior or contemporaneous outside evidence that contradicts, modifies, or supplements the contract. A complete integration will generally contain a strong integration clause specifically excluding any outside information not specifically mentioned in the terms of the agreement.

- *Partial Integration* - The written document may contain only part of the information constituting the agreement between the parties. If a court determines that a contract is a partial integration, it will allow certain outside evidence that serves to supplement or explain provisions of the contract. Even with a partial integration, the parol evidence rule restricts outside evidence of prior or contemporaneous communications that specifically contradict the terms of the written contract. Partial integrations generally do not contain integration clauses. Often, the agreement itself will make reference to outside communications to clarify certain provisions of the agreement.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/contract-complet-and-partial-integrations/

31. When does the parol evidence rule not bar the consideration of extrinsic evidence to a contract?

As stated above, extrinsic evidence or information prior to or contemporaneous with the formation of the contract cannot be introduced to contradict the contract. Nonetheless, it may be necessary to employ extrinsic evidence or information from outside of the contract for the following reasons:

- to aid in the interpretation of existing terms (for example, when an ambiguity exists),
- to show that a writing is or is not an integration,
- to establish that an integration is complete or partial,
- to establish subsequent agreements or modifications between the parties (i.e., those arising after the contract is completed), or
- to show that the terms of the contract were the product of illegality, fraud, duress, mistake, lack of consideration or other invalidating cause.

These exceptions exist to reduce misunderstanding and fraud between the parties and to promote judicial efficiency in the interpretation of agreements.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/exceptions-to-the-parol-evidence-rule/

35. What is a patent and latent ambiguity?

One important exception to the parol evidence rule is the use of extrinsic evidence to determine the meaning the parties attribute to certain terms or provisions. Generally, a court will give a term its common meaning or the meaning common in the context of the contract (such as a particular trade usage). Nonetheless, often a term or provision of the contract will be ambiguous. In such a case, Ambiguities are broken into latent and patent ambiguities. Generally, outside evidence may be introduced to clear up an

ambiguity that is obvious on the face of the document. This is known as a "patent" ambiguity. If a party claims that the contract contains an ambiguous term, but it is not obvious on the face of the contract, then the party is claiming that a latent ambiguity exists. In such a case the party may be able to introduce outside evidence to show that an ambiguity exists. If the court determines that an ambiguity exists, it may consider extrinsic evidence to resolve the ambiguity. Many courts may not distinguish between patent and latent ambiguities. If an ambiguity exists, extrinsic evidence is allowed to the extent necessary to clear up the ambiguity. The parol evidence rule's prohibition on the use of evidence to change or add to the contract remains intact.

- ***Discussion***:
- ***Practice Question***:
- ***Resource Video***: http://thebusinessprofessor.com/patent-and-latent-ambiguities-in-a-contract/