

## Answers to Assignment 2 Questions

NOTE: These answers are provided to give students a basic understanding of acceptable types of responses. They often are not the only valid answers and are not intended to provide an exhaustive response to the questions.

### Educational Objective 1

- 1-1. A bilateral contract is one in which each party becomes both a promisor and a promisee. If a default occurs, either party may enforce the other's promise in a legal action. In a unilateral contract, performance is required in exchange for the promise. A contract is not formed until performance occurs.
- 1-2. A voidable contract is a valid contract that can continue in force unless an innocent party (such as a minor) chooses to avoid it, one of the contracting parties commits fraud, or the contract is found to be the result of duress on one of the parties. A void contract is an agreement that is not really a contract because it is not legally enforceable, such as an agreement to commit a crime.

### Educational Objective 2

- 2-1. The first requirement is the intent to contract. The offeror must intend, or appear to intend, to create a legally enforceable contract if the offeree accepts the offer. The second requirement of an offer is definite terms. The third requirement is communication to the offeree.
- 2-2. Offers do not remain open indefinitely. An offer ceases to be binding when the time period the offer specifies expires or, absent a specific time period, when a reasonable amount of time passes. What is reasonable depends on considerations such as the contract's subject matter and the general commercial setting.
- 2-3. Generally, an offeror can revoke, or withdraw, an offer any time before acceptance. As in the case of the offer itself, the revocation is effective only when communicated. The revocation must be communicated to the offeree, and is effective only when the offeree actually receives it.

### Educational Objective 3

- 3-1.
  - a. An offer made to one person can only be accepted by the person to whom the offer is made, who is the offeree.
  - b. Any member of the group that has received the offer can accept it.
  - c. Anyone can accept an offer made to the public.
- 3-2. Acceptance of an offer must be unconditional and unequivocal. If there is an acceptance that deviates from the offer's terms, it is a counteroffer.
- 3-3. In a unilateral contract, performance of the contract is both acceptance and performance. Usually no communication other than performance or forbearance is required. In a bilateral contract, the offeree is typically required to communicate acceptance to the offeror.



## Educational Objective 4

- 4-1. For an agreement to qualify as a contract, the parties to it must have legal capacity to contract. Capacity refers to one's ability to sue or be sued or to enter into an enforceable contract. Capacity includes the ability to understand the consequences of one's actions. A party deemed competent to contract is one who has the mental ability to understand problems and make decisions.
- 4-2. The four parties who typically lack capacity to contract are minors, insane persons, intoxicated persons (under the influence of alcohol or drugs), and artificial entities (such as insurers) that are restricted by law or corporate charter from entering into certain contracts.
- 4-3. Corporations, although artificial creations of the state, are persons in the eyes of the law. They can enter into contracts, and most states do not restrict the types of contracts they can make. However, the extent of the competence of a corporation to enter into a contract may be restricted by its corporate charter or, in the case of insurance, banking, and transportation corporations, by license or regulation.

## Educational Objective 5

- 5-1. Valuable consideration is a legal benefit received by the promisor, such as money. Forbearance can be sufficient consideration to support a contract, such as a promise to refrain from an activity. Present consideration and future consideration, in contrast to past consideration, are both sufficient types of consideration to form an enforceable contract. Binding promises can also be sufficient consideration for forming an enforceable contract.
- 5-2. Past consideration is insufficient to support a contract. A promise to pay for performance previously completed without an agreement does not form an enforceable contract. A promise to perform an existing obligation, such as an obligation someone is legally required to perform, is also insufficient to form a binding contract. A compromise and release of claims does not form a binding contract, although there are exceptions.
- 5-3. Some contracts are enforceable despite a lack of consideration for equitable or public policy reasons or because state laws make specific exceptions. One example is promissory estoppel that applies when a party relies on the promise of the other party and only enforcement of the promise would achieve justice. Another example is a pledge made to a charitable organization.
- 5-4. There are several aspects of a property-casualty insurance contract:
  - a. The insurer's consideration is its promise to indemnify, or pay on behalf of, an insured resulting from a covered occurrence.
  - b. The insured's consideration is the premium payment or the promise of premium payment.
  - c. Payment of the premium does not become an obligation until coverage begins.

## Educational Objective 6

- 6-1. Such policies are considered wagering contracts because they gamble on others' lives or property and increase the likelihood of intentional harm or destruction.
- 6-2. If a person engages in an occupation without a required license, the recipients of that person's services can refuse to pay for them because the contract was illegal.



- 6-3. Common carriers are restricted due to the lack of equality of bargaining power between a large and powerful entity and the relatively powerless consumer.

## Educational Objective 7

- 7-1. If fraud is proved, the plaintiff can seek one of two remedies:
- The plaintiff may seek rescission. If the court rescinds the contract, the plaintiff has no further duties under it and is entitled to reimbursement of all payments made to the defendant.
  - If rescission would not make the plaintiff whole, the plaintiff can sue for damages in a tort action, usually called an action in deceit.
- 7-2. To assert the concealment defense, the insurer must prove two things:
- The insured knew that the fact concealed was material.
  - The insured concealed the fact with the intent to defraud.
- 7-3. A unilateral mistake ordinarily does not affect a contract. Bilateral mistakes occur when both parties to a contract make the same mistake of fact. Under these conditions, contracts are generally voidable.
- 7-4. A person who has reasonably relied on an innocently misrepresented material fact can later avoid a resulting contract because of lack of genuine assent.
- 7-5. The parol evidence rule serves three purposes:
- To carry out the parties' presumed intention
  - To achieve certainty and finality as to the parties' rights and duties
  - To exclude fraudulent and perjured claims

## Educational Objective 8

- 8-1. Maxims of construction are not strict legal rules but well-accepted guidelines for interpretation. They do not make a new contract or rewrite an old one. Courts apply them only to resolve doubts and ambiguities in a contract.
- 8-2. In an entire contract, one party must complete performance to be entitled to the other party's performance. In a divisible contract, the performance of a portion of the contract entitles the performing party to immediate payment.
- 8-3. Courts prefer to interpret contracts as divisible to avoid hardships that can result from delaying payments under the contract until full performance has been completed.
- 8-4. To resolve contradictory terms, courts apply this system of priorities:
- Handwriting prevails over typewriting.
  - Typewriting prevails over printing.
  - Words prevail over figures.



## Educational Objective 9

- 9-1. Contract rights are not assignable in these situations:
- Laws restrict prior assignment of such rights as veterans' disability benefits, government pensions, wages, inheritances, and workers compensation benefits.
  - The parties to an agreement might specify that they cannot, under the contract, assign the rights.
  - Personal rights are not assignable.
  - When an assignment materially alters or varies the obligor's performance, a court usually will not uphold it.
  - When a judgment is pending in a personal injury case, generally the injured person cannot assign a claim for damages resulting from the injury.
- 9-2. As a general rule, the assignee's rights are those of the assignor and do not extend beyond them.
- 9-3. These two types of beneficiaries are often treated as one class, intended beneficiaries, who are third-party beneficiaries to whom a benefit was intended by the contracting parties.

## Educational Objective 10

- 10-1. If a contract promises or guarantees satisfaction, unless the promisor can show bad faith on the promisee's part, obligations are not discharged until the promisee experiences personal and subjective satisfaction. Courts apply an objective standard to determine personal satisfaction relating to utility, fitness, or value.
- 10-2. For a novation to be effective, all parties must agree to the substitution. The remaining party must agree to accept the new party and must release the withdrawing party. The latter must consent to withdraw and to permit substitution of the new party. The presence of these essentials discharges the withdrawing party from the contract.
- 10-3. Frustration is the prevention of the attainment of a goal. To excuse a party's nonperformance of a contract, frustration must arise from an unforeseeable and uncontrollable circumstance that causes a fundamental change and that is the fault of neither party. Impracticability is an excuse for nonperformance of a contractual duty, the performance of which, though possible, would be extremely or unreasonably difficult.
- 10-4. These are four circumstances that may make performance of a contract impossible:
- If a change in law or a governmental act makes performance of an existing contract illegal, the promisor's performance is excused.
  - The death or incapacitating illness of a specific person necessary to perform a personal service discharges the duty to perform.
  - If the specific subject matter of the contract is destroyed or becomes nonexistent after contract formation without the promisor's fault, impossibility of performance discharges the promisor's duty.
  - If the other party's act prevents the performance of a contract, a court will excuse performance.



## Educational Objective 11

- 11-1. The circumstances that affect the materiality of a breach include the extent to which the breaching party has performed, the willfulness of the breach, and the extent to which the nonbreaching party has obtained benefits and can receive adequate compensation. A material breach by one party excuses the other party's performance and immediately gives rise to remedies for breach of contract. A minor breach may temporarily suspend any duty of performance by the nonbreaching party or may give the aggrieved party a basis to sue for damages resulting from the breach, but not for breach of the entire contract.
- 11-2. Compensatory damages are intended to place the injured party in approximately the position he or she would be in if the breaching party had performed the contract. Compensatory damages comprise the difference between the value of the promised performance and the plaintiff's cost of obtaining that performance elsewhere. They include losses caused by the breach and gains the breach prevented. Compensatory damages are typically awarded if a plaintiff prevails in a contract case. Punitive damages punish a defendant for a reckless, malicious, or deceitful act. Punitive damages are not usually appropriate in contract cases. If a seller of personal property commits fraud or misrepresentation, punitive damages can be appropriate; however, the punitive damages are usually based on the fraud, not on the breach of contract.
- 11-3. Courts order the equitable remedy of specific performance when money damages would be inappropriate or inadequate. To determine whether money damages would be adequate, courts consider the difficulty of valuing the subject matter of the contract, the existence of unique qualities of the subject, and the difficulty or impossibility of obtaining a duplicate or substantial equivalent of the subject of the contract.

## Educational Objective 12

- 12-1. Answers are based on the facts presented in Louis' case.
  - a. Establishing a contract requires agreement, which consists of a valid offer and a valid acceptance. A valid offer requires three elements: intent to contract, definite terms, and communication to the other party. It appears that Louis had intent to contract for the purchase of this yacht. The agreement included definite terms identifying the parties, the subject matter, the price, and a time of performance. Louis signed and returned the agreement, thereby communicating to Ed and his attorney.
  - b. Most statutes of frauds and the Uniform Commercial Code (UCC) require that contracts related to the sale of goods in excess of \$500 must be in writing. The parol evidence rule is based on the assumption that all prior negotiations, conversations, and agreements were merged into the final, written contract, which then becomes the complete statement of the parties' agreement. While it does not, on its own, make contracts unenforceable, it has important implications for contract interpretation, because once the parties have reduced any agreement to writing, no oral evidence may be admitted to contradict its terms. If the letter and conversation were not included in the final agreement, these items cannot alter the written agreement and any information contained in them are not enforceable at the time of closing.
  - c. Louis would have to prove that the contract was the result of fraud, that there was a mistake in the contract, or that he entered into the contract under duress. Additional factors include undue influence or reliance on an innocently misrepresented material fact.

