

## *Contracts I- Prof. Stevens, G.S.U., Fall 1999*

- I. Contract- An enforceable promise or set of promises; a promise with consideration; exchanging a promise for a detriment.
- A. Types of Contracts:
1. Bilateral Contract- Both parties are obligated.
  2. Unilateral Contract- Only one party has made a commitment.
    - Requirements Contract- Seller agrees to sell all that Buyer requires.
    - Output Contract- Buyer agrees to buy all that Seller produces.
  3. Conditional Contract- Performance is not due until after an event occurs (ex ins. policy).
- B. Contract Terms:
1. Promise- Commitment to do, or not do something.
    - Promissor- Party who makes the promise (Breaching Party).
    - Promisee- Party who receives the promise (Innocent Party).
  2. Performance- Fulfillment of a contract
  3. Breach- Breaking a contract.
    - Courts favor the enforcement of contracts where it is clear that the parties intended to be bound.
- C. Consideration- That which is exchanged for a promise; bargained for exchange.
1. Consideration has 3 elements:
    - Detriment
    - Detriment must have induced the promise (intent of promisee).
    - Promise must have been induced by the detriment (intent of promissor).
  2. Detriment- Consideration for a promise. Has 3 forms:
    - A promise.
    - Doing something you are not obligated to do (action).
    - Not doing something you have a legal right to do (inaction).
      - When there is no factual basis to bring an action, then forbearance from bringing the action is not a detriment (objective).
      - The action must be made in good faith in order for a detriment to have occurred (subjective).
  3. Moral obligation- there is a minority opinion that moral obligation is sufficient consideration when promissor has received a past material benefit.
  4. Gratuitous Promise- A promise without consideration because it has no exchange of detriment.
  5. Past Consideration- not consideration because there is no exchange.
  6. Pre-existing Duty- not consideration because there is no exchange of detriment.
    - Recision is a defense to pre-existing duty because both parties agree to end old agreement and form new agreement.
    - Restatement says that fair and unforeseen circumstances can justify recision.
- D. Mutuality of Obligation- both parties must be obligated to do something pursuant to their promise.
1. Illusory Promise- Promissor has unrestricted right to act or not to act.
    - Promise with restriction is not illusory.
  2. Good faith, reasonableness, fair dealing, best efforts, trade usage, course of dealing (how parties have formed contracts with each other in the past) , and course of performance (how parties have performed with each other in the past) are implied when a contract does not specifically set forth obligation.
  3. Definiteness- required in contracts; there is not mutuality of obligation without it.
    - Contract terms are indefinite when the parties obligation cannot be determined.
    - When term are indefinite, court asks, “did parties intend to be bound?” If yes, court will imply terms of good faith and reasonableness.
    - If discretion is limited by good faith and reasonableness, it is not indefinite.

- E. Assent (“Meeting of the Minds”) has two components:
1. Intent to be bound
    - Intent is defined by the Objective Theory of Contracts: If, objectively, a party intends to be bound, there is assent unless the other party subjectively knew, or should have known, that the first party did not intend to be bound.
      - Objective standard- By actions, not mental processes, reasonable person believes parties intended to be bound.
      - Subjective standard- Parties “believe” that they intended to be bound.
  2. Agreeing to the same terms.
    - Acquiescence- Agreement by remaining silent when a reasonable person would not have been silent had they disagreed; other side knows and doesn’t object. Assent can be determined by acquiescence.
    - Trade usage of terms is implied in every contract.
- F. Offer- Promise to do something.
1. Offeror is master of his offer, acceptance must be in form requested by offeror.
    - When promise is requested for acceptance, performance or acquiescence is acceptable for acceptance.
    - When offeror requests acceptance by promise, they are seeking 3 things\*:
      - Unconditional acceptance
      - Acceptance that is identical to offer
      - Commitment & Assent
  - \* (Can be inferred from words or conduct, if conduct clearly indicates acceptance)
  2. Advertisements or price listings are not offers because the seller does not intend to expose himself to unlimited liability. However, if the ad limits the number available, the seller’s liability is then limited/qualified and the ad becomes an offer.
  3. Bids and price quotations are offers.
  4. Offer is terminated in 4 ways:
    - Lapse- can occur after reasonable time or by the offer’s terms
    - Revocation by offeror- can be action that is inconsistent with offer (action that makes fulfillment of offer impossible); Retraction must be communicated to offeree, but can be communicated by reliable third party.
    - Rejection by offeree- can be manifested by actions that a reasonable person would interpret as inconsistent with acceptance.
    - Death of offeror
  5. An offer that is terminated cannot be accepted; termination kills the offer permanently.
  6. An offer can be revoked at any time before acceptance, unless the offer is made irrevocable by contract.
  7. An offer can be revoked after acceptance if four conditions are met:
    - Offeror has made material mistake.
    - Mistake was not the result of neglect of legal duty.
    - Enforcement of the contract would be unconscionable.
    - Offeree can be placed in status quo.
  8. Irrevocable offer- offer that cannot be revoked.
    - Option contract is an irrevocable offer
      - Option can be executed/exercised/accepted
      - Option contract contains an irrevocable offer to hold option open to a specific person for a specific amount of time.
    - Irrevocable offer not supported by consideration can be retracted.
  9. Last Shot Doctrine- Whoever sends the last document before there is action is the offeror.
- G. Acceptance- last element in the creation of a contract.
1. Acceptance must:
    - Be assent to terms of offer.
    - Be a commitment to be bound by the terms of the offer.

- Be unconditional, otherwise it is a counter-offer; Mirror image rule- must mirror the terms of the offer.
  - 2. Acceptance must be communicated to offeror, unless specified otherwise.
    - Acquiescence does not apply to acceptance unless parties agree; cannot be inaction.
  - 3. Acceptance with conditions is rejection and counter-offer.
  - 4. Mailbox Rule- Acceptance is effective when it is mailed rather than when it is received.
    - At mailing of acceptance, offer cannot be revoked, unless otherwise specified by the offer itself
    - Offer is effective upon receipt by offeree.
    - Revocation is effective upon receipt by offeree.
    - Rejection is effective upon receipt by offeror.
- II. Remedies- designed to make innocent party whole.
- A. Actions in Law (seek money)- Awarded to make innocent party whole; does not punish.
- B. Measures of Damages:
1. Restitution: Enables promisee to recover unjust enrichment gained by promisor, (Quantum Meruit).
  2. Reliance: Puts innocent party in the condition they were in before the contract (Status Quo Ante).
  3. Expectancy: Puts innocent party in condition they would have been in if contract had been performed.
- B. Actions in Equity (seek action)- Available only when money will not make you whole; “To get equity, you must do equity”; “If you seek equity, you must come into court with clean hands.”.
1. Money will not make you whole when:
    - You cannot, at a reasonable price, purchase the product elsewhere.
    - You cannot accurately speculate what damages will be.
    - The subject of the contract is unique.
    - The subject of the contract is land.
  2. Specific Performance: Remedy by enforcing contract, requiring party to do something.
    - Personal services contracts cannot be specifically enforced. (13<sup>th</sup> Am.)
  3. Injunction: Remedy by requiring party not to do something.
- III. Quasi-Contract- Enforcing an implied promise or promise without consideration.
- A. Restitution- Action when there is an implied contract, AND promisee gives benefit to promisor, AND if promisor did not pay, he would be unjustly enriched.
1. Defenses to Restitution:
    - Benefit was conferred gratuitously.
    - Benefits were subject to a separate contract, so there was no benefit conferred.
    - Benefit conferred cannot be calculated.
  2. Measures of benefits conferred:
    - Value of services rendered.
    - Difference in value before/after services were rendered.
    - Value of benefit conferred to promisor (Quantum Meruit).
- B. Reliance- Makes quasi-contract enforceable.
1. Detrimental Reliance/Promissory Estoppel- The promise is enforceable even in the absence of consideration, IF:
    - A promisee justifiably relies on a promise to their detriment, AND
    - The promisor reasonably expected promisee to rely on the promise, AND
    - It would be unjust not to enforce the promise.
  2. Under detrimental reliance/promissory estoppel action, damages recovered are reliance damages (Quantum Meruit).
  3. If a promise is relied upon, it must remain open for a reasonable period of time.
  4. Reliance on indefinite promise is justified when the promisor knows that promisee is relying on it.
  5. Implied Promise- there is a reasonable expectation of payment (gas pump).
  6. Reliance on offer that seeks performance:

- Once performance is commenced the offer becomes irrevocable. Offeree cannot recover until performance is completed.
- If offer is revoked, performance is excused, but offeree can still collect on offeror's promise if offeree can show that he was ready, willing and able to perform.

7. Reliance on offer that seeks promise:

- If an offeree relies on an offer that seeks a promise, the offer becomes irrevocable, if required to avoid an injustice.

IV. Uniform Commercial Code (UCC)

A. Article 2 controls in any contract for the sale of goods/merchandise/personal property.

B. Battle of the Forms- Occurs when seller's invoice does not match buyer's purchase order.

- UCC 2-207(1): Abolishes the mirror image rule. Expression of acceptance is acceptance even if terms are different, unless offeree expressly says acceptance is conditional upon them.

• UCC 2-207(2):

(a) Fall-out Rule- different or additional terms in acceptance "fall out". Offer becomes the contract.

(b) Between merchants, the acceptance becomes the contract, unless\*:

- Offer expressly limits acceptance to terms of offer.
- Terms in acceptance materially alter contract.
- Notification of objection to terms is given within reasonable time.

\*Courts are split on use of the knockout rule or fallout rule with these exceptions.

- UCC 2-207(3): Knock-out Rule- When parties act like they have a contract, all conflicting terms are knocked-out and the UCC is used to fill in the gaps; contract is the agreed terms plus the UCC.

V. Defenses to Contracts

A. Statute of Frauds- Certain types of contracts, in order to be enforceable, must be in writing, and signed by the party whose performance is sought.

1. Contracts for the sale of any interest in land; any agreement that transfers any interest in land, UNLESS it is a lease of 1 year or less.
2. Contracts whose performance cannot be completed within 1 year of entering into it. Is it *possible* for it to be completed within 1 year?
3. Suretyship contracts- when a party contracts with a creditor to ensure payment of, or to pay, the debt of a third party.
4. Contracts in consideration of marriage.
5. UCC- contracts for the sale of goods of \$500 dollars or more.
6. Defenses to Statute of Frauds under general law:
  - Promissory Estoppel/Detrimental Reliance.
  - Restitution
  - Part Performance
  - In court admission
7. Defenses to Statute of Frauds under UCC:
  - Partial Performance (performance must directly relate to the contract)
  - In Judio Admission (the party alleging Statute of Frauds admits to contract in court)
  - Specially Manufactured Goods

B. Capacity- ability or right to enter into a contract. Two types of incapacity:

1. Minors- parties who have not reached age of majority.
  - Minors are still liable for reasonable value of necessities.
  - If the party is no longer a minor, and he ratifies the contract (manifests an intent to be bound), he can no longer void the contract.
  - False representation of age doesn't matter.
2. Mental Incapacity- determined by looking at all the facts of the case, not bound by expert testimony.
  - Cognitive (old) test: Is the mind so affected that the person is unable to comprehend and understand the transaction?

- New Test: The infirmed party must be unable to act in a reasonable manner, in relation to the transaction, AND the other party must have reason to know.
  - Guardian must assert the rights of the infirmed party.
  - Majority rule is that being drunk is not a protected infirmity.
3. Contracts are voidable at the option of the party lacking capacity.
  4. If contract is rescinded, to the extent the party lacking capacity benefited:
    - Minors are not liable for anything.
    - Mental incapable parties are liable for restitution damages.
- C. Public Policy- Contract can be voided if it is against public policy; must affect public-at-large.
1. Public policy against exculpatory clauses. Exculpatory clauses do 5 things:
    - Disclaim all liability
    - Limit liability or recovery
    - State which law controls
    - State jurisdiction in which claim must be filed; Forum Selection Clause- if seriously inconvenient, courts will find it unfair.
    - Set forth time in which claim must be brought
- D. Unconscionability- has 3 elements:
1. Terms are grossly unfair.
    - Courts determine unfairness in two ways:
      - Retrospectively: looking back was contract fair?
      - Prospectively: Is contract fair now?
    - Unconscionability can be based on price alone. Court looks at who's buying it (Poor, elderly, women, uneducated).
  2. Inequality of bargaining power.
  3. Absence of meaningful choice.
- E. No Assent- there are 3 ways in which no assent can be found:
1. No assent in Contract of Adhesion: "take it or leave it" contract, and you have to take it. Requires standard form contract and unfairness in order to be struck down.
  2. When terms are unfair and the document is not normally thought of as a contract (ticket). Test is whether reasonable person would have thought contract existed, determined by:
    - Whether terms were known.
    - Whether person understood it to be a proposed contract.
    - Whether there was reasonable opportunity to accept or decline.
  3. When there is a lack of understanding. There is a lack of understanding when:
    - It is not reasonable that promisee would understand terms.
    - Terms were not brought to the attention of promisee.
    - Promisee did not have a chance to accept or reject terms.
- F. Illegal Contracts- if performance or formation of the contract violates criminal statute, is tortuous, or is against public policy.
1. 3 types of contracts violate public policy:
    - Bribery Contract- Contract to influence public officials.
    - Illegal Contract- Contract to commit illegal acts.
    - Contract related to collusive bidding on public contract.
  2. Commercial Bribery- while not illegal, courts hold that a person should not profit from his own immoral act.
  3. If there is a direct connection between an illegal or immoral act and the performance or formation of a contract, courts will not enforce the contract.
  4. Generally, the court will leave parties to an illegal contract where it finds them.
  5. When a legal contract is directly connected to an illegal contract and one party has received consideration, to prevent unjust enrichment the court may enforce the contract depending on:
    - Relative culpability of the parties.

- Inferior bargaining power of the injured party.
  - Both parties knowledge of the illegal contract.
6. A Non-compete clause will be upheld if 5 conditions are met:
- It is in writing.
  - It is part of an employment contract.
  - It is based on reasonable consideration.
  - It is necessary to protect the business interest of the employer.
  - It is reasonable in time/duration and geographical location/distance. 3-part test:
    - Is it injurious to the public?
    - Does it impose an undue hardship to the employee?
    - Is the time and distance greater than that which is required to protect the employer?
7. When a non-compete clause is found to be oppressive, courts have 3 options:
- Blue Pencil Rule- strike out oppressive terms in the contract. This keeps the court from re-writing the contract by modifying the terms.
  - All or Nothing Rule- if any terms are oppressive, the entire contract is invalid. This keeps the court from re-writing the agreement by selecting which terms will be enforced.
  - Rule of Reason- court enforces whatever is reasonable under the circumstances; court re-writes terms to be reasonable. This enables the court to more closely approximate the intent of the parties.
- G. Duress- wrongful threat of violence, imprisonment, or criminal prosecution that limits free choice.
- Economic Duress- must be wrongful and alleged within reasonable time; has 3 components:
    - Threat to withhold needful goods under contract.
    - Inability to get goods anywhere else.
    - Breach of contract remedy is inadequate.
- H. Misrepresentation of Fact
1. 3 Elements of Misrepresentation:
    - False representation (statement) of present or past fact, not opinion.
    - Must be material or fraudulent.
    - Must have justifiably relied on misrepresentation.
  2. There is a duty to disclose when:
    - There is a misrepresentation of fact.
    - Seller prevents buyer from discovering the truth (caveat emptor- buyer beware).
    - There is a fiduciary relationship between seller and buyer.
    - One party makes a mistake about a basic assumption of the contract and the other party knows it (party that knows must disclose).
    - When one party has special knowledge not generally available to the public.
  3. Partial disclosure related to facts requires full disclosure of facts.
  4. Effect of failure to disclose:
    - Defense to breach of contract.
    - Used affirmatively to rescind a contract.
  5. It is justifiable to rely on an attorney's opinion of the law in the state in which he practices. An attorney's opinion can be misrepresentation.
- I. Mistake- an erroneous belief about an existing fact.
1. Mutual Mistake- when both parties are mistaken. Contract can be rescinded when:
    - Mistake is about material element.
    - Mistake has significant effect on consideration.
    - Person seeking rescission did not contribute to mistake or cannot be blamed for mistake.
  2. Unilateral Mistake- when only one party is mistaken. Contract can be rescinded when:
    - Mistake is known to the other party.
    - The party alleging mistake did not contribute to mistake.
    - Unenforcement would be unconscionable.