Contract Law

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TYPES OF CONTRACTS

A contract is a legally enforceable agreement. People enter into agreements for many purposes, but not all agreements are legally enforceable contracts.

A **contract** must have four elements to be legally enforceable: agreement, capacity to contract, consideration, and legal purpose. Each party to a contract may be both a **promisor** and a **promisee**.

When two or more parties enter into a contract, they are said to be in **privity of contract**. Ordinarily, a party cannot sue for breach of contract without being in privity of contract with the other party. However, contracts frequently involve third parties' interests. A **third-party beneficiary** of a contract has a legal right to enforce the contract in the case of a **breach of contract** by either of the contracting parties.

A contract may be bilateral or unilateral, executed or executory, express or implied, void or voidable.

Bilateral and Unilateral Contracts

A contract is either a **bilateral contract** or a **unilateral contract**. Most contracts are bilateral. For example, Jay's promise to pay Tony $500 in exchange for Tony's promise to paint Jay's garage creates a bilateral contract 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, if Jay promises to pay $500 if Tony paints the garage, a binding contract requiring Jay to pay Tony arises only when Tony has painted the garage. The performance of an act, painting, is required in exchange for the promise, payment. Tony does not breach a contract by failing to paint the garage.

Executed and Executory Contracts

A contract is either an **executed contract** or an **executory contract**. When a contract is executed, nothing else is required of either party. For example, one party has bought and paid for clothes that another party has delivered.

A fire insurance policy is an example of an executory contract. The insurer's promise to perform is an executory promise conditional on the occurrence of a fire. As long as no fire occurs, the contract remains executory.

Contract

A legally enforceable agreement between two or more parties in which each party makes some promise to the other.

Promisee

The party to a contract to whom a promise is made.

Promisor

The party to a contract making a promise.

Privity of contract

The relationship that exists between the parties to a contract.

Third-party beneficiary

A person who is not a party to a contract but who benefits from it and has a legal right to enforce the contract if it is breached by either of the contracting parties.

Breach of contract

The failure, without legal excuse, to fulfill a contractual promise.

Unilateral contract

A contract in which only one party makes a promise or undertakes the requested performance.

Bilateral contract

A contract in which each party promises a performance.

Express and Implied Contracts

Executed contract

A contract that has been completely performed by both parties.

Executory contract

A contract that has not been completely performed by one or both of the parties.

Implied contract

A contract whose terms and intentions are indicated by the actions of the parties to the contract and the surrounding circumstances.

Express contract

A contract whose terms and intentions are explicitly stated.

Implied-in-fact contract

A contract that is not express but that the parties presumably intended, either by tacit understanding or by the assumption that it existed.

Implied-in-law contract

An obligation that is not an actual contract but that is imposed by law because of the parties' conduct or some special relationship between them or because one of them would otherwise be unjustly enriched.

Contracts are either **express contracts** or **implied contracts**. An insurance agent and insurance producer who agree either orally or in writing on an insurance premium rate of $1,000 per year create an express contract.

Implied contracts can be either **implied-in-fact contracts** or **implied-in-law contracts**. If Bill, who has a credit account at the local hardware store, picks up an item, shows it to the store owner without comment, and leaves the store with the item, he has made an implied-in-fact contract to pay for the item. Implied-in-fact contracts often arise through, and are subject to, trade customs, prior relations between parties, and community customs known to all parties.

Implied-in-law contracts are not actual contracts and are sometimes called quasi-contracts. These are obligations that do not arise from the parties' apparent intentions but from courts' notions of justice and equity in particular cases.

Voidable Contracts and Void Contracts

Voidable contract

A contract that one of the parties can reject (avoid) based on some circumstance surrounding its execution.

Void contract

An agreement that, despite the parties' intentions, never reaches contract status and is therefore not legally enforceable or binding.

Some contracts are **voidable contracts**, and some agreements are called **void contracts** (although they are not valid contracts).

A voidable contract is a valid contract that can continue in force, and the parties can execute it completely unless an innocent or injured party chooses to avoid it. For example, a minor who has entered into a contract can avoid it at any time during minority or within a reasonable time after reaching legal age. However, the minor may also choose to fulfill his or her promise under the contract and can hold the other party to it.

The behavior of one of the contracting parties, such as an act of fraud or illegal deceit, also can make a contract voidable. An example of fraud is a party's intentional misrepresentation of an important fact relating to a contract. Similarly, a party who has entered into a contract as the result of duress, a form of compulsion, can avoid the contract within a reasonable time. However, an injured party can ratify, or affirm, a voidable contract. For example, if fraud or duress has occurred, the innocent party can nevertheless elect to abide by the agreement and can hold the other party to the contract.

Other agreements are automatically void. Even though the term "void contract" is contradictory because the parties never really create a contract in the first place, courts use it to describe agreements that the parties intend to be contracts that never actually become contracts. Void contracts are not legally enforceable or binding. An agreement to commit a crime, for example, is void and unenforceable because it is made for unlawful purposes.

REQUIREMENTS OF AN OFFER

The first element of an enforceable contract is an agreement between the parties. An agreement comprises an offer and an acceptance.

For contract purposes, an **offer** is valid if it includes these requirements:

Offer

A promise that requires some action by the intended recipient to make an agreement.

- Intent to contract
- Definite terms
- Communication to the other party

If an offer with these requirements is accepted, a contract is created.

Intent to Contract

The first essential requirement of an offer 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 offeror's language is the most important factor indicating whether a communication is an offer. Because an offer is a promise, words of promise indicate the offeror's intent to make an offer. Without specific words of promise, the communication is only a general statement of intention or an invitation for an offer.

Offeror

The party to a contract who promises to give something in return for a promise or an act by another party.

Offeree

The party to a contract who makes a promise or acts in return for something offered by another party.

A key question in each case involving contractual intent is whether, by words or conduct, a party has shown an intent to be immediately bound. The test of whether the intent has been shown is based on how a reasonable person would interpret the intent, not the party's actual intent.

A general statement of intention that conveys no promise is not an offer. If Anne says to Miguel, "I am going to sell my car for $5,000," and Miguel replies, "All right, I'll pay $5,000 for your car," Anne and Miguel have not created a contract. The test is whether, under the circumstances, a reasonable person would conclude that Anne intended to promise to sell the car specifically to Miguel. A reasonable person would not draw that conclusion in this case. Anne's statement only expresses an intention to sell the car in the future and does not make an explicit offer to Miguel.

If Anne says to Miguel, "I will not sell my property for less than $20,000," and Miguel replies, "I accept your offer," no contract results. A reasonable person would not conclude that Anne's statement of a minimum price was a promise to sell at the figure mentioned.

Some communications are intended to induce others to respond with offers. These communications are not in themselves offers because they express no present intent to contract. Most advertisements, catalogs, and sales letters meet this description; they are invitations to negotiate or to make an offer.

However, some advertisements do constitute offers that would be bound by a customer's acceptance. For example, an advertisement that indicates that the first customer to enter the store can buy specific goods at a specific price has

spelled out the conditions of acceptance. When the first person who enters the store agrees to buy the goods, a contract arises. In this case, the advertiser has used words of promise and described specific circumstances under which a customer could purchase the goods, giving rise to a contract based on the advertiser's legally enforceable contractual intention.

A party that asks for offers is free to accept them or reject them. In construction, for example, a project owner asking for bids can elect to accept one bid or to reject all of them. Any bidder can withdraw the bid at any time before its acceptance. A party calling for bids can accept any bid, whether or not it is the lowest one (unless the law requires acceptance of the lowest bid).

Examples of statements that are not offers and that would not lead to valid contracts if accepted because they lack intent to contract include these:

- Social invitations
- Predictions
- Offers made in excitement or jest

For example, if a person withdraws a social invitation or cancels a social event, the invitation's recipient has no legal remedy. If a doctor has predicted that a patient will be in the hospital only a few days and the period of hospitalization turns out to be much longer, the doctor's prediction is not an enforceable promise. If a reasonable person would recognize that a statement was made in jest or in the heat of anger, then acceptance of the statement does not create a contract. However, whether a statement is made in excitement or jest is not always easy to recognize, and a contractual obligation can arise in some cases. Courts consider all the circumstances in a case to determine whether a statement could reasonably be considered an offer. See the exhibit "First Element of a Contract: Agreement."

First Element of a Contract: Agreement

1. Offer
   - Intent to contract
   - Definite terms
   - Communication to offeree
2. Acceptance
   - By offeree
   - Unconditional and unequivocal
   - Offeree's communication of acceptance

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Definite Terms

The second requirement of an offer is definite terms. Definite terms make an agreement enforceable and make it possible to determine whether the parties have fulfilled their promises. They can also allow for calculation of damages in the event of a breach of contract.

An offer's terms must be stated with at least a reasonable degree of certainty. Reasonable certainty generally means identifying the contracting parties, the contract's subject matter, the price, and the time of performance. The absence of one or more of these terms, however, does not necessarily invalidate the offer.

To determine reasonable certainty, courts may ask whether the offer's terms are clear enough to provide a basis for a remedy if default occurs. If necessary and possible, the courts supply such missing terms as price or time of performance. For example, if the parties do not designate a time for performance, courts usually find an implication that performance is to occur within a reasonable time, considering the subject matter involved. If the offer is definite enough to determine the parties' intent, then a court will enforce the offer even though it might be necessary to imply some terms. However, inability to identify the parties to, or the subject matter of, an agreement, makes the offer indefinite and therefore impossible to accept.

Contracts to deal with one supplier, called requirement contracts, are usually enforceable even though the need for the goods might never arise. For example, Allen's promise to buy "all steel required" from Anu is definite enough to enforce. Allen promises to buy all steel required from Anu, and Anu promises to sell Allen the steel. In contrast, if Anu promises to sell "all such steel as I want to supply" to Allen, then the agreement is illusory and too indefinite to provide a remedy in court. The indefiniteness stems from the possibility that Anu might not wish to supply any steel.

Communication to Offeree

The third requirement of an offer is communication to the offeree. An offeree cannot accept a proposal before knowing about it. For example, a newspaper advertisement offers "$100 to anyone who will enter the 100-yard dash on July 4 and beat David." Matt, unaware of the advertisement or offer, enters the race and beats David. No contract exists because Matt could not accept an offer of which he had no knowledge.

However, an offer can be valid if the offeree has begun performance before learning of the offer. For example, Jerry, a burglary victim, has offered a reward for information leading to the burglar's conviction. Paul has already investigated the burglary and has determined that Donna was the burglar. After learning about the reward, Paul reports Donna to the authorities. If Donna is convicted, Paul can collect the reward from Jerry even though part of his effort occurred before he learned of Jerry's offer. The crucial fact is that Paul

knew of the offer when he reported Donna as the burglar, that is, when he completed performance.

Duration and Termination

Duration and termination are key to determining whether an offer is binding. Factors considered include the following:

- Lapse of time
- Operation of law
- Offeree's rejection
- Counteroffers
- Offeror's revocation

Lapse of Time

Offers do not remain open indefinitely. An offer ceases to be binding when the time the offer specifies expires or, absent a specific time, 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. For example, in an offer to sell perishable goods, the time the goods stay fresh is a key factor.

Once an offer is terminated, any attempted acceptance becomes a counteroffer, which the original offeror can either accept or reject.

Operation of Law

Any one of several events occurring before acceptance can terminate an outstanding offer by operation of law. "Operation of law" means that rules of law apply automatically to a situation without any act by the parties. For example, an offer is terminated if performing a contract becomes illegal after the offer is made. If a law is passed that makes it unlawful to sell certain goods, then a preexisting offer to sell those goods would be automatically terminated by the enactment of the law. Similarly, if the subject matter of an offer is destroyed before acceptance, the offer terminates at the time of destruction, even if the offeree does not know about the destruction.

Also, if an offeror or offeree dies or is formally declared insane before an offer is accepted, the law automatically terminates the offer. For example, Andre writes to Angela to offer to sell her his home. Andre dies before the letter reaches Angela. Andre's offer automatically terminates on his death.

Once a contract arises, death or insanity will not terminate it unless it involves the deceased or insane party's personal or professional service. A contract not involving personal or professional services is enforceable against the deceased party's estate.

Offeree's Rejection

The offeree's rejection of the offer terminates it. A rejection occurs when the offeree notifies the offeror of an intention not to accept. An offeree may reject an offer either by expressly refusing to accept it or by making a new offer to the offeror, called a counteroffer.

Like the offer, the offeree's rejection is not effective until communicated to the offeror. Once the rejection is communicated, the offeree cannot attempt to accept the offer. Any such attempt is considered a new offer.

Counteroffers

A **counteroffer** is not the same as a request for more information, and a request for information is not a rejection of the offer. For example, if Gene offers to sell Patrick a television set for $200 and Patrick says, "I'll give you $150 for it," Patrick's reply is a counteroffer. It automatically rejects Gene's original offer, and Patrick cannot later accept the original $200 offer. If Patrick had replied to Gene's offer by inquiring, "Will you accept $150?", his question is not a counteroffer or a rejection; it is an inquiry. If Gene had responded to the inquiry that $150 was unsatisfactory, Patrick could still accept the $200 offer.

Counteroffer

A proposal an offeree makes to an offeror that varies in some material way from the original offer, resulting in rejection of the original offer and constituting a new offer.

Counteroffers do not terminate an offer that includes a statement that the offer will remain open beyond any counteroffers. Similarly, an offer remains open if the offeree makes it clear that the counteroffer does not reject the original offer.

Offeror's Revocation

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, in this case to the offeree, and only when the offeree actually receives it. Similarly, if the offeror mails a revocation but the offeree accepts the offer by telephone before receiving the mailed revocation, a contract exists.

Offerors must revoke offers to the general public through the same means of communication they used in making the original offers. For example, one who has offered a reward in an advertisement can revoke it only through another advertisement. The revocation, once advertised, is effective even if someone who has not seen the revocation tries to accept the original offer.

The offeror's statement that the offer is irrevocable for a specific period is not usually sufficient to remove the right of revocation; generally, the offeror can revoke the offer anyway.

If, in a unilateral contract offer, the offeree has partially performed the acts requested by the offer, most courts hold that the offer is irrevocable. For example, Marie promises to pay John $2,000 if John excavates Marie's prop-

erty. John has completed one-third of the excavation when Marie attempts to revoke the offer. The revocation is ineffective. Most courts require a substantial performance, more than just preparation to make a revocation ineffective. Once a substantial start occurs, the offeree has reasonable time to perform the entire acceptance. Whether substantial performance has begun is a question of fact, not law, in a trial.

REQUIREMENTS OF A VALID ACCEPTANCE

A contract is a legally binding agreement. To be able to determine whether a contract in fact exists, it is necessary to determine whether one party's offer has been accepted in the required manner by the other party.

The first element of an enforceable contract is an agreement between the parties. The parties must mutually agree to the same terms. Establishing this agreement involves two steps:

1. The presentation of an offer by the offeror
2. An acceptance of that offer by the offeree

Acceptance

The assent to an offer that occurs when the party to whom an offer has been made either agrees to the proposal or does what has been proposed.

Understanding what constitutes a valid **acceptance** helps differentiate legally binding contracts from simple agreements.

To create an enforceable agreement, an acceptance must meet three requirements:

- The acceptance must be made by the offeree.
- The acceptance must be unconditional and unequivocal.
- The offeree must communicate the acceptance to the offeror by appropriate word or act.

Acceptance by Offeree

Only the offeree can accept an offer. The offeror has the right to choose with whom to contract. For example, if Dan dies after receiving an offer from Alan, the executor of Dan's estate cannot accept the offer. The offer's language and circumstances determine the identity of the offeree. For example, Janet promises to sell and deliver books to Lisa if Lisa's father promises to pay $100 for the books. Lisa's father is the offeree; therefore, only he can accept the offer by making the return promise.

An offer can be made to one person, to a group or class of people, or to the public. When made to a particular group, any member of the group can accept it. If an offer is made to the public, as in the case of a reward advertisement, anyone can accept it. Once someone accepts the offer, no one else can accept it.

An acceptance expresses the offeree's consent to the offer's terms. Use of the word "accept" is not necessary to bind the offeree; any language showing that

the offeree agrees to the proposal suffices as long as it meets all three requirements for a binding acceptance. See the exhibit "First Element of a Contract: Agreement."

First Element of a Contract: Agreement

1. Offer
   - Intent to contract
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Unconditional and Unequivocal Acceptance

Acceptance must be unconditional and unequivocal. If the acceptance deviates from the offer's terms, it becomes a counteroffer. An offeree must comply strictly with provisions in an offer regarding time, place, or manner of acceptance.

Acceptances sometimes contain wording that appears to be conditional but that is, in fact, not. For example, a real estate buyer's acceptance that states "Good title must be passed" is an unconditional acceptance. The law implies good title (legal ownership) in real estate transactions. Good title would pass regardless of whether the parties say so.

Some acceptances include wording such as "details will be worked out." Whether this constitutes unconditional acceptance depends on the details. If they are routine clerical matters, this constitutes unconditional acceptance. In contrast, a reply that leaves essential terms undefined, which a court could not determine and therefore could not deem to be implied, cannot be a valid acceptance. For example, an offer to build a house and a reply that accepts the offer "subject to details to be worked out" does not create a binding agreement because too many essential elements are missing.

In addition to being unconditional, an acceptance must be unequivocal, or clear rather than vague. An equivocal response is not an acceptance, a counteroffer, or an outright rejection. For example, an expression of hope, such as "I hope to have the cash for you next Friday morning," does not constitute an acceptance, but neither is it a counteroffer or a rejection.

Offeree's Communication of Acceptance

The offeree must communicate the acceptance to the offeror by appropriate word or act. If an offer specifies certain means of acceptance, the acceptance must comply. Otherwise, customary means used in similar transactions or those reasonable under the circumstances are permissible.

Some situations do not require formal acceptance. For example, if an offer to sell contains the words, "This proposal becomes a contract when an executive officer of the company accepts and approves it," the acceptance occurs when an executive indicates acceptance on the document by signing it. However, some courts still require the offeree to inform the offeror of an acceptance within a reasonable time.

A complaint does not negate an acceptance. For example, a contract results even if an offeree replies to an offer by writing, "Your price is unfair. If I didn't urgently need the property, I would never accept at this price. Enclosed is my check for the unreasonable amount you demand."

An offeree's silence is not an acceptance, and language in an offer cannot circumvent this rule. However, the parties' prior dealings may impose a duty to reject a current offer. For example, if the parties' custom has been for the seller to send goods and the buyer to pay for them later, the buyer receiving an unrequested and unwanted additional shipment would have to reject it. In this case, silence would indicate acceptance.

What the offeree must communicate depends on the type of contract offer. Most offers are bilateral in the sense that they contemplate a return promise from the offeree. When it is unclear whether the parties intended a unilateral or a bilateral contract, courts usually find that the intent of the offer was for a bilateral contract. For bilateral contracts, acceptance is not complete until the offeree gives the offeror the appropriate return promise. The offeror can revoke the offer at any time until the offeree communicates the return promise to the offeror or to the offeror's agent.

While the usual response to a bilateral contract offer is a return promise, the offeree can choose to perform the act requested instead. For example, Jill writes to Barry, "I'll pay you $1,000 if you'll promise to paint my garage by June 1." Barry does not reply to the letter but proceeds to paint Jill's garage, with her knowledge, and completes the work before June 1. A court would likely conclude that a bilateral contract resulted.

Forbearance

The act of giving up or the promise to give up a legal right.

Substantial performance

The performance of the primary, necessary terms of an agreement.

For unilateral contracts, the offeror seeks either performance or **forbearance** from the offeree. The offeree need not communicate acceptance because presumably the offeror will learn of the offeree's compliance. However, in some cases, an offer specifies that the offeree must give notice of performance.

Problems arise when the offeree begins to perform and the offeror revokes the offer before performance is completed. Most courts hold that an offeree's **substantial performance** suspends the offeror's right to revoke the offer. In

court, what constitutes substantial performance is a question of fact, not law. Generally, preparations for performance are not substantial performance. A unilateral contract offer includes the understanding that if substantial performance occurs, the offeree can complete performance within the prescribed time.

An acceptance in a manner invited by an offer is effective as soon as it leaves the offeree's possession. The acceptance is effective even if it never reaches the offeror, so long as the offeree has intended it to go directly to the offeror. However, if the offeree simply tells a third person about accepting the offer, the acceptance is ineffective.

If an offer specifies acceptance by return mail, it generally requires that the acceptance be mailed the same business day as receipt of the offer. If no time is specified, acceptance must occur within a reasonable time. Acceptance is effective when the letter is mailed and creates a legally binding contract when it leaves the offeree's possession.

This rule also applies to other communication services not under the offeree's control. A contract is created when an acceptance is delivered to a private messenger or faxed, for example. In all such cases, the offeree must accurately address the acceptance to the offeror. If an incorrectly addressed acceptance arrives at the wrong address, it is effective only when the offeror actually receives it. Courts have yet to establish clear rules governing an offeree's acceptance by e-mail.

An offeror can expressly state that an offer is conditional upon the receipt of the acceptance. For example, Amy mails an offer to lease land to Victor, stating, "Send me a yes or no answer. If I do not hear from you by noon on Wednesday, I will conclude that your answer is no." Victor mails an acceptance, but Amy does not receive the letter until after noon on Wednesday. Victor and Amy have not formed a contract because Amy did not receive the acceptance within the period she prescribed.

An offeree cannot withdraw or revoke an acceptance once made. That the offeree conceivably can reclaim a mailed acceptance from the post office does not prevent the acceptance from taking effect when sent.

CAPACITY TO CONTRACT

Some parties are considered incapable of entering into legally binding contracts. However, under certain circumstances there may be exceptions to this general rule. Because insurance policies are contracts, it is important for insurance professionals to understand the situations in which these exceptions arise.

Competent party
A party to a contract who has the basic or minimal ability to do something and the mental ability to understand problems and make decisions.

Only a **competent party** can enter into a legally binding contract. Parties who may lack capacity to contract include these:

- Minors
- Insane persons
- Intoxicated persons (under the influence of alcohol or drugs)
- Artificial entities (such as insurers) that are restricted by law or corporate charter from entering into certain contracts

Competent Parties

A valid offer and a valid acceptance form an agreement, but for that 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 who lacks legal capacity to contract is considered incompetent under the law. A party deemed competent to contract is one who has the mental ability to understand problems and make decisions. An incompetent person who enters a contract can challenge its validity by arguing that the agreement is a voidable contract. The term that describes a successful challenge of a contract is "avoiding" the contract.

Minors' Contracts

Each state has its own statute that sets the age of majority for contracts. The most common age of majority today is eighteen. The law protects minors from disposing of their property while they are underage.

Generally, minors can assert their minority as a defense against liability in contracts. Even if a minor misrepresents his or her age to induce another party to enter into a contract, the minor can avoid the contract. In this case, however, the other party can also avoid the contract, on the grounds of misrepresentation.

Although minors can avoid contracts during minority, they cannot confirm contracts during minority. A minor can avoid a contract by any expression of intent to renounce the agreement. In addition, any act inconsistent with the contract constitutes avoidance. For example, a minor who contracts to sell property to one person but sells it to another immediately after reaching the age of majority has effectively avoided the original contract. If a minor has not avoided a contract within a reasonable time after coming of age, most courts hold that the minor has ratified the contract. What constitutes a "reasonable time" is a decision for the court.

Restitution
The return of specific property by court order.

Most courts require a minor to make **restitution** of any benefits received before avoiding a contract. A minor cannot challenge a contract and at the

same time retain contract benefits. A minor who has purchased an item and then trades it for something else must return the same or a comparable item available upon rejecting the contract.

Unlike most contracts that minors enter into, a minor's contract to purchase necessaries is not voidable, and minors must fulfill their obligations under such contracts. A minor is liable only for the reasonable value of necessaries actually received—for example, the reasonable value of necessary clothing purchased. Necessaries include anything related to a minor's health, education, and comfort appropriate to the minor's standard of living. This exception to the general rule is intended to protect minors. If contracts for necessaries were easily voidable, people would be discouraged from entering into them. Consequently, minors whose parents are unwilling or unable to provide for them would have difficulty obtaining what they need. The exception may not apply to minors whose parents supply the necessities of life; contracts that those minors enter into for necessaries may be voidable.

The concept of necessaries usually does not apply to items used for business purposes. Courts have held minors not liable under contracts for fire insurance and life insurance because these contracts are not for necessaries. However, when a vehicle is one of a minor's necessaries, mandatory auto insurance could arguably be necessary for that minor.

Contracts involving minors are nonvoidable in several other circumstances. For example, if a minor has married, has assumed the obligation of a bail bond, or has the duty of child support, overriding public policy considerations require binding the minor to those commitments. Similarly, if a court has approved a contract for performance of services by a child, such as a child actor, the court will enforce the contract against the minor. In some jurisdictions, minors actively engaged in business pursuits are liable for contracts involving the conduct of those pursuits—for example, matters involving transferring stock, handling bank accounts, and obtaining loans for higher education.

A parent is generally not liable for a minor child's contracts. For a court to hold otherwise would permit indirect enforcement of a minor's agreement. For example, if a minor contracts to purchase a boat and a parent has not become a party to the agreement by signing or otherwise promising to assume the obligation, then the parent is not liable if the minor defaults. In contrast, a parent who has cosigned a minor child's contract is personally liable if the child fails to perform the contract obligations. The parent's liability is the same as that imposed on any other cosigner who assumes liability for another's default.

However, the law does impose liability on a parent for a minor child's contracts in several other situations. For example, the parent is liable if a child has acted on the parent's behalf in a transaction or if a parent has directed a child to sign a contract for the parent's benefit. Similarly, if a parent has neglected or refused to pay for necessaries for a child and the child contracts to purchase them, the contracting party can take legal action against the minor or the parent to recover the reasonable value of the necessaries.

Insane Persons' Contracts

Any agreement an insane person enters into is void. For purposes of contractual liability avoidance, the law recognizes two classes of insane people:

1. Those adjudged insane
2. Those who claim insanity or mental incompetence

A person can be adjudged, or formally declared, insane by a court. A court's adjudication is conclusive and voids any contract that person has entered into while insane, regardless of whether anyone challenges it.

Some people attempt to avoid liability under their contracts by claiming that they were insane or otherwise mentally incompetent at the time they entered into the contracts. Contracts of people who claim insanity, but whom courts have not adjudicated insane, are voidable; they remain in full force and effect until avoided by the parties claiming insanity.

To avoid a contract, a person claiming insanity but not adjudged insane must prove one of these conditions:

- The person did not know that a contract was forming.
- The person did not understand the legal consequences of acts purporting to form the contract.

That a party experiences delusions or intervals of insanity, or is eccentric, does not affect a contract in the absence of one of those two conditions. It is not necessary to show that a person is permanently insane, only that the individual was insane at the time of contract formation. Contracts made by mentally ill people during lucid intervals are binding. A person confined to or receiving treatment in a mental institution could be competent to contract, if neither adjudged insane nor meeting one of the two conditions.

Only the incompetent or insane party has the power to avoid a contract. If the insane person has a guardian, then the guardian can avoid the contract. An insane party who has regained competency can affirm a previously made contract. An insane party who has avoided a contract must make full restitution if the other party acted in good faith and was unaware of the insanity.

Insane persons' liability for contracts for necessaries is the same kind of liability as that for minors. To determine what constitutes necessaries, courts examine the individual's station in life, including the need for nursing and medical attention. For example, if the person is institutionalized, legal services to obtain release from custody can be necessary.

If an agreement benefits an insane person and the other party is unaware of the infirmity, the insane person cannot avoid the contract. The party to a contract with an insane person can enforce the contract by proving these facts:

- The sane party lacked knowledge of the insanity.
- The contract benefits the insane person.

For example, an insane person contracts to have her house painted. The other party, who does not know about the insanity, paints the house. The painter has a right to compensation for those services, and the insane person cannot disaffirm the contract. However, if the contracting party knew or should have known of the person's insanity at the time the parties created the contract, the insane person is not liable if the contract has not yet been performed (executory). In such a case, a court will try to achieve fairness for both parties.

Intoxicated Persons' Contracts

Generally, a person who was intoxicated, by use of either alcohol or drugs, when entering a contract cannot avoid the contract. The law usually does not protect people from their own follies. Case law has tempered this rule, however, and exceptions have developed making contracts voidable if the person's judgment was impaired, using the same conditions applied to cases of insanity:

- The person did not know that a contract was forming.
- The person did not understand the legal consequences of acts purporting to form the contract.

Additionally, if one party to a contract has purposely caused the other party to become intoxicated to obtain an unfair advantage, the innocent party can avoid the contract.

In most states, courts can adjudge people as habitual drunkards, just as they can adjudge them insane. Adjudication is a matter of public record and serves as notice to the public that contracts such a person attempts to make are void. In such cases, the other party to the transaction cannot claim lack of knowledge of the party's condition. Conversely, if a contracting party has no knowledge of the other party's intoxication, the contract may be enforceable.

A person whose judgment was impaired because of intoxication when entering into a contract can either avoid or ratify the contract upon becoming sober. However, the other party can claim lack of knowledge of the person's condition to avoid the contract. The party who avoids a contract cannot later retract the avoidance and must return any items of value received.

Artificial Entities' Contracts

Corporations, although artificial creations of the state, are people in the eyes of the law. They can hold property, sue and be sued, commit crimes and torts, and enter into contracts. The extent of a corporation's competence to enter into contracts depends on the scope of the power its charter grants.

Most states permit corporations to engage in any lawful business and do not restrict the types of contracts they can make. However, specially licensed and controlled corporations, such as those in insurance, banking, and transportation, are subject to different restrictions.

Traditionally, an attempted contract that was not within corporate powers was voidable as an *ultra vires* contract, meaning a contract "beyond its power." Either party could avoid such a contract while it was fully executory (still unperformed). If either party had performed its part of the contract, however, the other party must perform. As for a fully executed contract, neither party could avoid the agreement even though an *ultra vires* act was involved. Most states have abolished the defense of *ultra vires*, but courts often use the term when discussing corporate concepts in written decisions.

CONSIDERATION

One element of an enforceable contract, in addition to agreement and capacity to contract, is consideration. Not all types of consideration, however, are sufficient to form a legally binding contract. To determine whether a binding contract exists, an insurance professional must be able to correctly evaluate the consideration associated with the agreement.

Consideration
Something of value or bargained for and exchanged by the parties to a contract.

For the element of **consideration** to be sufficient to create a valid contract, the promisor must receive a legal benefit, such as money, or the promisee must suffer a legal detriment, such as inconvenience, loss, or relinquishment of something of value. The consideration necessary to make a promise enforceable can be one of the following:

- A return promise
- An act performed
- A forbearance from acting

Types of Consideration

Five types of consideration are sufficient to form an enforceable contract:

- Valuable consideration
- Forbearance
- Present consideration
- Future consideration
- Binding promises

Each type of consideration has its own set of legal rules.

Good consideration
Consideration based on natural love or affection, or on moral duty, that is not sufficient to support a contract.

Valuable consideration
The consideration necessary and sufficient to support a valid contract.

Valuable Consideration

The law distinguishes between two types of consideration: **good consideration** and **valuable consideration**. For example, a father signs this written promise: "For and in consideration of the love and affection I have for my daughter, I will transfer my property to her on November 1." This expression of love and affection is good consideration but not the valuable consideration that can

create an enforceable contract. The father's promise is merely a **gratuitous promise.**

Gratuitous promise
A promise not supported by valuable consideration and, therefore, not binding.

Courts generally do not inquire into the adequacy of valuable consideration. Attempts to weigh the fairness of the numerous bargains in business would result in excessive litigation. Courts are not concerned if people are willing to pay $50 for a $20 item.

In some situations, courts do review the value of consideration. For example, a court could find an agreement unconscionable if a large seller charged an excessively high price to a small buyer that had no alternative but to deal with the seller. See the exhibit "Adequacy of Consideration."

Adequacy of Consideration

Mike has written a book and has given it to Bridget to read. Bridget, thinking the book is publishable, offers Mike $10,000 for the manuscript. Mike accepts the offer. Before paying Mike, Bridget attempts to find a publisher but is unsuccessful. Mike sues for the $10,000, and Bridget defends on the basis that she received no consideration because the manuscript was not worth $10,000. A court would rule Bridget's defense invalid because adequacy of the consideration is not an issue. The manuscript was sufficient consideration; that it proved unpublishable is immaterial. Bridget must pay the $10,000.

[DA06287]

Forbearance

Forbearance is sufficient consideration to support a contract and is commonly seen in cases of compromise. For example, a person injured in an automobile accident may have a right to sue for damages. A promise to refrain from suing in return for the other party's promise to pay a sum of money constitutes valuable consideration. However, if the injured person has no cause of action, then a promise to forbear from suing is not valid consideration because it surrenders no right.

Forbearance can be valuable consideration even if it benefits the forbearing party. For example, if a grandfather promised to give $5,000 to his sixteen-year-old granddaughter if she would refrain from smoking, drinking, or gambling until age twenty-one, a court might hold the granddaughter's forbearance sufficient consideration to enforce the promise.

Present and Future Consideration

To constitute valuable consideration, an act or a promise must involve a present or a future commitment. Many state courts and legislatures have created exceptions to this rule. Most jurisdictions enforce a new promise to pay an

existing obligation that has become unenforceable for one of the following three reasons:

- One of the parties is a minor.
- The promisor is bankrupt.
- The time for payment has ended.

Although no new consideration supports the new promise, some courts hold that the new promise couples itself to the preexisting debt, and that, therefore, valuable consideration supports the promise. Other courts find renewal promises enforceable because of a preexisting moral obligation sufficient to support the new promise.

To illustrate: When she was seventeen, Francine promised to buy a car from Joy for $200. Francine's promise was unenforceable because she was a minor. Upon reaching eighteen, the age of majority, and having paid none of the purchase price, Francine promises to pay $100 for the car. Although Joy could have disaffirmed the contract entirely and therefore owed no duty of performance (delivery of the car), Francine's new promise to pay $100 is enforceable. However, Joy cannot legally collect the $200 Francine promised initially as a minor.

A new promise to pay a debt previously unpaid due to bankruptcy is enforceable without any additional consideration. The promisor must clearly express the promise to pay, and some states require renewal promises to be in writing. A mere acknowledgment of the debt or partial payment, without an express promise to pay all or part of the preexisting obligation, is not sufficient to create a binding renewal promise to pay. A new promise to pay a debt barred by a statute of limitations is also enforceable.

Binding Promise

To be a valid consideration, a promise must be binding. For example, one party's promise to pay for any work it might request of another party is not binding because the promisor might ask for no work. A promisor who requests work can be bound to pay for it, but the promisee cannot claim that the promisor is legally obligated to request any work.

Courts generally use a different approach for requirements contracts and output contracts. For example, a promisor's agreement to buy from the promisee all the coal the promisor requires during a specified period is a binding promise. Similarly, a company's promise to sell all the coal it produces, or outputs, to a particular promisee is a binding promise.

In each case, the question is whether any requirements or outputs are involved. If some level of previous output has been furnished or expected requirement fulfilled between the parties, then the promise to continue meeting those requirements or providing the output is sufficient consideration. If the promisor does not anticipate any need for coal, then the promise is illusory and is not consideration. See the exhibit "Consideration in Insurance Contracts."

Consideration in Insurance Contracts

The insurance contract, like any other contract, requires valuable consideration. The insurer's consideration is its promise to indemnify or pay on behalf of an insured for loss resulting from a covered occurrence. The insured's consideration is the premium payment or the promise of premium payment.

An insured's obligation to pay a property-casualty insurance premium differs from the obligation to pay a life insurance premium. In property-casualty insurance, prepaying the premium is not a condition necessary to make the contract valid. In life insurance, the application or the policy itself usually provides that the insurance will not take effect until the purchaser pays the first full premium.

In property-casualty insurance, if an insured suffers a loss before paying a premium at the outset of a policy period, an insurer cannot refuse to pay based on lack of consideration. Payment of the entire premium becomes an obligation as soon as the coverage begins. However, parties can agree, for example, that the insured will pay the premium for an annual policy on a monthly basis. Even so, the premium is generally due and payable at the beginning of the agreed-on period. Any premium owed becomes the insured's debt. Canceling the policy during the coverage period requires an appropriate adjustment for collecting earned premium or refunding unearned premium.

In life insurance, the policyholder has no duty to pay premiums after payment of the first premium, but nonpayment of premiums can result in forfeiture of policy rights. The insurer may have the right to avoid the life insurance policy. If the policyholder has paid premiums for a number of years, the insurer might have to return any accumulated cash values to the insured at policy termination.

[DA06288]

What Is Not Valid Consideration?

Three types of consideration are insufficient for forming a binding contract:

- Past consideration
- Promises to perform existing obligations
- Compromise and release of claims

Past Consideration

Past consideration is insufficient to support a contract. For example, if a person mows a lawn without the property owner's knowledge, the owner's subsequent promise to pay for the work is not enforceable. Similarly, if a person finds a wallet and returns it to its owner, who then promises to pay a reward, the consideration exchanged for the owner's promise (the return of the lost wallet) represents a past consideration and is not sufficient to create an enforceable agreement.

Promise to Perform an Existing Obligation

A promise to perform an act that the promisor is already legally required to perform is not consideration. For example, a police officer's promise to the public to arrest a criminal is not enforceable because the arrest is the officer's job. However, if someone offers a firefighter a reward to enter a burning building to retrieve property at great risk, and beyond the firefighter's duty, that performance supports a claim for the reward.

Compromise and Release of Claims

Generally, partial payment of money owed is insufficient consideration to discharge an original obligation. When a debtor owes $100 and promises to pay $50 if the creditor will accept that amount as full payment, the promise is not binding. However, in some situations a promise to accept less than the amount of the original debt can be binding:

- In *bona fide*, or good faith, disputes about the amounts of money owed, the parties believe that their claims are just. Many such claims involve damage to property or injury to people. Each party's promise to surrender a claim for the amount in question is sufficient consideration for the return promise.
- A debtor may pay an amount less than a debt's total before the debt is due. If the creditor has led the debtor to believe that an early payment would discharge the entire obligation, then the promise to accept the lesser amount is binding on the creditor.

Accord and satisfaction

An agreement (accord) to substitute performance other than that required in a contract and the carrying out of that agreement (satisfaction).

- **Accord and satisfaction** allows for payment of less than the original debt. For example, if the debtor makes partial payment and also offers additional consideration in some form other than money, the creditor's agreement to accept is binding.
- One debtor may have many creditors. When several creditors join and each agrees to take a certain percentage of the original obligation owed, they form a composition of creditors. The resulting composition agreement is binding on the assenting creditors and completely extinguishes the original debt. Each creditor's agreement to accept a percentage of the full debt is sufficient consideration for the other creditors' same promise.

Exceptions to the Consideration Requirement

In some cases, contracts are enforceable despite the lack of consideration. These promises are enforceable for equitable or public policy reasons or because state laws make specific exceptions. For example, contracts without consideration are enforceable when one of these concepts or exceptions applies:

- Promissory estoppel
- Charitable subscriptions

Promissory Estoppel

Promises to make gifts, called gratuitous promises, do not involve payment and are therefore generally unenforceable. Inequities resulting from application of this rule led courts to develop the concept of **promissory estoppel**. The principle applies when the following three elements are proven:

Promissory estoppel

A legal principle that permits enforcement of a promise made without consideration in order to prevent injustice.

- A party has made a promise expecting another party to act, or to forbear from acting, in reliance on that promise.
- The other party has justifiably relied on the promise to his or her detriment and acts or forbears from acting.
- Only enforcement of the promise would achieve justice.

Promissory estoppel involves questions of fact to be determined by a judge or jury. Generally, evidence that the plaintiff will suffer substantial economic damage if the promise is not enforced is necessary for a court to enforce the promise. Under the doctrine of promissory estoppel, a court seeks to grant whatever remedy is necessary to prevent injustice.

For example, Nancy promised to employ Barry for an indefinite term. Barry, who lived a thousand miles away, incurred considerable expense to move closer to Nancy's company because of her promise. When Barry arrived at Nancy's office to accept the job, Nancy reneged on her promise. Barry can sue Nancy for damages even though he provided no valuable consideration in exchange for Nancy's promise.

Charitable Subscriptions

When a person makes a subscription or otherwise pledges money to a charitable organization that depends on voluntary contributions, the obligation involves more than a gratuitous promise to make a gift. The commitment is as fully binding on the pledging party as if consideration had supported it. In this situation, some courts apply the doctrine of promissory estoppel on the basis that the organization has relied on the pledge to its detriment by undertaking projects the pledge would support and that injustice would result if the promise were not enforced. However, in practice, many pledge solicitations include statements that the pledge is not legally binding.

LEGAL PURPOSE OF A CONTRACT

An agreement between competent parties, supported by consideration, requires a final element to be an enforceable contract. It must have a legal purpose. To determine whether a contract is legally binding, one must understand what types of contracts are illegal.

A contract is illegal when either its formation or its performance is a crime or a tort. Ordinarily, an illegal contract is void. Consequently, the parties to an illegal contract can neither recover damages for breach of contract nor seek recovery for the value of any partial performance they have made. Although

this rule can result in a wrongdoer's unjust enrichment, it deters parties from entering into illegal contracts.

Several exceptions apply to the legal purpose requirement based on overriding considerations of equity or public policy.

Types of Illegal Contracts

Contracts may be illegal either because they are contrary to constitutional, statutory, or case law or because they are against public policy. An agreement that is illegal at the outset does not become enforceable by a subsequent change in the law that makes similar agreements legal. Conversely, if a contract is legal at the outset but later becomes illegal as the result of a statute or court decision, the parties need not perform further. In this situation, referred to as supervening illegality, the parties could recover the value of performance while the contract was still legal. No recovery is available for acts the parties perform after the declaration of illegality.

Illegal contracts fall into nine categories:

- Contracts to commit crimes or torts
- Contracts harmful to the public interest
- Usury contracts
- Wagering contracts
- Contracts with unlicensed practitioners
- Contracts to transfer liability for negligence
- Contracts in restraint of marriage
- Contracts in restraint of trade
- Unconscionable bargains

Contracts to Commit Crimes or Torts

Any agreement under which one party consents to commit a crime or another wrongful act (tort) is illegal and therefore is a void contract. For example, contracts to cause another's injury or death, to induce a breach of contract, or to violate a patent right or copyright are illegal, unenforceable agreements.

Like all contracts, insurance contracts must involve legal subject matter. Insurance coverage of illegally owned or possessed goods is invalid. For example, a property insurance policy covering illegal drugs or illegal weapons is void and unenforceable. However, if the insurance is only incidental to an illegal purpose, then the contract is enforceable. For example, a property insurance policy on a building housing illegal gambling or prostitution is still enforceable because the coverage is on the building, not the activity. However, business interruption insurance on an illegal gambling activity or a house of prostitution would be void and unenforceable.

A legal insurance contract can become unenforceable because of the insured's wrongful conduct. For example, if an insured intentionally burns down his house, the insurance policy on the property does not permit recovery. The insured's illegal act precludes any right to insurance proceeds. In many states, if the insured sues for payment, the insurer must establish by a preponderance of evidence that the insured committed arson. Some states apply a fraud standard to arson, requiring the insurer to prove arson by clear and convincing evidence. A criminal conviction of arson is not necessary. In fact, an acquittal on the criminal charge does not preclude a civil lawsuit based on intentional damage for insurance proceeds. Although the insured who caused the damage could not recover, a majority of states allow an innocent insured spouse to receive a fair share of the insurance proceeds.

Similar issues apply in life insurance. When the beneficiary has caused the insured's death, courts in many states limit the conditions under which the beneficiary can recover policy proceeds. Generally, a beneficiary who has willfully caused or contributed to the death cannot recover, and any proceeds go to the deceased insured's estate or to a secondary beneficiary. In most states, a beneficiary who has accidentally caused an insured's death does not forfeit life insurance proceeds. A beneficiary who has killed an insured in self-defense or when insane also can recover benefits.

If a beneficiary obtained a life insurance policy with the intent to kill the insured for the proceeds and does in fact kill the insured, the insurer can avoid payment. Both the beneficiary's illegal intent and fraudulent concealment are bases for avoidance of the contract, and the policy is entirely void with no benefits payable to anyone.

Contracts Harmful to the Public Interest

Courts have found agreements illegal because they harm the public interest. One example is an agreement to buy or sell a public office. Similarly, agreements to procure government contracts illegally and agreements to contribute amounts exceeding legal limits to political campaigns are contrary to public policy and therefore void.

Agreements to interfere with or obstruct legal processes are also illegal. For example, agreements to bribe witnesses or to suppress evidence impede the administration of justice and are against the public interest. Likewise, agreements that stir up unnecessary litigation are illegal and unenforceable.

Insurable interest

An interest in the subject of an insurance policy that is not unduly remote and that would cause the interested party to suffer financial loss if an insured event occurred.

In insurance contracts, public policy requires that the insured have an **insurable interest** in any property or life to be covered by the policy. Policies not covering an insurable interest are illegal and void. They are considered wagering contracts because they gamble on others' lives or property. Such contracts increase the likelihood of intentional harm or destruction.

In property-casualty insurance, the insurable interest must exist at the time the loss occurs. The insurable interest in a life must exist at the time the applicant obtains insurance coverage. People can purchase life insurance on

their own lives. They have an insurable interest in another's life only if they receive economic benefit from the relationship with the covered person. Relationship by blood or marriage is generally sufficient.

Usury Contracts

Laws in each state limit the amount of interest that lenders may charge for loans. Any contract allowing a lender more than the maximum legal interest is a **usury** contract and is illegal. In most states, a lender that has charged an illegal rate is barred from collecting interest on the loan but can still recover the principal amount loaned. Other states permit recovering interest up to the maximum legal rate.

Usury
The charging of an illegally high rate of interest on a loan.

Wagering Contracts

Wagering (gambling) contracts are contracts entirely for sport, and their performance depends on the occurrence of an uncertain event. A bet placed on the outcome of a sporting event is an example of a wager. Most states have statutes making wagering contracts illegal.

Determining whether a contract involves wagering is difficult in some situations. Futures contracts in the commodity markets are an example. Under these contracts, a seller promises to sell goods, usually agricultural products, that he or she does not currently own. Futures contracts generally include hedging transactions, making simultaneous contracts to purchase and sell particular commodities at a future date. The intention is that a gain on one transaction will offset a loss on another transaction. These contracts protect against market price fluctuation and are not considered wagering contracts because they protect legitimate business profits.

Contracts With Unlicensed Practitioners

State statutes require people engaged in particular trades or occupations to have licenses. These laws are designed to protect the public against unqualified and incompetent people performing specialized services. Licensees must meet minimum levels of competence established by the state. Most states require lawyers, doctors, dentists, pharmacists, barbers, insurance producers, and architects to have licenses.

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. The licensing laws that apply are those in place in the state in which services are performed. For example, a surveyor licensed in one state cannot sue to recover a fee for work performed under contract in another state because the license does not extend to other states.

Contracts to Transfer Liability for Negligence

Another type of illegal contract involves the attempt to relieve a party of its own **negligence**. Courts narrowly interpret **exculpatory clauses** against the parties attempting to limit their liability. Courts often declare exculpatory clauses illegal because they are contrary to public policy, especially when the other party is at a bargaining disadvantage. An example of an exculpatory clause is a term in a residential lease excusing the owner from liability if the building burns down because of the owner's negligence. In most situations, courts would not enforce such a clause.

Negligence

The failure to exercise the degree of care that a reasonable person in a similar situation would exercise to avoid harming others.

Exculpatory clause (exculpatory agreement)

A contractual provision purporting to excuse a party from liability resulting from negligence or an otherwise wrongful act.

Common carriers, such as trains, airplanes, and buses, attempt to restrict their liability for negligence, as do certain public utilities and other monopolies. Such limits are prohibited unless permitted by statute, administrative agency ruling, or international agreement. The lack of equality of bargaining power between a large and powerful entity and the relatively powerless consumer is an important consideration in determining the legality of limits to liability. See the exhibit "Liability Transfer in Bailments."

Liability Transfer in Bailments

When the owner of personal property (bailor) temporarily gives that property to another person (bailee), the transaction is a bailment. For example, a customer (bailor) entrusting car keys to a parking attendant (bailee) or a coat to a checkroom attendant are bailments.

Bailees' attempts to disclaim liability for negligence raise illegal contract issues. The bailee of the goods generally has a duty to exercise reasonable care under all circumstances. Many bailees attempt to limit their liability for negligence in such places as parking lots or coat checkrooms by placing notices disclaiming liability for lost or damaged property on the receipts for the goods. Some courts hold these clauses to be illegal because the limitations could encourage all bailees to attempt to restrict liability, a result contrary to public policy.

[DA06326]

Contracts in Restraint of Marriage

Contracts restraining the freedom to marry are contrary to public policy and therefore illegal. Examples include these:

- Contracts between two persons to bring about or prevent the marriage of a third person
- Marriage brokerage contracts restraining the freedom of choice in entering into marriage

Restraints on marriage incidental to another legitimate purpose may be valid under some circumstances. People who promise not to marry until age twenty-one can enforce such contracts against parties who have promised to pay them to delay marriage. However, contracts not to marry that have no time limits are unenforceable.

Contracts in Restraint of Trade

Under statutory and common law, contracts that unreasonably restrain trade or stifle competition are illegal and void. Reasonable limits on trade or competition in contracts are legal if they impose no undue hardship on the restricted party and only if they are necessary to protect the parties. Restraint of trade issues often arise in the sale of businesses and in employment contracts.

Often in the sale of a business, a contract provision requires the seller to refrain from opening a new business within a certain distance and time to compete with the buyer. Whether such a restriction is legal depends on its extent. If the restriction bars the seller from ever again competing in the same business or in a particular area, the restriction is unreasonable and invalid. If the restriction prohibits the seller from competing with the buyer for one year and within two miles from the business sold, the restriction is probably enforceable. Similarly, **noncompete agreements** are generally enforceable if the restriction is necessary to protect the employer and is reasonable regarding the time and distance constraints on the employee.

Noncompete agreement

An agreement between an employer (the principal) and an employee (the agent) to protect the employer's customers, trade secrets, confidential information, and other items for a specific period after an employee relationship has been terminated.

Courts generally look more favorably on contracts not to compete that relate to the sale of a business than on those that apply to employment. Businesses generally have greater bargaining power than individuals in employment situations.

Unconscionable Bargains

Courts would not enforce contracts containing provisions so harsh and unfair that they cause undue suffering to the party resisting performance. Some state laws incorporate this common-law approach for sales contracts by permitting courts to refuse to enforce, or limit the application of, a contract or clause found to be unconscionable when created. For example, a contract provision that requires the seller to provide goods for free if the goods are delivered after a specified date could be considered unconscionable. Courts can revise such sales contracts to include more reasonable terms.

Exceptions to the Legal Purpose Requirement

A contract that might be illegal can still be totally or partially enforceable under three types of conditions, each involving overriding considerations of equity or public policy:

- When a specific group is protected by law, an illegal contract might be enforceable. For example, when a corporation issues a type of stock that it is prohibited by law from issuing, the stock's purchaser can sue to recover money paid under the illegal transaction. Similarly, an insurer that issues an illegal policy cannot use its own wrongdoing to defend itself in an insured's lawsuit to collect policy proceeds. The policy's illegal nature does

not prevent someone from asserting the right to protection under the policy.

- In the case of **in pari delicto agreements**, if both parties are equally at fault, the contract is not enforceable. However, if the parties bear a significantly unequal degree of fault, an illegal contract might be enforceable against the party at greater fault. Courts apply the concept of *in pari delicto* only in cases involving a clear disparity of fault between the contracting parties.

In pari delicto agreement
An illegal transaction in which both parties are equally at fault.

- In a **severable contract**, failure to perform one promise does not necessarily put the promisor in breach of the entire contract. When contracts contain both legal and illegal provisions, courts can enforce the legal parts. Enforcement is at the court's discretion and occurs only in cases in which the legal and illegal parts are readily separable. If the illegal provisions have tainted the entire transaction, a court can void the contract entirely.

Severable contract
A contract that includes two or more promises, each of which a court can enforce separately.

Courts will not enforce illegal contracts, and they do not aid a party who has knowingly entered an illegal contract to recover any loss. However, some courts permit a party to repent before the completion of an illegal contract and to obtain return of any consideration paid. A person electing to repent an illegal act before consummating it can recover any money or goods transferred under the contract—but only if repentance occurs before the contract is performed.

ENFORCEABILITY OF A CONTRACT

An agreement based on offer and acceptance, contractual capacity of the parties to the agreement, consideration, and a legal purpose can still be unenforceable. Ascertaining whether both parties actually intended to enter willingly into a contract is essential to determining whether that contract is enforceable.

Genuine assent in a contract is the demonstration that the parties have actually intended to form a legally binding agreement, breach of which has legal consequences. An innocent party who has not given genuine assent can generally avoid the contract.

Genuine assent
Contracting parties' actual assent to form a contract or their indication of intent to contract by their actions and words.

Genuine Assent

An apparently valid contract may be unenforceable if either party has not given genuine assent to contract. Genuine assent may be lacking if a party was induced to enter a contract by any of five factors:

- Fraud
- Mistake
- Duress

- Undue influence
- Innocent misrepresentation

In these five situations, courts do not uphold the contracts and sometimes award monetary damages to the wronged parties.

Fraud

Fraud

An intentional misrepresentation resulting in harm to a person or an organization.

Fraud by one party to a contract can result in a lack of genuine assent on the part of the other party. Fraud is a tort, and it can also be a crime. When one party to a contract has committed fraud, the contract is voidable and the innocent party may choose to repudiate it.

In a lawsuit alleging fraud, the plaintiff must prove six elements. Courts will generally rescind a contract if the first five elements of fraud are proven. In a suit for damages, the plaintiff must also prove the sixth. The legal definition of fraud is divided into these six elements:

Representation

A statement of fact or opinion made by the insured when applying for insurance, usually in response to a question from the insurer.

Material fact

In insurance, a fact that would affect the insurer's decision to provide or maintain insurance or to settle a claim.

- a false **representation**
- of a **material fact**
- knowingly made
- with intent to deceive
- on which the other party has placed justifiable reliance
- to his or her detriment.

If fraud is proved, the plaintiff can seek one of two remedies:

Rescission

A legal action that voids a principal's bid.

- 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. The plaintiff also must return anything of value received under the contract. The court attempts to put the parties back to the condition they were in before they entered the contract.
- If rescission would not make the plaintiff whole, the plaintiff can sue for damages in a tort action, usually called an action in deceit. The plaintiff can seek compensatory damages for quantifiable harm and punitive damages to punish the defendant and deter future, similar fraudulent actions. The plaintiff must prove the extent of the loss or detriment.

In insurance contracts, each party is expected to deal with the other party in the utmost good faith. However, in some cases, applicants for insurance misrepresent or conceal material facts. See the exhibit "Fraud in Insurance Contracts."

Mistake

Mistake

A perception that does not agree with the facts.

Like fraud, a **mistake** in a contract can also result in lack of genuine assent. People can make mistakes regarding the facts of a transaction or the law affecting an agreement. Mistakes can involve errors in typing, in arithmetic,

or in the value of property in question. While some mistakes do not affect the parties' rights, others make the agreement voidable or unenforceable. Mistakes can be either **unilateral mistakes** or **bilateral mistakes**.

Bilateral mistake

A perception by both parties to a contract that does not agree with the facts.

Unilateral mistake

A perception by one party to a contract that does not agree with the facts.

Fraud in Insurance Contracts

A person fraudulently induced to make or sign an insurance application can rescind the contract and recover any premium paid. The insurer also has the right to cancel an insurance policy because of fraud by the insured. Any fraudulent action or statement by the insured in procuring the policy, if material, permits the insurer to avoid it.

In cases of alleged fraud, the concealment defense is very important in both property and life insurance. The insurer relies on the applicant's full disclosure to determine acceptability, appropriate coverage, and premium. Most courts impose a duty on the insured to reveal material facts to the insurer. The insured's failure to do so can constitute concealment. For example, an applicant who knows that the property to be insured is subject to an unusual hazard must reveal that information to the insurer. Failure to do so could constitute concealment and avoid the policy.

Fraudulent concealment is generally a question of fact to be determined by a jury. 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.

Courts find intent to defraud only when the facts are clearly and obviously material. They agree that any fact that is the subject of a specific inquiry by the insurer is generally material. An exception to this would be a question on an insurance application that concerns a possibility of loss not covered by the policy applied for.

Standard insurance applications may not include questions about all possible loss exposures. When the insured is aware of an unusual loss exposure not addressed in the application, the test of materiality is whether the information would influence the insurer's decision to enter into the contract. In this case, courts use the reasonable person standard to determine materiality.

Courts have also considered whether previous losses or claims must be disclosed in the absence of a specific question about loss history on an insurance application. Courts have found that such information is not material and have affirmed insurance policies, even when insureds have failed to reveal prior claims.

Most courts agree that an insurance applicant must be reasonably diligent in notifying the insurer of material facts that come to the applicant's knowledge after applying and up to the time the contract becomes effective. The effective date of policy inception, therefore, is crucial.

[DA06349]

A unilateral mistake ordinarily does not affect a contract. For example, if an offeree accepts an offer that was mistakenly transmitted, a contract is formed because only the offeror was mistaken. However, courts do not permit one party to knowingly exploit another's mistake. For example, if a contract bid is

so low that it is obvious that a clerical or mathematical mistake has occurred, the offeree cannot take advantage of the error by accepting the offer.

In certain situations in construction bids, parties can avoid a contract because of a unilateral mistake of fact. A contractor who has made a material mistake in a bid on a public works project can retract the bid if both of these events occur:

- The contractor makes the retraction promptly after discovery.
- The governmental agency involved has done nothing more in reliance on the bid than accept it.

Ordinarily, however, one party's mistake of fact does not affect the other party's rights.

Bilateral mistakes occur when both parties to a contract make the same mistake of fact. Under these conditions, contracts are generally voidable. The mutual mistake must relate to a material fact. Mistakes about collateral considerations, not crucial to the contract, are not grounds for avoidance.

Bilateral mistakes about the subject matter's value do not make a contract voidable. For example, if parties contract for the sale of a jewel, neither knowing the jewel's true value nor making value a condition of their contract, they cannot avoid the contract if the jewel has a different value than either party or both parties anticipated. Courts do not remake such bargains. However, if the mistake is about the jewel's identity, the parties can rescind the contract. For example, parties might mistake a relatively inexpensive cubic zirconium for a diamond. See the exhibit "Mistakes in Insurance Contracts."

Duress

Duress
The use of restraint, violence, or threats of violence to compel a party to act contrary to his or her wishes or interests.

A party who enters a contract under **duress** may not have given genuine assent. The question is whether the wrongdoer deprived the plaintiff of free will in entering the agreement. The court considers the victim's physical health, mentality, experience, education, and intelligence.

Threats of bodily harm to a person or to his or her close relatives constitute sufficient duress to justify contract avoidance. Similarly, a threat to burn down a person's home or to destroy other valuable property belonging to a person constitutes duress. A threat to prosecute someone for a crime also constitutes duress, as could threat of eviction or of damage to one's credit standing.

A court might find duress if one party would suffer irreparable loss under the contract. However, the threat of economic loss or the threat of a civil lawsuit is not generally sufficient to deprive a reasonable person of free will. Similarly, the threat to cease doing business with a person does not constitute duress sufficient to avoid a contract. A threat to withhold payment for work already done unless additional work is performed free of charge is not duress. In such cases, the fear of force imposed on the person is not sufficient to avoid the contract.

Mistakes in Insurance Contracts

Of the thousands of insurance policies issued each year, a considerable number contain mistakes. The correction of mistakes over one party's protest can create legal problems. The law does not correct mistakes in judgment or relieve a party of the unforeseen consequences of an act. However, courts do correct errors in expression by interpreting ambiguous policy language or reforming the contract. Court interpretation and reformation are two remedies for mistakenly worded insurance policies.

When interpreting an ambiguity or incorrect description in an insurance policy, courts focus on the parties' intent when entering the contract. The court's ability to interpret the policy is limited to some extent by the restrictions of the parol evidence rule, which prohibits the use of oral evidence to show that the contract terms were different from those in the written policy. However, several exceptions apply to the parol evidence rule.

Courts grant the remedy of reformation only on proof of mutual mistake or of unilateral mistake of which one side was aware. For example, if both the applicant and the insurance producer understood when entering a contract that particular coverage applies but that coverage is not included in the policy, the court can reform the policy in keeping with the contract.

Mistakes of law, whether unilateral or bilateral, do not affect the binding nature of a contract, particularly when the law is not clear. Court decisions can change the law after parties form a contract. For example, both parties to an insurance contract mistakenly believe that property insurance obtained in an individual partner's name protects the partnership's interest in the property. After a loss occurrence, the court could correct the policy to cover the partnership's interest, even though the belief was a mistake of law.

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Undue Influence

Undue influence

The improper use of power or trust to deprive a person of free will and substitute another's objective, resulting in lack of genuine assent to a contract.

Undue influence can also result in lack of genuine assent to a contract. Undue influence can occur in relationships such as parent and child, nurse and invalid, attorney and client, doctor and patient, and guardian and ward. In contracts between such individuals, the law will assist the victim of undue influence.

Most cases of undue influence concern gifts and wills made by people, often recently bereaved spouses who may be temporarily infirm or elderly persons suffering from physical ailments or dementia.

Innocent Misrepresentation

A person who has reasonably relied on an innocently misrepresented material fact can later avoid a resulting contract because of lack of genuine assent. Even when no intent to defraud exists, the materiality and reasonable reliance elements of fraud also apply to misrepresentation. Misrepresentation is easier to prove than fraud because the plaintiff need not prove intent to deceive. The victim of an innocent misrepresentation asks a court to rescind the contract. Courts do not award monetary damages for innocent misrepresentation.

Statute of Frauds and Parol Evidence Rule

Forms of contracts, as well as rules for interpretation, breach, and discharge of contracts, are determined by the common law, state or federal statutes, court interpretations, and the Uniform Commercial Code (UCC). Statutes of frauds also have significant effects on contracts, and they may permit parol (oral) evidence if needed to interpret a written contract.

Statute of Frauds

Statute of frauds

A law to prevent fraud and perjury by requiring that certain contracts be in writing and contain the signature of the party responsible for performing that contract.

Early common law enforced oral contracts if the parties could establish their terms in court. Even today, most contracts are oral and, if provable, are enforceable. Each state's **statute of frauds** changed common law. All states have enacted statutes of frauds, designed to provide certainty with respect to contractual obligations and reduce the possibility of fraud by requiring written proof of intentions. The usual statute of frauds provision states that "no action shall be brought unless the agreement, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith…."

While state statutes of frauds sometimes include additional provisions, most of them name six situations in which contracts must be written to guarantee enforceability:

- Contracts for the sale of land or any interest in land
- Contracts that cannot be performed within one year
- Contracts to pay another's debt
- Contracts in consideration of marriage
- Contracts by executors of decedents' estates to pay estate debts from executors' own funds
- Contracts for the sale of goods for $500 or more

Some contracts fall into more than one of these categories.

Real property (realty)

Tangible property consisting of land, all structures permanently attached to the land, and whatever is growing on the land.

Contracts related to the sale of **real property** or legal interests in real property must be in writing. Legal interests in real property can be complete, such as actual ownership, or partial, such as a renter's interest. Oral contracts for the sale of these interests are generally unenforceable. However, courts have qualified some statute of frauds requirements relating to real estate contracts. For example, when the purchaser of real property has taken possession of the property and made substantial improvements in reliance on an oral contract to sell, most courts enforce the oral contract in the interest of fairness. Under these conditions, the case is "outside the statute of frauds," and the contract may be enforceable. The judge or jury must decide what constitutes substantial improvements.

The statute of frauds does not allow rescission of a contract but only serves as a defense to a suit for breach of contract. A party who has purchased or sold land under an oral contract, therefore, cannot obtain a refund of money or a return of the deed to land.

Oral contracts not complying with the statute of frauds are not void, but are merely voidable. Either party may use lack of compliance with the statute as a procedural defense in a lawsuit to enforce the contract, but if neither party raises that defense, the contract can be carried through to completion.

Disputes over the terms of long-term oral contracts arise frequently. For this reason, statutes of frauds usually require written evidence of contracts that cannot be performed within one year from the date of their formation. This one-year provision applies only to bilateral contracts. Unilateral contracts that are made orally and are not capable of being performed within one year are enforceable.

Statutes of frauds require one party's promise to another person to pay the debt of a third person to be in writing. For example, if Bob owes Carol money and Annie promises Carol that she will pay Bob's debt if he fails to do so, Annie's promise must be in writing to be enforceable.

Another area subject to fraud and abuse involves promises made in consideration of marriage. The statute of frauds requires that promises to pay money or property if someone marries or promises to marry a person must be in writing to be enforceable.

Oral promises to pay debts against a decedent's estate are enforceable. Such promises may be made by executors or administrators. Most contracts an executor or administrator makes in settling an estate need not be in writing. However, any promise made by an executor or administrator to pay an estate debt from his or her personal funds must be in writing to be enforceable. This rule applies only to promises to pay debts against the estate that arose during the decedent's life. Generally, an executor or administrator would have no legal obligation to pay the decedent's debts out of personal funds. Therefore, a writing is the only way to make such a commitment binding.

Many states have enacted all or part of the **Uniform Commercial Code (UCC)**. The UCC provides that a contract for the sale of goods for $500 or more is not enforceable unless it is in writing. The $500 limit applies to the total price of all the goods the contract purports to sell. If several items, each with a value under $500 but totaling more than $500, are the subject of one contract, then the contract must be in writing.

Uniform Commercial Code (UCC)

A model code that has been adopted in whole or in part by each state. Its purpose is to provide a consistent legal basis for business transactions throughout the United States and its territories. Its articles cover the sale and lease of goods; negotiable instruments; banks and banking; funds transfers; letters of credit; bulk transfers and bulk sales; warehouse receipts, bills of lading, and other documents of title; investment securities; and secured transactions.

The writing required as evidence of a contract under the statute of frauds may be a simple note or memorandum. No formal written contract is necessary. The writing can be in any form and can consist of several communications, so long as it provides evidence of the contract's existence.

The statute of frauds requires that the writings be signed by the parties against whom contracts are to be enforced. Signings can consist of signatures, initials, typewritten names, electronic signatures, or any marks that appropriately identify the parties acknowledging the memorandum or communication as their writings. Similarly, signatures, in any of those forms, of representatives who have authority to execute such contracts for others will satisfy

the statute's requirement of signed writings. An example is a producer with authority to sign on behalf of an insurance agency. See the exhibit "Insurance Contracts."

Insurance Contracts

Oral insurance policies are valid and enforceable. The customary statute of frauds provisions do not apply to insurance policies. While it is desirable that insurance policies be in writing, the hardship of enforcing this requirement would fall on insureds, and courts therefore do not require written contracts.

In virtually all insurance policies, the contract eventually becomes a written policy, which generally stands by itself as the best evidence of the contract between insurer and insured.

Of the six situations to which the statute of frauds applies, courts have considered applying only two to insurance contracts:

- Policies that are contracts that cannot be performed within one year
- Policies that are promises to answer for another's debt

Courts have held that neither of these statute of frauds provisions applies to insurance contracts.

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Parol Evidence Rule

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. Words spoken by the parties before or at the time of contracting, and letters or memoranda they might have prepared before the drafting of the final contract, cannot alter the written words of the contract, and therefore any provisions they contained are unenforceable. The written contract is the only admissible evidence of the agreement.

The parol evidence rule applies to all written documents. In addition to ordinary contracts, it applies to such writings as deeds, wills, leases, insurance policies, releases, and similar legal instruments. The 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

For example, Roy sells a boat to Steve. The bill of sale indicates the boat's price, make, model, and year. Steve later claims in a lawsuit that Roy had promised to include other items, such as communications equipment, in the

sale. Steve attempts to support his claim in court with a letter Roy wrote and signed before the date of the final bill of sale, in which he promised to include the claimed items. Under the parol evidence rule, the court will not admit the letter into evidence because its terms were not part of the final contract, the bill of sale.

A contract can consist of a series of letters or other documents. The possibility that several documents can constitute a contract can give rise to uncertainty concerning the contractual terms. Parties to a contract can avoid such uncertainty by including the entire agreement in the final contract and not relying on other documents or conversations.

The parol evidence rule applies only to prior or contemporaneous statements and not to oral or written agreements the parties make subsequent to the written contract. Evidence of subsequent agreements is admissible to show that, after entering into the written agreement, the parties agreed to modify or cancel their written contract.

Oral evidence is always admissible to help interpret or explain a written agreement, but not to alter its terms. Legal decisions have established a number of exceptions to the parol evidence rule. They permit the admission of oral evidence of prior or contemporaneous agreements in these situations:

- When an essential contract term is missing, parol evidence is admissible in court to prove that term. For example, Sharon orally agreed to sell her city condominium and her beach house to Tom for $350,000 each. She prepares the agreement of sale for $700,000, which she and Tom both sign, but which does not refer to the beach house. In an action to reform the contract, Tom can introduce evidence of their oral agreement.
- If the written contract contains ambiguous language, oral evidence is admissible to clarify the parties' intent. For example, Isabel provides in her will for payment of money "to my nephew, Bill." If Isabel has two nephews named Bill, after her death, parol evidence can be admitted to determine which nephew Isabel intended to receive the money.
- When fraud or illegality taints a transaction, oral evidence can be admitted to support an allegation of wrongdoing. For example, if one of the parties intentionally substituted the wrong document for the other party's signature, oral testimony is allowed to prove fraudulent conduct. The parties' oral testimony also can show mistakes resulting from the writing process, such as typographical errors.
- Parol evidence is admissible to show that a written document that appears to be a contract never became a contract because of failure of some **condition precedent** to the agreement. For example, if delivery is a condition required before performance, oral evidence can be used to show that delivery did not occur.

Condition precedent
An event that must occur before a duty of performance arises in a contract.

The UCC also makes exceptions to the parol evidence rule.

CONTRACT INTERPRETATION

When the wording of a contract is unclear, it can be difficult to accurately ascertain the obligations of the parties to the contract. In the case of a suit involving an ambiguous contract, a court will interpret the contract based on a set of legal guidelines. Understanding these guidelines helps predict how a court might interpret a contract.

Courts consider a number of factors when interpreting contracts, and they apply certain standards:

- Words are understood in their plain meaning.
- The goal is effectuation of the parties' intent.
- Contracts are classed as entire or divisible.
- Clerical errors and omissions are corrected.
- Contradictory terms are prioritized.
- Ambiguities are interpreted against the writer of the document.
- The parties' own interpretations are considered.
- The court seeks a legal and fair interpretation.
- Trade usage, course of dealings, and performance are considered.

Plain Meaning

When the language of a contract is ambiguous or obscure, courts apply established maxims of construction to ascertain the parties' intent. 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.

A fundamental standard of contract interpretation is that words are to be understood in their plain and usual meaning. This standard applies even though the parties who agreed to the wording might not have anticipated the consequences. For technical language, courts apply technical meanings, and legal terms are given their established legal meaning.

The law of the location where the contract was made controls the formation of the contract. A court looks at contract language within the context of the contract's subject matter, nature, objectives, and purposes. In every case, the circumstances under which the parties entered into the contract are relevant, whether the contract was oral or written. The circumstances of the agreement, the subject matter, the parties' relationship, and the subject of the agreement all can be considered in determining the meaning of the agreement and in giving effect to the parties' intent. In interpreting the words and conduct of the parties to a contract, a court seeks to put itself in the positions of the parties at the time they made the contract.

Although the plain meaning standard can help ascertain the intention of both parties to a contract, it might not apply when only one party's intention is unclear. For example, a life insurance applicant names his beneficiary as "my wife." At the time the insured obtained the policy, he was living with a woman who was not his legal wife because he had gone through a ceremony of marriage with her without divorcing his first wife. Because the plain meaning of the term "my wife" clearly conflicts with the insured's actual intention, a court can ignore the plain meaning and apply the insured's intention.

Effectuation of Intent

When interpreting a contract, courts apply the interpretation that best carries out the parties' intentions. To ascertain those intentions, a court reads the contract as a whole. If several documents relate to the transaction, a court considers all of them together.

Courts interpret individual clauses and specific words in relation to the main purpose of the contract. The intention expressed in the contract applies, not the subjective intention of one of the parties. If the intention appears clear from the words used, courts have no need to go further.

Courts do not attempt, under the pretext of interpretation, to make new contracts for the parties. Neither do they change written contracts to make them express intentions different from those the parties expressed in the contractual language. Courts generally presume that people mean what they say. Courts do not make agreements for the parties, but they ascertain what the parties' agreements were.

Entire and Divisible Contracts

In an entire contract, one party must complete performance to be entitled to the other party's performance. For example, unless a contract states otherwise, delivery of goods is necessary before payment. In contrast, in a divisible contract, the performance of a portion of the contract entitles the performing party to immediate payment.

A contract is divisible if each party's performance can be divided into two or more parts and if it appears that the parties to the contract contemplated separate compensation for each installment of the performance. Failure to perform one installment is not failure to perform the entire agreement. However, if the division of the contract into parts is only to provide periodic payments applicable toward the amount due upon contract completion, the contract is entire and not divisible. Whenever possible, 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.

Clerical Errors and Omissions

Courts correct obvious clerical errors or mistakes in writing and grammar in contracts. If necessary, courts may transpose, reject, or supply words to clarify language to reflect the parties' intent—unless the error or omission makes it impossible to determine the parties' intent.

Courts consider some contractual terms implied if needed to carry out the parties' intent. In these instances, the unexpressed or implied obligations are those the court believes to be inherent in the transaction. The parties must abide not only by what they expressly intended, but also by intentions the court presumes the parties would have had if they had given more thought to the matter. For example, courts generally presume that payment under a contract is not to be in foreign currency or in a substitute for money. In service contracts, courts find the implication that the parties will render the service with reasonable care and skill. If the parties do not specify the time of performance, it must occur within a reasonable time. If it is customary in the trade to extend credit, a court will read that trade practice into the contract. Therefore, the parties do not need to set forth every contractual provision.

Contradictory Terms

If clauses in a contract conflict but can be interpreted in a way that makes them effective, a court will adopt that interpretation. When the parties have made typewritten or handwritten changes in a printed contract form, courts apply a system of priorities:

- Handwriting prevails over typewriting.
- Typewriting prevails over printing.
- Words prevail over figures.

This is a common-sense approach because parties usually make handwritten changes last. If a document is printed, it is safe to assume that any typing on the document occurred later. For example, words written on a check prevail over figures.

Ambiguity

Ambiguity is uncertainty of meaning, or the capability of being understood in two or more ways. In contract law, ambiguity appears in two different forms:

- A contractual provision can be reasonably interpreted in more than one way.
- The meaning of a provision cannot be determined even by application of all the tools of interpretation.

If a provision can have more than one reasonable meaning, courts adopt the interpretation least favorable to the party who put the provision into the contract and most favorable for the party who assented to it. For example, a court

interprets an insurance policy against the insurer that created it. Similarly, courts interpret words in offers against the offerors and words in acceptances against the acceptors. The principle for this rule is that people are responsible for ambiguities in their own expressions.

If a provision is so ambiguous that its meaning cannot be determined with the usual tools of interpretation, the court can admit evidence from outside the contract. For example, a court will permit evidence of prior or contemporaneous agreements to help determine the meaning of ambiguous language.

The **parol evidence rule** does not apply to the introduction of evidence to explain ambiguities. The purpose of this evidence is to clarify what the parties intended the final contract to mean. Evidence to clarify ambiguities explains but does not contradict. Therefore, evidence of the course of performance under the contract, of the parties' prior course of dealings, or of the usages of trade is all admissible to assist the court in determining contractual meaning.

Parol evidence rule

A rule of evidence that limits the terms of a contract evidenced by a writing to those expressed in writing.

Parties' Own Interpretation

The interpretation that the parties have placed on their contract, as shown by their subsequent conduct, has great weight in determining the meaning of doubtful terms. The parties know best what they meant by their words, and their actions under the agreement are some of the best indications of what they meant. However, if a court finds no ambiguity in the contract, and the meaning of its terms is clear, the parties' subsequent conduct placing an unreasonable and erroneous interpretation upon the contract does not prevent a court from enforcing it according to the contractual terms. A court will not remake the contract for parties who have acted in a manner contrary to its provisions.

Legal and Fair Interpretation

If both a legal and an illegal contractual interpretation are possible, the courts assume that the parties intended the legal interpretation. If the court has a choice, it will interpret a contract as reasonable and fair rather than unreasonable and harsh to one of the parties. With that approach, courts adopt interpretations that avoid forfeitures of property when possible. If the terms of the contract itself leave its meaning in doubt, courts attribute to the parties the intent to enter into a fair agreement and therefore interpret the contract equitably.

Trade Usage, Course of Dealings, and Performance

In interpreting contract language, courts give common words their ordinary meanings and technical terms their technical meanings. They also consider local, cultural, and trade usage meanings. In attempting to establish the parties' intent, courts consider their prior course of dealings and their performance under the contract.

A course of dealings relates to similar transactions between the parties before the contract in question. Course of performance involves the performance of the contract that has occurred without either party's objection. If the parties' intent is not clearly expressed in the terms of the agreement, the parties' prior course of dealings takes precedence over usage of the trade in establishing the meaning of the contract. Courts admit evidence on these questions.

THIRD-PARTY CONTRACTUAL RIGHTS

The general rule of contract law is that only the parties to a contract have rights under that contract. There are, however, exceptions to this rule. Understanding these exceptions helps identify contractual situations in which a third party's interests need to be considered.

Third parties have enforceable rights under contracts others have made in two situations:

- An assignment of a contract, by which one party transfers rights arising under a contract to a third party
- Third-party beneficiary contracts, in which one party contracts with another party to confer a benefit on a third party

Assignment

The transfer of rights or property.

Assignor

The party to a contract who makes an assignment.

Assignee

The individual or entity to whom property, rights, or interests have been transferred.

Contract Assignments

Assignment of contracts is common. Contractual assignments involve transfers of contractual performance rights to other people. For example, creditors often assign the right to receive money from debtors to third parties, such as banks. In this example, the creditor is the **assignor**, and the bank is the **assign**ee. If the nonassigning party, in this case the debtor, does not honor the assignment, the assignee may sue the nonassigning party just as though the assignee were a party to the original contract.

When a contract has been assigned, the assignor no longer has any right to performance by the nonassigning party. If that party fails to perform, the right to sue to recover rests solely with the assignee.

Just as contract rights can be assigned, obligations under a contract can be delegated to third parties. Unlike with assignment, which eliminates the assignor's rights under an assigned contract, delegation does not relieve the delegating party from the duties under the original contract. Delegation also does not give enforceable contract rights to any third party.

Rights Assignable

Most contract rights are assignable. A seller can assign the right to receive payment for the sale of goods to a third person. The party owing the obligation to pay for the goods, the obligor, then must pay the assignee. Ordinarily, any right to collect a debt is assignable because it is usually no more difficult

for a debtor to pay the assignee the amount owed than it would have been to pay the original assignor.

Rights Not Assignable

Notwithstanding the general rule that contract rights are assignable, certain contractual rights are not assignable. These are the most common situations in which contract rights are not assignable:

- 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. For example, the standard fire insurance policy prohibits insureds from assigning it to new owners of the insured property without the insurer's consent.
- Personal rights are not assignable. For example, a person who contracts to receive the services of a personal trainer cannot assign a third party the right to those services.
- When an assignment materially alters or varies the obligor's performance, a court usually will not uphold it. For example, if Bob contracts to deliver oil to Nancy's house, Nancy cannot assign the right to receive oil delivery to Daniel, who lives in a distant location.
- When a judgment is pending in a personal injury case, generally the injured person cannot assign a claim for damages resulting from the injury. A final judgment, however, is assignable, as is the right to sue to recover for property loss or damage. These assignments involve the right of subrogation, which enables the insurer to obtain damages.

Forms of Assignment

To be effective, an assignment requires neither formality nor writing. Any words or actions that indicate the assignor's intention to transfer contractual rights effects a valid assignment. Assignments are transfers and need not be contracts.

However, an assignment involving subject matter covered by a statute of frauds, such as an assignment of rights under a land sale contract, must be in writing to be enforceable. Statutes of frauds in all states require that transfers of interests in land be in writing.

Although an assignment is a transfer and not a contract, a promise to make an assignment is enforceable only if it is a valid contract. Therefore, if Alphonse (assignor) promises to assign a contract right to Bob (assignee), all of the elements of a valid contract, including consideration, must be present for Bob to enforce Alphonse's promise.

Assignee's Rights

As a general rule, the assignee's rights are those of the assignor and do not extend beyond them. If a party assigns contract rights to an assignee, but a third party to the contract has a defense against the assignor, the third party can assert that same defense against the assignee. For example, if the assignor obtained the original contract through fraud or duress, this defense can be valid against the assignee.

Many consumer sales contracts provide that, if the seller assigns the contract, usually to a finance company or bank, the buyer agrees not to assert any defenses against the assignee that might be valid against the seller-assignor. Adding such provisions to a sales contract makes the contract more marketable to third parties because it places the assignee in a favored position. For the most part, however, people who receive assignments of sales contracts accept them subject to any defenses that would be valid against the assignor.

Notice of Assignment

A valid assignment is effective immediately, even though the assignor has not yet advised the obligor of the assignment. The assignee should nevertheless notify the obligor of the assignment to ensure that the obligor pays the assignee rather than the assignor, thus defeating the original assignor's right to demand the obligor's payment or performance. In such a case, the assignee might have a right to sue the assignor for refusal to, in turn, pay the assignee.

An assignee's notice of assignment to the obligor on the contract also protects additional parties who might take subsequent assignments from the assignors. An assignor would not have the right to make a second assignment but might do so nevertheless, and the original obligor might pay the second assignee. To illustrate, John assigns his contractual rights with George to Dennis. Subsequently, John assigns the same contractual rights to Howard. If Dennis has not given George notice of his own first assignment, George has no reason to know about it and might pay Howard instead. Therefore, it would be to Dennis's benefit to let George know of the first assignment at the outset.

Third-Party Beneficiaries

Formerly, at common law, only the parties to a contract could enforce it. Those were the parties who gave or received consideration or who were in privity of contract. Today, third parties that benefit from contracts may also have enforceable rights under those contracts.

Types of Third-Party Beneficiaries

Third-party beneficiary contracts benefit three types of beneficiaries:

- Creditor beneficiaries
- Donee beneficiaries
- Incidental beneficiaries

Third-party beneficiary contract

A contract between two parties that benefits a third party.

Donee and creditor beneficiaries have enforceable rights against the original promisor, but an incidental beneficiary has no enforceable rights.

For example, Henry owes Chuck $500. Henry sells his car to Jeremy for $1,000. Henry receives $500 in cash and Jeremy's promise to pay $500 to Chuck. If Henry's intent in obtaining the promise from Jeremy was to discharge his obligation to Chuck, Chuck is a **creditor beneficiary**. It is the promisee's intent that governs these situations. The promisor's or the third-party beneficiary's intent is not the decisive factor.

Creditor beneficiary

A third-party beneficiary owed a debt that is to be satisfied by performance of a contract.

If Chuck does not receive payment, he has two possible remedies:

- To proceed as a creditor beneficiary against Jeremy
- To proceed against Henry under the original $500 debt

As another example, Henry wishes to make a $500 gift to Chuck. Henry sells his car to Jeremy for $500 and obtains Jeremy's promise to pay Chuck the $500 price for the car. Chuck is a **donee beneficiary** of Jeremy's promise to pay $500. If he does not do so, Chuck can sue Jeremy for $500.

Donee beneficiary

A third-party beneficiary who receives the benefit of a contract's performance as a gift from the promisee, with the intent of the contracting parties.

As a final example, Middletown contracts with Water Company to maintain sufficient water pressure at Middletown's hydrants for fire protection. A Middletown citizen's house burns down because of insufficient water pressure. The citizen is an **incidental beneficiary** and has no enforceable rights under the contract between Middletown and Water Company. Any duty to the citizen is, at best, indirect.

Incidental beneficiary

A third-party beneficiary who has no contractual rights but benefits from a contract even though that is not the intent of the parties to the contract.

The legal distinction between creditor and donee beneficiary contracts is becoming less important. They are often treated as one class, intended beneficiaries, who are third-party beneficiaries to whom a benefit was intended by the contracting parties. For instance, Chuck contracts to purchase land from Jeremy, breaches the contract, and forfeits a deposit to Jeremy. Helen wants to buy the land, but finds out about Chuck's forfeited deposit. She does not know Chuck but believes that Jeremy should not keep Chuck's deposit. She agrees to purchase the land only if Jeremy promises to repay Chuck's deposit. Jeremy agrees. Helen intended to benefit Chuck, and, regardless of her motive, Chuck is an intended beneficiary with a right to obtain the forfeited deposit from Jeremy in some jurisdictions.

When a person claims beneficiary status, the court must decide whether the contracting parties intended to confer a benefit upon that person. Unless the claimant can show a direct interest in the performance of the contract about which the contracting parties are aware, the third party is an incidental beneficiary only.

Characteristics of Beneficiary Contracts

Certain rules apply to third-party beneficiary contracts:

- A binding contract must exist between the promisor and promisee.
- The parties to the contract must intend that the third party receive benefits and acquire rights under the contract. Some courts have held that the promisee must have the intention only to benefit the third party.
- The parties must take care in each case to clarify to whom the performance is due. If the parties owe performance to a third party, the third party can sue to enforce it. If, however, performance is due solely to the promisee, only the promisee can sue, and a third party has no rights against the promisor.
- The beneficiary is always subject to defenses the promisor might have against the promisee, including the usual defenses in contract actions, such as lack of consideration, illegality, and fraud.

Beneficiaries' Rights

In general, a beneficiary under a contract—whether creditor, donee, or intended---can enforce the contract. Suppose, however, that the original parties—the promisor and the promisee—agree to annul or change the contract and to eliminate or reduce the beneficiary's rights.

Parties may agree in a contract either to retain or not to retain the right to eliminate or modify the promisor's duty to the third-party beneficiary. The modern legal trend is to permit the original parties in all cases to cut off the beneficiaries' rights unless the beneficiaries can prove that their positions have changed materially in reasonable reliance on the contracts.

TERMINATION OF A CONTRACT

Once a contract has been established, parties to it have contractual obligations to discharge. Understanding the ways in which those obligations can be discharged is essential to identifying whether a breach of contract may have occurred.

The end of contract obligations discharges a contract, terminating the parties' contractual duties. Parties can discharge their contractual obligations in many ways, including these:

- Complete performance of contractual obligations
- Agreement of the parties
- Substitution of a new contract, by waiver, novation, accord and satisfaction, or other agreements
- Impossibility of performance, such as the destruction of the contractual subject matter

- Fraudulent alteration
- Contractual conditions

Performance

Performance discharges most contracts. When each party fulfills all promises, no obligations remain and the contract ceases to exist. Performance under a contract can occur in a number of ways:

- Payment of a debt discharges the contract.
- Rejection by the other party of a **tender** to perform discharges that obligation. However, rejection of a tender of payment of a debt does not discharge the debt.
- When contractual obligations are difficult to perform entirely, courts may consider substantial performance sufficient to discharge the contract if the party performed in good faith.
- 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.
- If a contract fails to specify a time of performance, each party has a reasonable time to perform. Whether performance occurs within a reasonable time is a question for a court to decide.

Tender
An offer to perform one's duties under a contract.

Discharge of contractual obligations by rejection of a tender can affect damages and defenses in lawsuits for breach of contract, as well as the amount that can be collected on a debt. See the exhibit "Tender of Performance or Payment."

Agreement of the Parties

The parties to a contract can agree in advance that a certain event will discharge their obligations to one another. For example, Arthur agrees to paint Josh's house unless Josh sells the house by June 1. If Josh sells the house before June 1, Arthur is discharged from the obligation. The occurrence of that contractual condition (the sale of the house) relieves the parties of performance.

Just as the parties can agree to form a contract, they also can agree to rescind it. Unless the original contract requires that any modification or rescission be in writing, the rescission can be oral. Even if the contract requires written rescission, an attempted oral rescission can be effective as a waiver of the writing requirement. The effectiveness of such a waiver can depend on whether the contract is for the sale of goods or for the sale of land.

Tender of Performance or Payment

In a contract for the sale of goods, if the seller attempts to deliver the goods and the other party refuses delivery, the refusal discharges the seller from performance. However, refusal to accept the goods permits the tendering party to sue the refusing party for breach of contract. It also allows the tendering party to defend a later action by the refusing party alleging breach of contract for failure to deliver.

In contrast, if the performance due is the payment of money, a refusal to accept an offer to pay the money will not discharge the debt. A valid tender, however, stops any interest from accruing on the debt, and the most the creditor can collect is the amount due on the date of the tender. For the tender to be valid, it must include the entire amount of the debt.

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Substitution

The parties to a contract can agree to substitute a new contract for a previous one. The decision to replace an old contract with a new one is subject to the same rules that apply to rescission of agreements.

Novation

The substitution of a third party for one of the original parties to a contract, releasing the original party from rights and obligations under the contract.

One type of substitution in contractual agreements is **novation**. For the substitution to be effective, all parties must agree to it. 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.

To illustrate, Sean contracts to perform cleaning services for Jennifer. Later, Jennifer and Sean agree that Toby will perform Sean's obligations, and Jennifer expressly releases Sean from the original contract. Toby's agreement to replace Sean discharges Sean from the contract. If Jennifer does not expressly release Sean, no novation occurs. Sean has merely delegated performance to Toby and remains liable under the contract.

An accord and satisfaction is used to discharge a debt. For example, if Bill owes John $200, and they agree that Bill will paint John's home in satisfaction of the debt, an accord exists. Bill's painting the home is the satisfaction that discharges the obligation because the accord and satisfaction are complete.

If Joe owes Lisa $500, Lisa's agreement to accept less than $500 in full payment is not binding unless Lisa receives consideration for the promise to discharge Joe. However, Lisa can agree to discharge the debt for a lesser sum in return for payment before the due date or in return for a lesser sum plus an item of value. The value of the additional item may or may not equal the amount of the unpaid debt. The parties have agreed to performance other than that required by the contract (accord), and performance has occurred (satisfaction).

Impossibility

A promisor's duty to perform is discharged if, after the contract has been formed, performance becomes objectively impossible. If the objectively impossible performance was the major undertaking of the contract, both parties are discharged from all contractual duties. For example, an insurance producer has promised an applicant to place a homeowners insurance policy only with a specific insurer, but that insurer becomes insolvent. Performance is impossible, and the producer is not liable to the applicant.

Three similar terms related to contract performance are sometimes confused—frustration, impracticability, and impossibility:

- 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.
- Impossibility is the condition of not being able to occur, exist, or be done, excusing performance.

Impossibility may be either objective or subjective. Objective impossibility means that a promisor cannot conceivably perform. An example would be a one-of-a-kind antique that is destroyed by fire after a contract for its sale is entered. Subjective impossibility means that the promisor will not perform even though performance is conceivable. Most courts hold that only objective impossibility excuses the promisor's performance. Subjective impossibility does not discharge the obligation.

Changes in circumstances affecting contract parties and subject matter can lead to impossibility of performance. Several circumstances 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. Ordinary contracts of production and sale are not personal, so the death or illness of one or both parties does not affect them.
- 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. Exhaustion of an oil well, for example, discharges a contract to furnish oil.
- If the other party's act prevents the performance of a contract, a court will excuse performance. For example, if a contract requires the promisor to

cut trees on the promisee's land, and the promisee prevents entry to the land, the promisor cannot perform and a court will discharge the contract.

Impossibility may affect less than the entire performance of a contract. It may be temporary or partial, or it may arise after the contract has been partially performed. Temporary impossibility suspends, but does not discharge, the promisor's duty. After the impossibility has ended, the duty to perform renews.

If performance is only partially impossible, a court will excuse the duty to perform only to the extent that it is impossible. The promisor must perform the balance of the duty regardless of added expense or difficulty. Impossibility of performance often becomes apparent only after partial performance. The performing party is entitled to payment for reasonable value of all the work performed and other expenses.

A mere additional burden does not constitute legal impossibility. The destruction of a partially completed building, for example, does not make performance impossible. Performance still is possible by starting construction anew, although the cost is greater than anticipated, and the owner must bear the additional cost.

Frustration of purpose can discharge a contract that is possible to perform, when a supervening event destroys the purpose or value of the contract, provided that both parties are aware of that purpose or value. For example, Richard's house is on a street where a parade is scheduled to pass. Richard rents a room to Ashley for the day knowing that she intends to view the parade. If the parade does not pass Richard's house, the frustration of purpose excuses Ashley's performance of the contract.

Fraudulent Alteration

If a party to the contract intentionally makes a material alteration to the contract, the contract is discharged. For example, if the payee on a check fraudulently increases the amount payable, the material alteration discharges the liability of the check's maker to the payee.

Contractual Conditions

Failure to fulfill a contract condition may alter, limit, or discharge contractual obligations. For example, if a party does not deliver goods on the specific day required by the contract, the buyer can treat the nondelivery as a breach of condition that extends the duty to pay to a later date.

Contracts contain three types of conditions:

- Nonfulfillment of a condition precedent can discharge a contractual obligation. For example, filing a notice of loss under an insurance policy is a condition precedent to claim payment. Although it is not a promise, until

the insured files a claim, the insurer has no duty to perform its contractual obligation.

- If a contract expressly or impliedly provides that both parties are to perform at the same time, then each party's performance is a **condition concurrent**. For example, a sale of goods contract includes a condition for cash payment upon delivery. If the goods are delivered and the buyer cannot pay, the seller can retain the goods because the buyer cannot perform under the contract. This condition is a promise, and the seller can sue for breach.

Condition concurrent
An event that must occur at the same time as another condition in a contract.

- Occurrence of a **condition subsequent** terminates contractual rights. For example, a store lease in a mall provides that the mall owner is to receive a certain amount of rent plus a percentage of the store's gross sales. If the store's sales drop below a set dollar amount per month (condition subsequent), the lease terminates at the mall's option. If the sales do not reach a set dollar amount per month within a year (condition subsequent), the lease terminates at the mall's option. If either of the conditions subsequent occur, the mall can terminate all lease rights and duties. Neither condition is a promise.

Condition subsequent
An event that, if it occurs, discharges a duty of performance in a contract.

Many contracts contain several conditions that can affect the parties' rights. To determine the legal consequences of the conditions, it is important to know whether they exist as conditions precedent, concurrent, or subsequent. See the exhibit "Insurance Policy Conditions."

Insurance Policy Conditions

The insurance policy is an example of a contract containing multiple conditions, and it is not always easy to determine whether the parties to the policy intended a condition to be precedent or subsequent to liability. Examples of insurance policy conditions include:

- The premium payment is a condition precedent to liability under a policy.
- A loss is a condition precedent to an insurer's liability under a policy.
- A condition that an insured must sue within one year from the date of a loss is a condition subsequent.
- The requirement that an insured submit a notice of loss within sixty days of the loss is either a condition precedent to an insurer's liability or, depending on the wording of the condition, a condition subsequent to the insured's loss. For example, a policy can state, "The insurer's obligation will be discharged if no notice of loss is given within sixty days."

Determination of the intent and legal effect of a condition in an insurance policy often requires careful scrutiny by a court.

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BREACH OF CONTRACT

The parties to a contract do not always fulfill their obligations. What happens in such a case? What options are available to the innocent party who suffers a loss as a result?

A breach of contract can be total or partial and may occur when a party fails to perform acts promised, hinders or prevents performance, or otherwise indicates an intention not to fulfill the contract. The nonbreaching party has legal remedies against a breaching party.

Types of Breach

The remedy for breach may depend on its timing in relation to performance and on its effect on complete performance. Types of breach include those made in repudiation or anticipation, and material and minor breaches.

Repudiation

Repudiation

A party's refusal to meet obligations under a contract.

Repudiation of a contract must be positive and unequivocal to constitute a breach. A statement of inability to perform in the future is not repudiation. For example, Marcus and John formed a contract requiring performance on November 1. If, on October 15, Marcus says to John, "I doubt that I can perform the contract—and, the way prices are going up, I don't think I want to anyway," Marcus has not repudiated the contract and John may not sue for breach. John cannot sue successfully for breach until the time for performance has arrived and Marcus has failed to perform. A party must give a positive repudiation by words as well as by conduct. If, on November 1, Marcus says, "I cannot perform," he has repudiated the contract.

Anticipatory Breach

Anticipatory breach
A party's unequivocal indication before contract performance is due that he or she will not perform when performance is due.

The concept of **anticipatory breach** developed to avoid "enforced idleness" on the part of an aggrieved party, who must wait until the time of performance to sue for breach, and to make it unnecessary for that party to tender performance at the time stated in the contract to prove the other party's breach.

The concept gives the nonbreaching party the option of not waiting until the actual date of performance to determine whether the other party will breach the contract. The aggrieved party can treat the repudiation as a present total breach and can sue immediately if two requirements are present:

- The contract is an executory, bilateral contract entailing mutual and dependent conditions.
- The promisor has made a clear expression of his or her intention not to perform.

For example, Millie promises to sell her land, and Tina promises to buy it, for $150,000 on December 1. On November 15, Tina says to Millie, "I cannot and will not go through with our contract." Tina's statement is a breach of contract by anticipatory repudiation. Millie need not wait until December, but may sue immediately for damages for breach of contract.

Anticipatory breach does not apply to a unilateral contract because the promisee has the option to perform an act and to become entitled to compensation. If the promisee does not perform the act, the promisor has no basis to sue.

Material Breach

Material breach of contract
Violation of the agreement that would justify an owner's termination of the contract.

Many courts distinguish between **material breach of contract** and minor breach. A material breach allows the nonbreaching party to sue the breaching party for damages. The materiality of the breach is a question of fact. Several circumstances affect the materiality of a breach, including these:

- The extent to which the breaching party has performed
- The willfulness of the breach
- The extent to which the nonbreaching party has obtained benefits and can receive adequate compensation

One party's material breach excuses the other party's performance and immediately gives rise to remedies for breach of contract. In contrast, a minor breach causes only slight delay in performance or a slight deviation in quantity or quality. A minor breach can have these effects:

- It may temporarily suspend any duty of performance by the nonbreaching party that would have arisen on proper performance.
- It may give the aggrieved party a basis to sue for damages for the breach—usually an offset to the agreed price—but not for remedies for breach of the entire contract.

Remedies for Breach

If a contract is breached, the injured party can seek a legal remedy by suing to collect money damages. An injured party in a breach of contract for the sale of goods can sue either for money damages or for the price of the goods. Alternatively, an injured party can ask a court for one of two equitable remedies to correct the situation: specific performance of the contract or injunction.

Damages

Damages in breach of contract lawsuits fall into five categories:

- Compensatory
- Consequential
- Punitive
- Extracontractual
- Liquidated

The most frequent remedy for breach of contract is money damages. **Compensatory damages** are intended to give the injured party the "benefit of the bargain," that is, 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
A payment awarded by a court to reimburse a victim for actual harm.

Consequential damages
A payment awarded by a court to indemnify an injured party for losses that result indirectly from a wrong such as a breach of contract or a tort.

Punitive damages (exemplary damages)
A payment awarded by a court to punish a defendant for a reckless, malicious, or deceitful act to deter similar conduct; the award need not bear any relation to a party's actual damages.

In addition to the standard measure of compensatory contract damages, a breaching party may also be liable for any **consequential damages**. Recoverable losses are those that the defendant, as a reasonable person, should have foreseen at the time of contract formation. A plaintiff can recover consequential damages only when the defendant was aware of the probable occurrence of the loss. See the exhibit "Foreseeable Consequences and Consequential Damages."

Punitive, or exemplary, damages punish a defendant for a reckless, malicious, or deceitful act. To establish their value, courts seek a reasonable ratio of punitive damages to actual damages. Courts more commonly award punitive damages in tort actions, such as for an unprovoked and malicious assault and battery. One purpose of punitive damages is to deter such conduct.

Punitive damages are not appropriate in most contract cases because the purpose of contract damages is to give the plaintiff the benefit of the bargain. However, if a seller of personal property has committed fraud or misrepresentation, punitive damages can be appropriate, based on the fraud rather than on breach of contract. An insurer that has unreasonably delayed a claim payment or contested a claim without reasonable grounds can, by statute, be liable for the insured's attorney's fees as a penalty.

Foreseeable Consequences and Consequential Damages

A manufacturer orders a supply of raw materials for delivery on a certain date. The seller does not deliver until after that date, and the manufacturer cannot obtain the materials anywhere else and must shut down the plant. The manufacturer then demands as part of the damages the loss incurred because of the plant shutdown.

Although that loss flowed directly from the breach, the manufacturer cannot successfully sue for these damages because manufacturers usually order raw materials for delivery in advance of actual need. Additionally, raw materials are usually available from substitute sources. The seller, therefore, has no reason to believe that delayed shipment will cause a shutdown. However, if the manufacturer had informed the seller of the critical need and the seller, with that knowledge, promised to deliver on the given day, delayed delivery would make the seller liable for the foreseeable loss arising from the shutdown.

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In an insurance case alleging **bad faith**, a court can award **extracontractual damages**, also called excess damages and excess-liability damages. See the exhibit "Extracontractual Damages."

Extracontractual damages

A payment awarded by a court that exceeds the usual contract damages for a breach of contract.

Bad faith (outrage)

An intentional or reckless act, extreme or outrageous in nature, causing severe emotional distress that results in physical injury; generally applied in suits for breach of insurance contracts.

Extracontractual Damages

These are the grounds for assessing extracontractual damages:

- Breach of the insurer's duty of good faith and fair dealing in insurance contracts
- Intentional infliction of emotional distress on the insured by the insurer's extreme and outrageous conduct

Extracontractual damages for either of these causes can include both consequential damages for such things as physical and mental suffering and distress, loss of assets, and attorney fees; and punitive damages. In most cases, extracontractual damages far exceed contract damages resulting from the breach.

Laws relating to bad faith and extracontractual damages vary from state to state and continue to evolve. It is important that practitioners keep current in this area and ensure that they clearly understand relevant law.

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Mitigation of damages

A duty owed by an injured party to a claim to take reasonable measures to minimize or avoid additional injury or loss.

Liquidated damages

A reasonable estimation of actual damages, agreed to by contracting parties and included in the contract, to be paid in the event of a breach or for negligence.

The nonbreaching party to a contract is responsible for **mitigation of damages**. When the buyer breaches a contract for the sale of goods, the seller must dispose of the goods elsewhere at the best price possible. If a seller delivers a defective product and the buyer knows that the product is dangerous and could cause injury, the buyer must not permit its use.

The parties can agree on an amount for **liquidated damages** in the contract. To be valid, the clause must specify a sum determined by the parties' good faith effort to estimate actual damages that probably would result from a

breach. A court will not enforce a liquidated damages provision if it finds the damages to be a penalty. In that case, the injured party then must prove actual damages. In either case, a court considers whether the contract involved subject matter that would make damages difficult to ascertain and whether the amount the parties agreed on represented a reasonable estimate of the damages that might actually result from breach.

In a contract for the sale of goods, the seller has two remedies for breach: damages and contract price. The first remedy, damages, is available if the seller appropriately resells the goods and receives less than the contract price. The difference between the contract price and the price on resale is the damages. If the seller receives more than the agreed price, the excess need not go to the buyer and belongs to the seller.

A seller of goods will sue for the agreed contract price only in certain circumstances:[1]

- When the buyer has received and kept the goods
- When the goods are destroyed or damaged after the buyer has assumed the risk of loss
- When the buyer has wrongfully rejected delivery and the goods cannot be sold after reasonable effort to sell them at a reasonable price

Equitable Remedies

In cases involving the sale of goods subject to the Uniform Commercial Code (UCC), a suit for damages is not always an effective remedy. Often, when the burden of loss has passed to the buyer, only equitable remedies can make the nonbreaching party whole. Examples of situations that often give rise only to equitable remedies are these:[2]

- When the buyer has accepted the goods
- When a carrier has tendered the goods to the buyer if the contract requires the seller to ship them to the buyer
- When the seller has delivered the goods to the carrier if the contract provides only for delivery to the carrier and not to the destination
- When a third party holds the goods for delivery without moving them
- When the buyer has received a document indicating the buyer's right to the goods
- When the third party acknowledges the buyer's right to possession

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 these factors:

Specific performance
A court-ordered equitable remedy requiring a party to perform a certain act, often—but not always—as a result of breach of a contract.

- The difficulty of valuing the subject matter of the contract
- The existence of sentimental and aesthetic qualities of the subject matter that make it unique
- The difficulty or impossibility of obtaining a duplicate or substantial equivalent of the subject matter

Lawsuits requesting specific performance of a contract occur most frequently in contracts for the sale of real estate, which is unique. A court will order a seller to perform the contract and transfer title to an injured party.

Specific performance is an appropriate remedy for breach of a contract to sell personal property only if the item is in some way unique, such as an antique or a painting.

Courts do not direct specific performance of personal service contracts or any other contracts that would require court supervision to ensure that the performance is adequate.

If the services agreed to under a personal service contract are truly unique, a court can issue an **injunction** to prevent the promisor from performing elsewhere during the term of the contract. For example, a court might enjoin an important soloist who breached a contract from singing elsewhere but probably would not impose that remedy on a singer in an opera chorus who broke a contract, because the latter's performance would not cause loss to the other party.

Injunction
A court-ordered equitable remedy requiring a party to act or refrain from acting.

Commercial contracts containing negative agreements are enforceable by injunction. If an owner sells a business and promises not to compete with the buyer in a given area for a certain time, the restriction is legal. If the seller breaches the provision, the buyer can request an order enjoining the seller from competing.

Injunction is an appropriate remedy in both of these cases because money damages would be inadequate. A court has no way to assess the money value of the soloist's performance, and a series of lawsuits for damages resulting from the illegal competition would be too burdensome on the buyer.

CONTRACTS CASE STUDY

The student should have an understanding of these areas of contract law:

- Requirements of an offer
- Requirements of a valid acceptance
- Capacity to contract
- Consideration

- Legal purpose of a contract
- Enforceability of a contract
- Termination of a contract
- Breach of contract

Individuals and organizations often enter into agreements with other parties. Being able to ascertain whether an agreement is a legally enforceable contract is essential to determining what an injured party's options are, if any, in the event of a breach of that agreement.

This case study involves an agreement between a builder and the co-owners of a restaurant. Based on the facts provided, these questions are examined:

- Was a valid contract formed?
- Is the contract enforceable?
- Was the contract breached, and, if so, what is the remedy?

Case Facts

Jake and Marta are co-owners of Le Garde-Manger, a popular French-style bistro. The restaurant is located in the town's historic district and backs onto a river. The bistro is especially busy during the summer tourist season, and guests often have to wait for a table. Jake and Marta have decided to build a large deck overlooking the river to allow for more space during the busy summer months. Their goal is to double the bistro's seating capacity.

Jake and Marta contact a number of building contractors. Several visit the site to discuss the project with the owners. Three return with rough sketches and preliminary estimates that range from $16,000 to $30,000. The fourth, Paul, makes an appointment to see the owners the following week and arrives at the meeting with detailed drawings of the proposed deck specifying dimensions, materials, and construction details. Paul's proposal also includes a description of the work to be done and a listing of the labor and materials required to complete the project. He indicates that he has time for the project and would like to do the work for them. See the exhibit "Proposal: Le Garde-Manger Deck Project."

Jake and Marta take several days to consider Paul's proposal and check his references. They discover he has all the required licenses, proper insurance coverage, and an excellent reputation for doing quality work and meeting deadlines. They agree to hire Paul to do the work and arrange to meet with him to discuss the proposal in detail. They make no changes to the original drawings Paul provided. Jake tells Paul, "We like your proposal and we'd like to contract you to do the work." Both he and Marta sign the proposal, as does Paul. They write Paul a check for $5,000 as a deposit payment and agree to pay the balance within thirty days of receipt of the final invoice from Paul.

Proposal: Le Garde-Manger Deck Project

From: Paul Vaughan Construction

To: Jake Olidad and Marta Schweiger
Co-owners, Le Garde-Manger Bistro

Re: Deck Construction Project

Projected start date: April 15, 20XX
Projected finish date: May 15, 20XX

Project Description: To construct deck, according to all applicable building code requirements for a licensed restaurant establishment, as per the attached drawings with pressure-treated substructure and red cedar decking. Balusters to be black metal. Railing to be cedar. Deck to be sanded and stained with water-based stain in owner's color choice. Owner to provide color choice by April 30, 20XX.

Items included: Repair to existing building as required, compressor and breaker rental, and cost of the building permit.

Projected Costs

Construction:	
Materials	$ 18,751
Labor	$ 4,000
Subtotal	$ 22,751
Sanding and Staining:	
Materials	$ 160
Labor	$ 500
Subtotal	$ 660
Total Cost	$ 23,411
Deposit	$ 5,000

Signature (Paul Vaughan Construction)

_____

Signatures (Co-Owners, Le Garde-Manger Bistro)

_____

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The parties agree that work will start April 15 and that Jake and Marta will select the stain color that afternoon. On the following day, they e-mail Paul with the stain manufacturer's name and the number of the color they have

selected. Paul acknowledges the color selection by return e-mail and informs them that the building inspector approved the drawings that morning.

Work on the deck progresses on schedule. Jake and Marta are excited at the thought of having the work completed in time for the beginning of their summer rush and anticipate that the prospect of dining outdoors overlooking the river will draw many new customers into the bistro. The building portion of the project is completed on May 4. All that remains is to have the railings sanded and the deck and railings stained.

Paul and his employees do not arrive at the jobsite for several days. On May 8, Paul comes to the bistro and explains that three of his employees were badly injured in an auto accident on the way to work several days earlier, and that he has been called for jury duty. Paul tells Jake and Marta, "I have another really big job starting in a week, and I just don't have enough people available at the moment to finish the sanding and staining on the deck. I'm sorry, but there's nothing I can do."

Jake and Marta are frustrated that Paul is going to repudiate the contract. They insist that the work be completed by the date specified in the agreement and point out that it will hurt their business if they have to wait until later and then close down what they expect to be a popular spot for several days to have the staining done. On the other hand, they can appreciate Paul's predicament. They decide to discuss the situation with their attorney.

Was a Contract Formed?

The first step in resolving this case is determining whether Paul and the owners of Le Garde-Manger have actually formed a contract.

The first element required to establish a contract is agreement—this requires a valid offer and valid acceptance. Three elements make an offer valid:

- Intent to contract
- Definite terms
- Communication to offeree

In this case, Jake and Marta invited several contractors to make an offer to construct the deck. Because Paul is a contractor by profession, his offer to do work for Jake and Marta can be reasonably interpreted as indicating intent to contract. By providing detailed drawings, a project description, and projected labor and materials costs, he outlines clearly and definitely the terms of the offer. Moreover, in both his written proposal and the subsequent meeting, he communicates his offer clearly to Jake and Marta.

Three elements are required to make an acceptance valid:

- It must be made by the offeree.
- It must be unconditional and unequivocal.
- The offeree must communicate the acceptance to the offeror by appropriate word or act.

In this case, Paul made his offer to Jake and Marta as co-owners of the bistro, and they accepted the offer. Their acceptance was unconditional and unequivocal—the details of the project were clearly defined, and they accepted them as proposed. They communicated verbally to Paul both their acceptance of the offer and their intent to contract. They demonstrated acceptance in their actions by making a deposit payment and promptly providing Paul with their choice of stain color.

Certain parties are considered incompetent to contract under most circumstances. These include minors, insane persons, intoxicated persons, and in some situations artificial entities. Paul, Jake, and Marta are all adults, mentally competent, and were not intoxicated at the time that the agreement was reached.

To create an enforceable contract, consideration is required. That consideration must be valuable consideration or forbearance, present or future consideration, and involve a binding promise. In this case, the valuable consideration exchanged for the deck's construction is $23,411. The deposit payment represents present consideration. In addition, the promise to pay the outstanding balance is a binding promise of future consideration because Jake and Marta have contracted with Paul to perform a specific task—to build the deck.

Illegal contracts are unenforceable and fall into nine categories: contracts to commit crimes or torts, contracts harmful to the public interest, usury contracts, wagering contracts, contracts with unlicensed practitioners, contracts to transfer liability for negligence, contracts in restraint of marriage, contracts in restraint of trade, and unconscionable bargains. The agreement between Paul and the owners of Le Garde-Manger does not relate to crimes or torts. The building of a deck is not harmful to the public interest. Paul has all the licenses required to pursue his occupation, and the agreement does not appear to be an unconscionable bargain.

Because, in this case, the offer and acceptance are valid, the parties have legal capacity to contract, valuable consideration is being exchanged, and the agreement is not illegal, a contract has been formed.

Is the Contract Enforceable?

An apparently valid contract may be unenforceable if either party has not given genuine assent to contract. Genuine assent may be lacking if a party

was induced to enter a contract by fraud, mistake, duress, undue influence, or innocent misrepresentation.

Fraud is legally defined as a false representation of a material fact knowingly made with intent to deceive on which the other party has placed justifiable reliance to his or her detriment. Material misrepresentation in this situation might involve such actions as Paul's intentional misleading of the bistro owners with regard to his qualifications to do the work or Jake and Marta's intentionally misleading Paul as to their financial condition and ability to pay for the work. In this case, all parties to the agreement acted honestly and in good faith.

As an experienced contractor, Paul demonstrated his competence in preparing drawings that met applicable building codes and in accurately estimating construction work. The proposal and drawings contained no typographical or mathematical errors, and the building inspector approved the drawings. Jake and Marta considered the proposal carefully and willingly agreed to contract with Paul under no duress or undue influence. Neither party has innocently misrepresented material facts to the other. In this case, it would appear that the contract is enforceable.

Was the Contract Breached, and, if so, What Is the Remedy?

The attorney Jake and Marta have consulted regarding Paul's stated intention not to complete the work explains that the concept of anticipatory breach applies to their situation. In anticipatory breach, the aggrieved party can treat the repudiation as a present total breach and can sue immediately if two requirements are present:

- The contract is an executory, bilateral contract entailing mutual and dependent conditions.
- The promisor has made a clear expression of his or her intention not to perform.

Because the contract they have with Paul is bilateral and has not been completely performed, and because Paul has indicated that he intends not to complete the work, Jake and Marta have a cause of action against Paul for breach of contract. They could bring a lawsuit against Paul seeking compensatory damages. For example, if the cost to have the deck stained by another contractor is substantially more than the $660 Paul has quoted, they can recover the difference between those two amounts. In addition, they may be able to sue for consequential damages for such things as loss of income resulting from the breach.

Jake and Marta ask the attorney whether a court could force Paul to complete the work. The attorney explains that courts typically order that remedy, specific performance, only when monetary damages would be inappropriate

or inadequate. In this case, monetary damages would be more appropriate, particularly considering the reasons for the breach.

The attorney also points out that, when contractual obligations are difficult to perform entirely, courts may consider substantial performance sufficient to discharge the contract if the party performed in good faith. It appears that Paul has performed in good faith and that, given the relatively small cost of the staining, his work to date might constitute substantial performance. In that case, Jake and Marta would incur the cost of a lawsuit without obtaining any benefit.

The attorney inquires about the relationship between the restaurant owners and the builder, and Marta concedes that it had been very good until this disagreement. The attorney discourages Jake and Marta from pursuing a court action and suggests an alternative. If Jake, Marta, and Paul can agree to new terms, they have the option to amend their original agreement. One option would be to amend the contract to include only the deck construction at the original quoted value for that work of $22,751. Alternatively, they could agree to novation and simply release Paul Vaughn Construction from the original contract and substitute another firm to complete the project.

After discussing the situation, Jake and Marta approach a painting contractor about the project. The painter inspects the site and offers to do the staining work for $600. Jake and Marta indicate that they would like to discuss the situation with Paul before accepting his offer, and the painter agrees. Jake and Marta meet with Paul and propose amending the contract to include only the deck construction at the original quoted value for that work of $22,751. Paul is relieved to reach cooperative agreement in what for him has been an embarrassing situation. He makes handwritten changes to both his copy and the owners' copy of the original agreement, and all parties initial the changes and date and re-sign the amended contract. Paul is relieved from further performance under the original contract, and Jake and Marta are free to contract the alternative painting contractor.

In this case, because there has been a valid offer and acceptance, the parties have legal capacity to contract, valuable consideration is being exchanged, and the agreement is not illegal, a contract has been formed. Genuine assent is present because none of the parties were induced to enter the contract by fraud, mistake, duress, undue influence, or innocent misrepresentation. Because the contract is bilateral and executory, and Paul has indicated that he intends not to complete the work promised, Jake and Marta have a cause of action against Paul for breach of contract. In court, they could seek compensatory damages and perhaps consequential damages. Specific performance would not be an appropriate remedy in this case. Alternatively, Jake, Marta, and Paul can agree to amend the terms of their original agreement or to execute a novation.

SUMMARY

A contract may be bilateral or unilateral, executed or executory, express or implied, void or voidable.

A valid offer to contract requires that the offeror intend to enter into a legally binding contract, that the offer includes definite terms, and that the offer be communicated to the offeree. Duration and termination are key to determining whether an offer is binding, and the factors considered include lapse of time, operation of law, the offeree's rejection, counteroffers, and the offeror's revocation.

A valid agreement to contract requires the presentation of an offer by the offeror and an acceptance of that offer by the offeree. To create an enforceable contract, acceptance must meet three requirements:

- The acceptance must be made by the offeree.
- The acceptance must be unconditional and unequivocal.
- The offeree must communicate the acceptance to the offeror by appropriate word or act.

Minors, insane persons, and intoxicated persons generally cannot enter into legally binding contracts because they are not considered competent to do so. Under some circumstances, however, these parties can contract. Artificial entities, such as corporations, can generally contract, but their ability to do so may be limited by their charter.

Five types of consideration are sufficient for forming an enforceable contract: valuable consideration, forbearance, present consideration, future consideration, and binding promises. Each type of consideration has its own set of legal rules.

Three types of consideration are not considered sufficient for forming a binding contract: past consideration, promises to perform existing obligations, and compromise and release of claims.

In some cases, contracts are enforceable for equitable or public policy reasons despite the lack of consideration. Contracts without consideration are enforceable when promissory estoppel applies or in some cases involving charitable subscriptions.

The nine categories of illegal contract are: contracts to commit crimes or torts, contracts harmful to the public interest, usury contracts, wagering contracts, contracts with unlicensed practitioners, contracts to transfer liability for negligence, contracts in restraint of marriage, contracts in restraint of trade, and unconscionable bargains. Although courts generally do not enforce illegal contracts, they may do so when a specific group is protected by law, in the case of *in pari delicto* agreements, or in severable contracts that contain legal provisions.

Genuine assent may be lacking if a party was induced to enter a contract through fraud, mistake, duress, undue influence, or innocent misrepresentation. When genuine assent is lacking, the innocent party has the right to avoid the contract. In these cases, courts do not uphold the contracts and sometimes award monetary damages to the wronged parties.

Under state statutes of fraud, some contracts must be in writing to be enforceable. Generally, when a contract is in writing, oral evidence cannot be used to change the terms of the agreement. However, oral evidence can be used to prove missing contract terms, clarify ambiguities, support an allegation of wrongdoing, or demonstrate the failure of a condition precedent.

When courts are interpreting ambiguous or unclear contracts, words are understood in their plain meaning. The goal is effectuation of the parties' intent. Contracts are classed as entire or divisible, clerical errors and omissions are corrected, contradictory terms are prioritized, ambiguities are interpreted against the writer of a document, and the parties' own interpretations are considered. Courts seek a legal and fair interpretation, and trade usage, course of dealings, and performance are considered.

A third party ordinarily does not have any rights under contracts made by other parties. However, in two situations third parties do have enforceable rights under contracts others have made: assignment and third-party beneficiary contracts.

Although most contract rights are assignable, some are not. To be effective, an assignment needs neither formality nor writing. A primary obligation to perform usually remains with the assignor. In general, if a party assigns rights to the assignee, the third party can enforce against either the assignee or the assignor, but not against both.

Third-party beneficiary contracts benefit creditor beneficiaries, donee beneficiaries, and incidental beneficiaries. Donee and creditor beneficiaries, referred to as intended beneficiaries, have enforceable rights against the original promisor, but an incidental beneficiary has no enforceable rights.

Parties can discharge their contractual obligations by complete performance, agreement of the parties, substitution of a new contract, impossibility of performance, or operation of law. In addition, failure to fulfill a contract condition may alter, limit, or discharge contractual obligations.

A breach of contract can occur through repudiation or anticipatory breach, and breaches can be either material or minor. In the case of a breach of contract, the nonbreaching party can sue for compensatory damages, consequential damages, and in some cases for punitive damages. Extracontractual damages can be awarded against insurers. Parties to a contract can also agree on an amount of liquidated damages when the contract is formed. When money damages are an inappropriate or inadequate remedy for breach of contract, a nonbreaching party can seek equitable remedies including specific performance and injunctions.

Given the facts of a particular case, in order to determine whether a contract is legally enforceable it is necessary to establish two things.

- Was a valid contract formed?
- Is the contract enforceable?

If a contract is legally enforceable and a breach occurs, remedies and other options are available to the innocent party injured by the breach.

ASSIGNMENT NOTES

1. UCC, § 2-709.
2. UCC, § 2-509. *See also* UCC, § 2-510.