

2: UNDERSTANDING CONTRACT LAW, PART 1

- key terms
 - offeror: party who initially promises to give something up in exchange for something from the other party
 - offeree: party who agrees to give something up in return for something offered by the other party
 - promisor: party making a promise in contract
 - promisee: party that promise is being made to in contract
 - privity of contract: refers to the contractual relationship that exists btwn the parties of contract
 - breach of contract: the failure to fulfill a contractual promise, w/o valid legal reason for failure
 - forbearance: act of giving up legal right or promising to give up legal right
 - avoid: exercising your lawful right to cancel a contract
 - ratify: agreeing to go through w/ & be bound by a contract when you had the right to cancel it
 - restitution: repaying or reimbursing for goods/services received, usually b/c you are canceling contract
 - remedy: solution sought by innocent party in court
- types of contracts
 - bilateral:
 - both parties make a promise
 - i.e., each party is both a promisor and a promisee
 - either party can sue the other for not acting on the promise
 - (ex: ins co promises to indemnify & insd promises to pay prem)
 - unilateral:
 - only 1 party makes promise
 - usually takes format of “**IF** A does ____, then B promises to ____”
 - A is not obligated to act
 - if A **does** act but B fails to uphold their promise, B is in breach of contract
 - executed: contract already completely performed by both parties (i.e., finished contract)
 - executory:
 - contract that hasn't been completely performed by all parties
 - (ex: homeowner's pol, because ins co promise to indemnify isn't done until pol period over)
 - express: contract terms & intentions explicitly stated
 - implied-in-fact:
 - contract whose terms/intentions are implied by context/surroundings
 - typically applies to parties w/ prior transactions that set pattern/expectation
 - ex: if party w/ credit acct shows cashier an item but doesn't pay, it can be presumed they'll pay later
 - implied-in-law:
 - not explicit, but is imposed by law
 - usually enforced to avoid one party being unfairly enriched
 - void:
 - agreement that **never** reaches contract status **despite** parties' intentions & thus is **not** binding
 - ex: contract to commit crime
 - voidable:
 - contract that one of parties can rightfully avoid based on some circumstance
 - i.e., contract that becomes cancelable b/c one party did something wrong
 - innocent party can usually still choose to affirm/go through w/ contract
 - right of avoidance is reserved for **innocent** party

- (6) elements of a contract (**see BONUS handout – Ch 2 Elements of a Contract**)

- agreement
 - offer
 - acceptance
- capacity to contract
- assent
- consideration
- legal purpose
- made in the form required by law

~~~~~

- offer:

- promise that requires some action/acceptance by intended recipient to form a complete agreement
- (3) key elements for a valid offer
  - 1) intent to contract
    - key question: did the offeror intend to be **immediately bound** to a particular party by their acceptance?
    - **language of offeror is most important factor**
    - examples of **no** intent to contract:
      - advertisements, if they don't promise who specifically they are selling to
        - not binding: "Milk on sale \$2.99"
        - probably binding: "Milk for \$2.99 to first five customers to enter our store"
      - social invitations (ex: you can't sue for someone canceling a party)
      - predictions (ex: you can't sue because the weatherman was wrong)
      - offers made in excitement or jest (ex: you can't sue someone who was joking)
  - 2) definite terms (but absence of 1 term doesn't necessarily invalidate entire contract)
    - involved parties
    - subject matter
    - price
    - time
  - 3) communication to other party
    - i.e., you didn't really make an offer if the other party didn't know about it
    - (ex: if person didn't know there was reward for finding dog, he can't claim it after he's already turned in the dog)
    - you can accept offer if you started performing your part before you knew of offer (ex: you can claim reward offered as long as you learned of it before turning in the dog)
- how offers can terminate
  - lapse of time
    - offers aren't open indefinitely
    - if offer terminated, attempt to accept afterwards is considered a counteroffer
  - operation of law
    - if law makes contract (ex: becomes illegal to sell a certain product)
    - if subject matter is destroyed before acceptance (ex: offer to sell house can't if house burns down)
    - if either party dies or is formally declared insane before acceptance

- offeree's rejection
  - rejection terminates original offer
  - attempts to accept the offer again are considered a new offer
- counteroffer
  - explicit rejection of orig offer & change in terms that creates a new offer
  - differs from request for info (where you don't reject orig offer yet)
- offeror's revocation
  - offers to general public must be revoked in same manner offer was made
  - for unilateral contract offers, if offeree has substantially performed act then offer is irrevocable (performance of the primary, necessary terms of the agreement)
- acceptance
  - assent to an offer that offeree agrees to proposal or does what has been proposed
  - 3 requirements for valid acceptance
    - accepted by offeree (person who promise is being made to)
      - i.e., someone else can't accept offer & automatically bind offeror
      - offers made to a group or the public can be accepted by any member of group/public
    - unconditional & unequivocal
      - acceptance can't have modifications to offer (if it does, that's a counteroffer)
      - acceptance must show clear, definite intent to be bound
        - i.e., "maybe I can pay you next week" is *equivocal* (**not** clear enough)
    - communication of acceptance
      - if offer specifies how acceptance to be communicated, offeree must comply for valid acceptance
      - if offer doesn't specify, any reasonable method acceptable
      - forms of acceptance:
        - explicit return promise
        - performing the act requested by the offeror
          - if offeree does substantial performance, offeror might lose right to revoke offer
  - timing of acceptance
    - in most cases, *mailbox rule* applies (acceptance effective as soon as it leaves offeree's possession **even if it never reaches offeror**)
    - in some jurisdictions, offeror must receive acceptance, especially if knowledge of acceptance is critical
    - offeror can make offer conditional upon their receipt of acceptance
    - communication to party other than offeror is **not** valid acceptance
    - offeree **cannot** revoke acceptance once it is made
  - silence is usually **not** acceptance, unless past behavior establishes otherwise
    - ex: if seller delivers goods each month & buyer doesn't reject them, buyer will have to pay
  - complaints about offer do **not** negate offeree's right to accept it anyway
- capacity to contract
  - competent party:
    - has the basic or minimal ability to do something
    - has the mental ability to understand problems & make decisions

- 4 types of parties who may **lack** capacity (and can dispute a contract)
  - 1) minors
    - generally, minor can dispute contract even if minor lied about his age
    - to avoid contract, minor must avoid it w/i reasonable time after coming of age
      - if minor doesn't avoid contract, generally assumed they are ratifying it
    - usually required to pay restitution before avoiding contract
    - **circumstances when contract is **not** voidable**
      - **contract to purchase necessities**
        - for things related to health, education, comfort for his standard of living
        - law doesn't want merchants to fear entering contracts w/ minors for basic necessities
      - minor has married
      - minor has assumed obligation of bail bond
      - minor has duty of child support
      - certain contracts for child to perform services or biz transactions (ex: child actor)
    - parents **generally not** liable for child's contracts unless:
      - parent co-signed
      - child acted on parent's behalf in transaction
      - parent directed child to sign for parent's benefit
      - parent neglected or refused to pay for necessities, which is what contract is for
  - 2) insane
    - 2 classes:
      - *adjudged insane*: legally declared insane by court
      - *self-declared*: person who claims he is insane or mental incompetent
    - those who claim insanity must prove 1 of 2 conditions:
      - person didn't know contract was forming
      - person didn't u/s consequences of acts purporting to form contract
    - **insane person **can't** avoid contract if other party proves **both**:**
      - sane party didn't know about insanity
      - **contract has already benefited insane person**
      - (ex: sane person enters contract & paints a guy's house, then finds out guy is mentally incompetent when trying to collect pay)
      - not fair to let insane party get a benefit (newly painted house) while sane innocent party suffers loss (loss of time & cost of supplies)
  - 3) intoxicated
    - generally, intoxicated party **can't** avoid contract but case law has tempered that
    - intoxicated party must prove 1 of 2 conditions:
      - person didn't know contract was forming
      - person didn't u/s consequences of acts purporting to form contract
    - upon being sober, intoxicated person can ratify or avoid contract
    - if 1 party purposely caused the other to be intoxicated, contract is voidable
  - 4) artificial entities that are restricted by law or corporate charter from entering certain contracts
    - i.e., non-person party (company, biz, assoc, etc) that didn't have auth to enter contract
    - *ultra vires contract*: contract "beyond one's powers"
    - usually voidable
    - if either party performed part of contract, other party must still perform

- assent
  - involved parties must have willingly intended to be bound by a contract
  - (see Chapter 3)
- consideration
  - something of value or bargained for and exchanged by the parties to the contract
  - i.e., both parties need to exchange something tangible or intangible w/ each other
  - 5 “types” of consideration
    - valuable consideration
      - consideration that is necessary & sufficient to support a valid contract
      - catch-all term for anything that doesn’t fit the other categories, but still qualifies as valid consideration
      - courts generally do **not** review *adequacy* of consideration (whether amt/value of consideration was fair or worth it)
    - forbearance (agreeing to give up a right)
    - present consideration (committing to something now)
    - future consideration (committing to something in the future)
    - binding promises
      - (ex: ins pol – ins co promises to cover loss & ph promises to pay prem)
      - both parties must be bound to something (ex: if Kate promises to hire Leah to do all repair work **if** Kate decides to build, consideration is **not** sufficient b/c Kate is not bound)
  - 3 types of **invalid** consideration
    - past consideration (ex: asking for car now in exchange for a gift you gave 5 yrs ago)
    - promise to perform existing obligation
    - compromise & release of clms
      - i.e., offering partial payment to settle debt in full
      - exceptions (i.e., when compromises are valid)
        - *bona fide* (good faith) dispute exists about amts owed
        - creditor agrees to accept lesser payment to discharge entire debt
        - if a debtor has many creditors & those creditors join together to negotiate
        - accord and satisfaction:
          - substituting performance of other than what was originally required
          - (ex: pay part of debt & agree to add’t consideration besides money)
  - exceptions to requirement for consideration
    - promissory estoppel:
      - 3 elements:
        - 1<sup>st</sup> party made promise expecting 2<sup>nd</sup> party to act
        - 2<sup>nd</sup> party justifiably relied on promise and suffered detriment
        - only enforcement of promise would achieve justice
      - court can enforce contract in order to prevent injustice
      - ex: if ins co agrees to fix claimant's car so claimant orders parts, then ins co changes mind & denies cov, claimant suffered a loss (the cost of parts)
    - charitable subscriptions
    - promise to repay old debt that was barred by bankruptcy (does not require **new** consideration)

- legal purpose
  - i.e., contract can't be for illegal purpose
  - if contract was illegal from the start:
    - neither party can sue for breach or seek damages for partial performance
    - does **not** automatically become enforceable if change in law makes it legal
  - if contract was legal but becomes illegal due to change in law, parties still owed fair compensation for work done thus far
  - (9) types of illegal contracts
    - to commit crimes/torts (ex: biz interruption ins for prostitute)
    - wagering (gambling)
    - harmful to public interest (ex: contract to bribe wit)
      - insurable interest:
        - beneficiary to an ins pol must actually have the potential to suffer a financial loss if insd suffers harm
        - i.e., you can't take a pol out on someone who has no financial connection to you
    - usury (charging higher interest rate than legally allowed)
    - contracts w/ unlicensed practitioners
    - transferring liab for [your own] negligence
      - i.e., your contract can't exempt you from **all** neg & give you the right to act recklessly
      - exculpatory clause:
        - clause where one party is excused from liab
        - not viewed favorably by court, especially if that party is trying to get away w/ willful/wanton negligence
    - restraint of marriage
      - contract btwn 2 people to bring about or prevent marriage of 3<sup>rd</sup> person
      - marriage brokerage contracts that prevent freedom of choice for marriage
    - restraint of trade
      - suppressing free trade or fair competition
      - illegal, unless necessary to protect interests of parties & doesn't impose undue hardship
      - noncompete agreements
        - when two parties agree not to share confidential biz info (clients, recipes, trade secrets, etc.) after they've terminated a biz relationship w/ each other
        - generally enforceable if there is definite time limit set
    - unconscionable bargains
      - (i.e., too-extreme terms)
      - (ex: if you miss even 1 mortgage payment, bank keeps all the money you paid + house)
  - exceptions to requirement for legal purpose
    - when a specific group is protected by law
      - (ex: ins co that issued illegal pol can't use this defense to get out of covering loss)
    - in pari delicto agreements
      - illegal transaction in which both parties were equally at fault
      - usually renders contract unenforceable
      - however, contract might be enforceable if one party is far more at fault
    - severable contract:
      - contract w/ 2+ promises that court can enforce separately
      - i.e., court won't uphold illegal part, but may require parties to do rest of contract