There is grim irony in speaking of the freedom of contract of those who, because of their economic necessities, give their service for less than is needful to keep body and soul together.

*Harlan Stone, Chief Justice of the U.S. Supreme Court, 1941–1946*

The obligations established by contract are among the most prized—some might even say “sacred”—features of the American culture. In a society so prone to resolving disputes in court, the written contract becomes a hopeful refuge from litigation or, alternatively, a shield against liability. To that purpose, contracts seem to grow in length almost exponentially from year to year.

Even in the simple events of everyday life, it seems impossible to avoid the written contract. The parking lot claim check, the videotape rental receipt, the hotel registration card—each of these comes with a unilaterally drafted contract that we must accept without negotiation. Our only alternative is to go elsewhere to park our car, rent a video, or get a night’s sleep.

As our national economy becomes ever more “globalized,” American businesses are more frequently dealing with some foreign cultures in which written contracts are rare. When written contracts are accepted reluctantly—at our determined insistence—by business executives in other lands, they might easily be regarded in that culture as irrelevant window dressing to satisfy a “neurotic American psyche.” The irony is that, in some of these cultures, the nod of one’s head or the shaking of hands creates an ethical bond and commitment that a written contract can never achieve—something akin, perhaps, to the solemn handshake of our own American ancestors a century or two ago.

The student who has carefully read this chapter should be prepared to answer these questions:

- What are the different types of contracts?
- What are the essentials of an enforceable contract?
- What is the Statute of Frauds and how does it affect contracts?
- What is the role of parol evidence in contract law?
How does legal capacity affect the validity of contracts?

How are contracts affected by assignment, performance, and discharge?

What are the remedies for breach of contract?

How does the Uniform Commercial Code (UCC) govern commercial transactions?

**SCENARIO**

In re BABY ANGELICA

Johann and Maria Kinski were deeply disappointed by their inability to have a baby. After a series of miscarriages, their doctors suggested that it was unlikely that Maria could carry a pregnancy to full term. Reluctantly, they agreed to consider adoption.

A colleague of Johann’s confided that he and his wife had the same problem and were working with an attorney to locate a surrogate mother. The colleague explained that his wife’s egg would be fertilized *in vitro* and then implanted in the surrogate’s uterus so that their child would be their own genetically. After consulting with their doctor, Maria and Johann decided to seek a surrogate mother and attempt the *in vitro* fertilization.

Johann and Maria met with Mary Cho, the attorney recommended by Johann’s colleague, and discussed the legal ramifications of their plan. Ms. Cho explained that the law regarding surrogate motherhood was a new field fraught with uncertainty because numerous legal issues had never been tested in the courts. Ms. Cho explained a retainer agreement that stated that legal uncertainties and risks could arise from entering into the surrogacy contract. The retainer agreement included a waiver, stating that Ms. Cho was not to be liable if any court should rule that the surrogacy contract was illegal or that the Kinskis were not entitled to custody of the child. After some discussion, the Kinskis signed the retainer. They gave Ms. Cho two checks: one for $4,000 as an advance on legal fees and costs, and one for $5,000 as an advance for the surrogate mother’s living and medical expenses.

Within a few months, the attorney located several qualified candidates. The Kinskis selected Irena Ashton, a widow who had borne two children of her own and whose health, personal history, and references suggested that she would be an excellent surrogate mother.

Ms. Cho went over a very detailed surrogacy contract that the Kinskis and Irena Ashton would have to sign. The contract contained the same statement about legal uncertainties that was in the Kinski’s retainer agreement with Ms. Cho. The contract obligated all three parties to assume the responsibilities of “true and natural parents, regardless of any actual relationship each might have with the child to be conceived, carried to full term and delivered.” In addition to that broad statement of parental responsibility, certain specific responsibilities were assigned in the contract to the Kinskis or the surrogate mother, as the case might be. The contract stated that Irena agreed to irrevocably surrender any rights she might have to the child, once the child was born, and to execute all legal documents necessary to relinquish any parental rights she might have. It further stated that the Kinskis were to irrevocably assume all privileges and responsibilities of legal parenthood. All three parties signed the surrogacy contract, and Ms. Cho handed to Irena the $5,000 advanced by the Kinskis toward her necessary living and medical expenses during her pregnancy.
Kinskis handed Irena a separate check for $1.00, in compensation for all inconvenience, discomfort, pain, injury, and/or emotional distress that she might experience during the pregnancy and delivery.

Two months before the birth, Johann and Maria Kinski were served with legal papers notifying them of a lawsuit for declaratory judgment that had been filed by Irena Ashton, seeking a determination by the court that Irena Ashton was the “natural mother” of the anticipated child. The court papers alleged that Irena had been induced to “sell” the expected child to the Kinskis—a criminal act. For that reason, Irena’s lawsuit claimed that the surrogacy contract was void as a violation of public policy. Irena asked for sole custody of the child and a judgment by the court that the Kinskis lacked any parental rights.

In a state of shock, Maria and Johann went immediately to their attorney, Ms. Cho. Ms. Cho reminded the Kinskis that their retainer agreement and the surrogacy contract both included cautionary language about risks associated with legal uncertainties.

Irena gave birth to a healthy girl. Ironically, she unintentionally complied with the intentions of Johann and Maria when she named the child “Angelica.”

In their answer and cross-complaint to Irena Ashton’s lawsuit, Maria and Johann alleged that:

- They were Angelica’s natural parents because they had jointly contributed the ovum and sperm that determined the child’s genetic heritage.
- They had proceeded with the in vitro conception in good faith reliance upon Irena’s promises in the surrogacy agreement.
- During gestation, Irena was a voluntary “custodian” of the fetus and a “trustee” of the parental rights of Johann and Maria, and of the ancestral rights and birth rights of Angelica.
- The $5,000 advanced to Irena was for her living and medical expenses and was not a payment for surrender of the child into their custody.
- Irena had entered into the surrogacy contract with full knowledge of its terms and with free intent to surrender her rights (if any) to custody of the child.
- The surrogacy contract did not violate public policy any more than a contract between a doctor and a patient to save that patient’s life by performing a vital organ transplant.
- Once conceived in vitro, the embryo to be known as Angelica could not have survived without being implanted in a surrogate mother.

The Kinskis asked the court to declare them to be the natural and legal parents of Angelica, to grant them sole custody, to find that Irena had no parental rights whatsoever, and to find that Irena had breached the surrogacy contract.

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**Most Contractual Relationships Are Determined Privately**

When we pump our own gas at the self-service station, we agree—that is, we enter into a contract—to pay the posted price, without negotiation, without a written agreement, perhaps without even a spoken word. If one doubts that a contract
A contract of adhesion is an agreement written by the vendor for the sale of consumer goods or services without any bargaining, and is offered to the buyer on a “take it or leave it” basis.

A disclaimer is a denial (usually in advance) of any responsibility or legal liability.

Annulment is the court judgment that a valid marriage never existed.

A prenuptial agreement is made between prospective spouses in contemplation of their marriage and determines the relative property rights that each shall have during (and, possibly, after) the marriage.

is formed, after pumping the gas she should try paying less than the posted price. If we stop at an upscale bar on the way home from work and order a beer without asking the price, can we drink the beer but refuse to pay that bar’s standard $7.00 tab? Depending upon the law of that state, we might be held by a court to have entered into a contract to pay the customary price for a beer in that particular bar, or the customary bar price for beers in that community. Enforceable contracts are made much more easily than most of us realize.

In a commercial parking lot, the driver receives a ticket stub that typically commands him to “read the contract printed on the reverse side,” which virtually no one reads, of course. Does he have a contract with that parking lot? If he accepts the stub and parks in the lot, he does have a contract, of course. But it might not be the exact contract spelled out on the reverse side of the stub. That parking lot ticket stub is a classic example of a contract of adhesion, meaning that the driver had no opportunity to negotiate the terms of the contract—he simply had to “take it or leave it.” Many self-serving provisions in such contracts, known as disclaimers or exculpatory clauses (e.g., “we are not responsible for any damage or loss by fire”), often are not enforceable under the law. The courts simply will not allow the one who unilaterally writes the contract—to evade liability unfairly.

People enter into contracts when they exchange marriage vows, when they accept gas money from their car-pool passengers, and possibly when they pay the monthly bills of their elderly parents. In the latter example, they “possibly” incur a liability because their payment of the parents’ bills might lead a landlord, public utility, or gardener, for example, to continue providing accommodations or services to the parents—in reliance upon a reasonable expectation that the adult son and daughter will continue to pay the bills. It is not necessary that the son and daughter intend to formally create what one would call a “contract”—it is only necessary that they voluntarily do something that causes them to assume an enforceable obligation. The son and daughter might argue that they did not intend to enter into such a contractual arrangement with their parents’ landlord, telephone company, or gardener. But those creditors might argue that the adult childrens’ conduct—paying their parents’ bills—induced those creditors to do what they otherwise would not have done.

SOME CONTRACTUAL RELATIONSHIPS ARE DETERMINED BY LAW

Although all contracts are subject to various restrictions and requirements imposed by law, the fundamental nature of some contractual relationships is established more by the law than by the desires and intentions of the parties. The most obvious example is the legal relationship between husband and wife. In family matters, the law expresses a public policy that says that in some areas of the marital relationship, the interests of society—as an interested “third party”—are more important than our personal intentions and private agreements. Of course, the legal principles discussed in this chapter might vary somewhat from the law of any given state jurisdiction.

Although marriage is a “state of being”—a legal union of two persons as husband and wife—it is entered into by making a contract by exchanging the marriage vows. If this marriage “contract” is void for any reason, there is no marital state under the law. Annulment is the court’s determination that the parties were never married because of some deficiency (e.g., one or both being under the age of consent; a marriage obtained by fraud or duress; a failure to consummate the marriage by cohabitation).

Prenuptial agreements are used to limit financial obligations and establish property rights in a contemplated marriage relationship, but society restricts
the latitude of those private contracts. Depending upon the state in which they reside, spouses might be obligated to provide financial support and necessary personal care for their mate, regardless of any prenuptial agreement. The division of property under a prenuptial agreement might be disregarded by the courts whenever equity or a strong public policy requires it.

The law dictates terms for other contractual relationships also, far beyond the realm of family life. When an employer hires someone, she assumes all of the obligations imposed by law on the employer-employee relationship. For example, state laws mandating periodic “breaks” cannot be evaded by any private agreement that the employee will work without breaks. Federal Aviation Administration regulations limiting the duty hours of airline crews cannot be overruled by union contracts allowing the airline to impose longer duty hours.

Under the common law, employment contracts are generally at-will—the employer may fire, or the employee may quit, at any time and for any reason whatsoever. “Just because” is reason enough. Nonetheless, an employer may not dismiss an at-will employee for reasons specifically forbidden by statute: racial, ethnic, or religious status, for example. Nor may an employee be dismissed because he files a worker’s compensation claim. State and federal laws generally prohibit dismissing employees for organizing a labor union or for participating in lawful union activities. In most jurisdictions, statutes also protect whistleblowers, who may not be fired for revealing to authorities the illegal conduct of their employer. An at-will employment contract cannot override the statutory or common law rights of employees.

In the following Case in Point, the Montana Supreme Court considers a wrongful discharge case in which the plaintiff claims to have been wrongfully terminated for blowing the whistle on illegal conduct at his workplace. The bracketed notations “[expletive deleted]” appear also in the Montana Supreme Court’s own decision, which is excerpted here.

A CASE IN POINT

Krebs v. Ryan Oldsmobile
Supreme Court of Montana
255 Mont. 291, 843 P.2d 312 (1992)

Plaintiff David A. Krebs brought a wrongful discharge from employment action in the District Court of the Thirteenth Judicial District, Yellowstone County, against defendant Ryan Oldsmobile. Both parties brought motions for summary judgment. The District Court granted Ryan Oldsmobile’s motion for summary judgment and denied Krebs’ motion. We affirm in part and reverse in part.

We phrase the issues before the Court as follows:

1. Did the District Court err in granting Ryan Oldsmobile’s motion for summary judgment?
2. Did the District Court err in denying Krebs’ motion for summary judgment?

David A. Krebs was employed by Ryan Oldsmobile from July 25, 1989, until January 10, 1990, when he was discharged. On January 4, 1990, Krebs provided information to the Montana Criminal Investigation Bureau (MCIB) concerning illegal drug activity by several employees of Ryan Oldsmobile. At this time, Krebs agreed to continue to provide information on illegal activity at Ryan Oldsmobile and to attempt to purchase illegal drugs from the employees of Ryan Oldsmobile who were allegedly selling drugs. There is no evidence indicating that Krebs was to be paid for providing this information.
On January 9, 1990, a vehicle owned by a known fugitive from justice was dropped off at Ryan Oldsmobile. Krebs called the MCIB and informed them of the vehicle. Sometime after Krebs made the call to MCIB, Dick Ryan of Ryan Oldsmobile pressed the redial button on the phone Krebs had used and learned that Krebs had called a law enforcement agency.

The following day, January 10, 1990, Dick Ryan and Pat Ryan, along with several employees of Ryan Oldsmobile, schemed to “set up” Krebs. Pat Ryan announced that he was going to meet the fugitive at a local business in the vicinity of Ryan Oldsmobile. The purpose of this scheme was apparently to determine if Krebs would report to law enforcement information regarding this fictitious meeting with the fugitive. Krebs did phone the MCIB and informed them that Pat Ryan would be meeting at a nearby business establishment with the fugitive. An employee of Ryan Oldsmobile hit the redial button on the phone used by Krebs and learned that Krebs had again called a law enforcement agency. The employee informed Pat Ryan who immediately sought out Krebs and fired him.

The scheme devised by Pat Ryan to confirm his belief that Krebs would report illegal activity if given the chance also got Mr. Ryan into trouble with law enforcement and federal prosecutors. Acting on this information, law enforcement personnel surrounded the local business establishment in an attempt to capture the fugitive. They did not capture anyone.

On January 11, 1990, one day after he had been fired, Krebs called Pat Ryan. The telephone conversation was recorded and the following is a transcript of that conversation:

Krebs: How are you doing? Hey, I am wondering what the deal is here. What, you’re so upset about, what is, you know, what’s the story here, as far as, as me working? What’s, what’s up?

Ryan: Well, number one is the misuse of the dealer plate, Dave. You know that you can’t run dealer plates on your, on your truck. Number two, you’re a [expletive deleted] snitch and we don’t want you around here, basically.

Krebs: How’s that? I mean, I don’t . . .

Ryan: Every time we make a move, you call the [expletive deleted] FBI. We caught you [expletive deleted] redhanded twice.

Krebs: I’m sorry, you’re wrong.

Ryan: (unintelligible) . . . Well, I know that I’m not wrong, Dave. No matter what you say, I know you’re [expletive deleted] boldfaced lying.

Krebs: Uh . . .

Ryan: I set you up yesterday, partner. You went over to the service department, you made a call, we hit redial after you left and it was some federal crime bureau. The same thing happened the night before when Dick and Alisse set you up, Dave. You went into Harkin’s office. After you left Dick hit redial, same [expletive deleted] group of people. It’s funny how I walk out and the place is surrounded by FBI agents. I laughed my [expletive deleted] off, and there you were watching all the action. You come get your [expletive deleted] check, get your plate back and I need your key too. That’s all I have to say to you.

Krebs: Uh . . .

Ryan: Tell . . . Tell Carl nice try.

Krebs: That doesn’t make. . . .

Krebs brought a wrongful discharge from employment action on September 10, 1990. Ryan Oldsmobile alleged that Krebs did not get along with other employees, that he disrupted the operation, and that various other legitimate business reasons existed which justified Krebs’ discharge. The District Court granted Ryan Oldsmobile’s motion for summary judgment and denied Krebs’ motion for summary judgment.
I

Did the District Court err in granting Ryan Oldsmobile’s motion for summary judgment?

A district court judge may grant summary judgment when:

[The pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. Sherrodd, Inc. v. Morrison-Knudsen Co. (1991), 249 Mont. 282, 282, 815 P.2d 1135, 1136; Rule 56(c), M.R.Civ.P.

The party moving for summary judgment has the initial burden of showing that there is a complete absence of any genuine issue of material fact. To satisfy this burden, the movant must make a clear showing as to what the truth is so as to exclude any real doubt as to the evidence of any genuine issue of material fact. [Citation omitted.] . . .

Krebs brought an action claiming that his termination from employment violated the Montana Wrongful Discharge From Employment Act (Wrongful Discharge Act) found at § 39-2-901 through -914, MCA. Section 39-2-904, MCA, of the Wrongful Discharge Act sets forth the elements of wrongful discharge, and provides that:

A discharge is wrongful only if:

(1) It was in retaliation for the employee’s refusal to violate public policy or for reporting a violation of public policy;

(2) The discharge was not for good cause and the employee had completed the employer’s probationary period of employment; or

(3) The employer violated the express provisions of its own written personnel policy.

The clear and unambiguous language of the statute provides that proof of any one of the three elements will support a wrongful discharge action. . . .

* * * *

Ryan Oldsmobile presented evidence to the District Court which, if proven to be true, could support their contention that Krebs was discharged for good cause. However, Krebs also presented evidence tending to show that he was not discharged for good cause. The evidence presented by Krebs clearly presents a genuine issue of material fact which remains to be determined, thus precluding summary judgment on the issue of whether good cause existed for the discharge.

The District Court then recognized that the Wrongful Discharge Act protects a good faith “whistle blower.” However, the court stated that the Wrongful Discharge Act would not cover “a paid government agent (undercover police officer) whose sole purpose is to investigate and report public policy violations to their primary employer.” The court concluded that Krebs’ status was more akin to that of an undercover police officer, and therefore, the statute forbidding termination of an employee for the reporting of a violation of public policy did not apply to Krebs. We disagree. Krebs was clearly an employee [of Ryan Oldsmobile] as defined in § 39-2-903(3), MCA. Krebs approached law enforcement in order to volunteer information. He was not sought out or placed by law enforcement. Krebs was not promised remuneration. Krebs provided information on only three occasions. Krebs’ relationship with law enforcement lasted a total of six days. Finally, Krebs was paid a grand total of $40 for the information provided and this sum was paid several weeks after he was discharged. To hold that an individual who provides information concerning violations of public policy will not be covered by the Wrongful Discharge Act if they agree to cooperate, even minimally with law enforcement, would be to thwart the very purpose of the statute. The statute states that a discharge in retaliation for reporting a violation of public policy is a wrongful discharge. Krebs’ conduct was protected under the Wrongful Discharge Act.
In this case, the recorded telephone conversation, by itself, is sufficient to create a genuine issue of material fact as to whether Krebs was discharged in retaliation for reporting a violation of public policy. Summary judgment was not appropriate in light of the contested factual issues.

Summary judgment is proper when there is no genuine issue of material fact as to whether an employee was discharged for good cause or in retaliation for reporting a violation of public policy. However, in this case there are genuine issues of material fact which remain to be decided by the trier of fact. The District Court’s granting of summary judgment to Ryan Oldsmobile is reversed.

II

Did the District Court err in denying Krebs’ motion for summary judgment?

Ryan Oldsmobile denies that Krebs was wrongfully discharged and argues that numerous reasons existed which justified Krebs’ discharge. Ryan Oldsmobile has raised genuine issues of material fact which are in dispute relating to Krebs’ discharge and which are clearly sufficient to survive Krebs’ motion for summary judgment. The District Court’s denial of Krebs’ motion for summary judgment is affirmed.

This matter is affirmed in part and reversed in part and remanded to the District Court for a trial to determine whether Krebs was discharged for “good cause” and for a determination of whether Krebs was discharged in retaliation for reporting a violation of public policy.

It is interesting that the Montana Supreme Court remanded for trial both issues in Krebs. If Krebs prevails at a subsequent trial on the retaliation issue, it appears that the allegations of “good cause” for his dismissal might become irrelevant. Otherwise, the court would have to determine which cause was predominant in his dismissal—the retaliation or the good cause. It would thwart the very purpose of the Montana statute if a dismissal for some “minor” good cause could shield an employer from all liability for an egregious dismissal in retaliation for reporting illegal activity.

**EXPRESSION AND IMPLIED CONTRACTS**

A contract defines a relationship between the parties who enter into that contract. A typical contract establishes mutual promises that a court will enforce. Promises alone, however, do not always a contract make. Much depends upon the nature of the promises and the intention of the parties. Later in this chapter, we will identify the essential characteristics of every valid contract.

A contract is either expressed in words or implied by the conduct of the parties. The typical implied contract is of the sort described earlier, as when a customer pumps her own gas at the filling station. Without a spoken word, the customer enters into a contract to pay the posted price for the gasoline. Implied contracts are just as enforceable as those expressed in words—but it might be more difficult to prove and enforce their terms.

In some situations, a contract of major importance might be partially expressed in words and partially implied. This often occurs when the parties have had a series of dealings and agree to embark on yet another deal. Perhaps one of them says, “Let’s do another deal,” and the other party says, “O.K.”—and nothing more is said. No specific terms are expressed, either orally or in writing, but the parties have voiced their consent to terms that both believe are mutually understood. Because their understanding is based upon their own past conduct, those terms are said to be implied.

An express contract can be oral or in writing (note that there is no “ed” in “express”). The main advantage of a written contract is the greater certainty
about the terms of agreement. A written agreement also makes it more difficult for one of the parties to deny that any contract was made, at all. Obviously, both are important advantages.

**BILATERAL AND UNILATERAL CONTRACTS**

The terms “bilateral” and “unilateral” refer to *the manner in which a contract is formed*—they do not define the nature of the contract that results. In the typical contract, two people exchange promises, for example, when someone sells a used car. She promises to deliver the car next Monday and the buyer promises to pay her $7,000 next Monday. That is called a **bilateral contract**. Each party makes a promise, and then each party later performs the promised acts.

Suppose the owner does not advertise her car, but some stranger unexpectedly offers her $30,000 cash-in-hand for immediate delivery. Suppose, without saying a word, she hands over the keys, the car, and the vehicle registration. That is a **unilateral contract** because *the seller never made a promise to do anything in the future*. Only the buyer made a promise: “If you give me the car I’ll give you $30,000—you have 60 seconds to make up your mind.” The contract was both created and performed at the moment they exchanged the car, keys, and registration for the $30,000.

If the seller had said, “No, I need the car today, but I’ll sell it to you tomorrow for $30,000”—and the stranger agreed—they would have formed a bilateral contract (a promise exchanged for a promise). If the seller had done nothing and said nothing, no contract would have been formed. When the seller accepted $30,000 in cash for immediate delivery of the vehicle, a contract was both created and executed (i.e., performed) in an instant, and neither the seller nor the buyer had any legal right to back out of the deal.

**EXECUTORY CONTRACTS**

When a bilateral contract is formed, it is always an **executory contract**. The promises exchanged have yet to be executed—that is, carried out or performed. If one party performs its promises, the contract is still executory until the other party has performed all of its promises as well. Once all promises have been performed by both parties, the agreement is an executed contract.

**Quasi Contracts**

Finally, we shall consider a quasi contract, which *really is not a true contract at all*. As we will see later in this chapter, a true contract requires an offer and an acceptance—a “meeting of the minds.” But the law imposes a **quasi contract**—which actually is a *legal remedy*—in situations wherein basic fairness requires that someone assume an obligation to prevent his own **unjust enrichment** (e.g., obtaining someone’s property without paying for it). The legal remedy is called “quasi contract” because the court imposes an obligation similar to that which would result from entering into an actual contract. One must sue in court to obtain this remedy of quasi contract.

For example, if a new refrigerator is delivered to the wrong address, but the homeowner says nothing and allows the delivery crew to install it, the courts will impose an obligation to surrender the refrigerator—or to pay for it—under the doctrine of quasi contract. On the other hand, if the same homeowner returns from work one evening to discover that workers had mistakenly painted his house that day, rather than the one next door, it is less likely that a court
would impose an obligation under the remedy of quasi contract to pay the misdirected painters. The homeowner is an innocent “victim” of someone else’s mistake and had no opportunity to prevent that mistake.

**THE ESSENTIAL ELEMENTS OF A VALID CONTRACT**

There are four basic elements of a valid contract:

1. parties with the capacity to form a contract
2. a legal purpose
3. a meeting of the minds
4. consideration

**LEGAL CAPACITY TO MAKE A CONTRACT**

A person cannot be bound to an agreement he is incapable of making. A party cannot “agree” to something she does not understand, so a party to every contract must have the capacity to understand the general nature of the promises being made—and the consequences of making these promises. This does not mean that she must comprehend every legal nuance and minor consequence of the agreement—the comprehension of an ordinary layperson is generally sufficient. (Perhaps it is assumed that the ill-informed layperson will recognize the need for legal advice, when appropriate, and will seek it.)

A minor child is presumed to lack the intellectual and social maturity to understand the legal obligations under a contract. Until recently, most contracts entered into by a minor have been *voidable* by the minor, but only at his option (i.e., if he wants to perform the contract, then the contract is enforceable). Consequently, a merchant could be bound by the contract even though the minor was permitted to *avoid* it—that is, to treat it as void. The minor’s right of avoidance, however, did not generally apply to the necessities of daily life, including food, shelter, clothing, and medical care (also known as “necessaries”). If, however, a contract for a necessity was still executory (not yet performed), the minor could repudiate it. For example, if a minor signed a rental agreement for an apartment, the minor could repudiate that contract before moving in and also demand the return of any rent or security deposit made—the landlord would have no legal recourse.

Although these protections for minors generally still exist, the modern trend has been to modify them for minors old enough and sophisticated enough to understand the consequences of their actions when making ordinary purchases. Teenagers have become a multi-billion-dollar force in the marketplace for consumer goods and commonly make purchases with credit cards and personal checking accounts. Television and consumer education courses have contributed to a rising level of sophistication among teenagers, and the courts are becoming reluctant to allow teenagers to avoid contracts that are not unreasonable, especially where there is no evidence that the minor has been exploited. Obviously, the old rules still apply to very young children and to teenagers who enter into extraordinary contracts—for example, the purchase of real estate or a business enterprise.

A contract made by a minor can be *ratified* (i.e., affirmed) later, upon reaching the age of majority. Ratification causes the original contract to be binding from the moment of its formation. Ratification cannot be revoked. Ratification need not be expressly made; it can be inferred from the new adult’s conduct.
continuing to use the property or making payments toward the purchase price, for example. Similar to a minor, a mentally incompetent adult (e.g., a developmentally handicapped or insane person) has the same powers of avoidance and ratification, although ratification must occur during a lucid period.

Subject to the limitations just explained, incompetent adults and most minors have the option of voiding a contract they have made. However, their contracts are not automatically void, but remain valid until they are repudiated. Thus, the weaker party to the contract has the best of both worlds: If the contract is favorable, he can perform his own obligations and receive the benefit of the bargain; if unfavorable, he can repudiate the contract and escape his obligations. The stronger party takes all the risks when he contracts with a minor or an incompetent person.

Fully competent adults can avoid contracts that have been induced by fraud, misrepresentation, duress, or undue influence, but these contracts are not automatically void. In spite of the improper inducement, it might be preferable to complete the contract rather than to avoid it. So, the victim of the improper inducement can choose to perform and enforce the contract or to avoid it. If there has been some injury to the victim of the misconduct, the injured party may continue to perform the contract and also sue for damages.

In contrast to voidable contracts, agreements that are deemed never to have been enforceable in the first place are called void contracts—which actually is a contradiction in terms. (By definition, a contract is an enforceable agreement.) There is no need to repudiate a void contract. Although a contract made with someone discovered later to have been incompetent when he made the contract is voidable at the option of the incompetent person, any contract with a person adjudicated (i.e., previously determined by court order) to be incompetent is void. That is true because the adjudicated incompetent has a court-appointed guardian or conservator capable of making any contracts needed for the incompetent’s benefit.

**LEGAL PURPOSE**

An agreement to commit a crime is always void. Other agreements can be unenforceable because they violate civil statutes or public policy. Public policy is the “conscience of society” regarding matters of public morals, health, safety, and welfare—as expressed in the law. Public policy asserts broad, universal values of American society (e.g., the importance of the family as a social institution and the responsibility of society-at-large to protect all children). The courts discover public policy in the cumulative body of legal tradition of our nation and define it on a case-by-case basis.

For example, the courts of some states have long refused on public policy grounds to enforce a restrictive covenant (in a deed to real estate) that forbade transfer of the property to members of a specified race or ethnic group. Ultimately, in *Shelley v. Kraemer*, 334 U.S. 1 (1948), the Supreme Court held that enforcement of such “private” covenants by the state courts would itself constitute a “state action” in violation of the 14th Amendment’s Equal Protection Clause.

Under the public policy doctrine, courts will not enforce contracts that are clearly unconscionable: those with harsh terms imposed by the overwhelming bargaining power of one party (e.g., contracts exacting the proverbial “pound of flesh”). An unconscionable contract is one that no informed person of independent judgment would agree to and that no person who was not seeking an unfair advantage would insist upon making.

Public policy also precludes enforcement of an agreement shocking to the public conscience for other reasons. The owner of a professional football team could offer a large bonus for any player who permanently cripples an opposing
star quarterback, but no court would enforce such a promise. (Compare the discussion in Chapter 12 about tort law and injuries in competitive sports.) Similarly, it would violate public policy to enforce contracts to seduce the spouse of a personal enemy or to use unfair and deceitful tactics to disrupt another’s business relationships.

MEETING OF THE MINDS

A “meeting of the minds” really means that both parties have the intent to enter into the same contract. It assumes that each understands what the other is promising to do and under what conditions. A common problem with contracts is an apparent meeting of the minds when, in fact, there is a serious misunderstanding. That type of misunderstanding can easily lead to suspicion and accusations of bad faith. A major purpose of detailed, written contracts is to preclude such misunderstandings.

In the classic model for contracts, a meeting of the minds is achieved by exchanging an offer and an acceptance. The offer should state the proposed terms of the contract in reasonably clear language. The acceptance is presumed to reflect both an understanding of the terms and an agreement to abide by them. To create a contract, both the offer and the acceptance must each be “communicated” to the other party. In some cases, the wordless behavior of the parties is evidence of effective communication. As we have seen, the latter results in an implied contract.

Offer and Acceptance

An offer may be extended to a specific person or to the general public. However, an apparent offer is not legally effective unless it is intended to be an offer under contract law. Although it might appear to be legalistic “smoke and mirrors,” the law does not consider a newspaper advertisement by a merchant describing goods and quoting prices to be an offer. It is merely a solicitation for potential customers to enter the merchant’s store and present actual offers to the merchant: “Please put this on my credit card.” The theory behind the merchant’s advertised “offer” (which, technically, is not an offer) is that the ad contains no promise to sell and leaves essential terms of a contract unstated. This theory gets the merchant off the hook when prices are accidentally misprinted in the ad or public demand quickly exhausts the quantity that the merchant is willing to sell at the advertised price. A public announcement might constitute an offer if it makes a promise and does not omit essential terms. Offers of an unconditional reward for the return of lost pets are the classic example.

In recent years, there has been a rapid increase in disclaimer statements and qualifications announced in printed and broadcast advertisements. The most sweeping of these is the ubiquitous “Significant restrictions may apply.” Some radio and television advertisements even present these in a slightly humorous manner: “And now, a few words from our attorney.” But, if advertisements are not bona fide offers, why are lawyers already involved? It is because the customer might assume that the terms of the advertisement will apply and includes them by implication in his offer to buy that Mediterranean cruise at the Super Duper Discount Fare. Advertisers have also been challenged by the attorneys general of many states for false advertising and/or unfair business practices due to the omission of significant limitations or qualifications in their advertisements.

An offer must state the proposed terms with sufficient definition that the parties understand their mutual promises. A minor ambiguity or incidental omission is not necessarily fatal. Every person who enters into a contract has a
good faith obligation to “make the agreement work” to the mutual benefit of all parties. Courts often rely upon the “custom and practice” of a particular industry, or on the past practices of the parties, to fill in the blanks. Reasonable terms may be provided when the contract is silent. If no time for performance is stated, for example, the court may determine a time period that is “reasonable” under the circumstances—and hold the parties to that deadline.

**When an Offer Is Effective**

An offer is effective when it is received by the person(s) to whom it is extended. It remains active until one of the following occurs:

- it is revoked by the person making the offer (the **offeror**)
- the person receiving the offer (the **offeree**) rejects it or counteroffers
- the subject matter of the proposed contract (e.g., the house for sale) is destroyed
- the offeror dies
- the offer expires

The offer itself might contain a time limit for communicating the acceptance, in which case the offer expires when that time limit has lapsed. If no time limit is stated, the offer will expire after a reasonable period of time, without the necessity of revocation by the offeror. What is a “reasonable” period, of course, depends upon what is being sold. Under the “reasonable” standard, an offer to sell fresh fruit would expire sooner than an offer to sell canned fruit.

**Rejections and Counteroffers**

It is important to understand that both a rejection and a counteroffer have the same effect: The original offer is automatically “off the table” and cannot be revived by a later withdrawal of the rejection or counteroffer. Under the common law “mirror image” rule, a **counteroffer amounts to a rejection** because it does not accept the offer—instead, it proposes a different contract. In effect, a **counteroffer** is simply a new offer coming from the opposite party. In a legal sense, it starts a whole new ball game. Rejections and counteroffers are effective when received.

Acceptance of an active offer **forms a contract**. Acceptance must be unequivocal—anything less is a counteroffer. Except in retail purchases, relatively few contracts are ever formed by the offeree’s acceptance of the first offer. Instead, various counteroffers are exchanged until a meeting of the minds occurs and a contract is finally formed. That process is called “negotiations.”

**When an Acceptance Is Effective**

There are (of course) some rules regarding an effective acceptance. Although an offer is not effective until it has been received, an acceptance is generally effective as soon as it is transmitted (e.g., mailed or left on a telephone answering machine). If an acceptance and a revocation of the offer cross paths in the mail, a contract will be formed because the acceptance is effective upon mailing, but the revocation is effective only upon its receipt. **Silence is not an acceptance**, so an offer cannot impose a contract by stating, “Unless I hear otherwise by close of business on the 25th, you will be bound by these terms.” But suppose that, prior to the 25th, the offeree proceeds to perform her duties under the proposed contract. An acceptance could result from the conduct of the offeree, even though she communicated no verbal acceptance.

Although an acceptance generally is effective when transmitted, it is not immediately effective if an “unauthorized means” of communication is used.
Consideration is something of value that induces a person to enter into a contract.

Mutuality of consideration is the principle that requires a reciprocal exchange of consideration so that both parties will be bound by the contract.

A forbearance is declining (or purposely failing) to do what one otherwise has a legal right to do.

For example, if the offer specifies a response by registered mail, an acceptance sent by unregistered first-class mail will be effective only upon receipt by the offeror. Similarly, an oral acceptance would not be effective if the offer specified that an acceptance be in writing. (In either example, however, the offeror could choose to waive the requirement for registered mail or a written acceptance and treat the unauthorized form of acceptance as a counteroffer.) If no specific method of response is required by the offer, the offeree may use the same means of delivery used to communicate the offer—for example, a statement posted on an electronic bulletin board—in which case the acceptance is effective upon transmittal.

If the offer solicited a specific act (e.g., returning a lost pet), that act constitutes an acceptance only if it is intended to be one. For example, if someone is unaware of the offered reward, but finds and returns the pet out of the goodness of her heart, it is not an acceptance, and no contract is formed. The pet was not returned as an intended acceptance, but for some other reason.

**BARGAINED-FOR CONSIDERATION**

For every contract, there must be legally sufficient consideration. For that reason, one cannot enforce someone’s promise to make an absolute gift. Also, each party to the contract must receive consideration—this is called mutuality of consideration. In effect, this doctrine requires that both parties be bound by their contract, or else neither party will be bound. “Mutuality” does not mean equal value—it means only that consideration must pass in both directions between the parties.

To be “legally sufficient,” the consideration must be something of value that has been bargained for between the parties. Consideration may be any of the following:

- money
- a promise to act
- a promise to refrain from acting (a forbearance)
- real or personal property

Any one of these may be exchanged for any of the others—for example, money in exchange for a promise to forbear from bringing a lawsuit. There is no requirement that the considerations exchanged be equal in value or even that they have any substantial value at all, in monetary or market terms.

One dollar is sometimes used as consideration for the sale of assets with far greater market value (e.g., land sold by a city to a school district serving the same community). The sum of $1.00 is used because the parties want to enter into a genuine contract determining ownership, liability, and other legal issues (such as joint use of the school’s athletic fields). The courts do not generally second-guess a negotiated agreement if genuine value (no matter how small) is exchanged. An exception, of course, would occur if the value of the consideration had been misrepresented, as often occurs in cases of fraud. Also, any consideration negotiated under extreme duress—a drowning man’s promise to exchange his house for a life buoy, for example—would not be enforced. Courts would refuse to enforce the latter agreement on public policy grounds.

**Scenario**

Maureen Wellems began her paralegal career in civil litigation. Her law firm handled a wide variety of litigation, and she enjoyed working on cases that arose from totally different circumstances. “I worked on cases ranging all the way from
wrongful termination to shareholder lawsuits. It was always different and interesting.” However, one of the senior partners noticed that she was rapidly developing advanced skills and came to call upon her frequently for assistance with the partner's cases. “At first, I was a little disappointed because the partner concentrated on breach of contract cases, and I was afraid that I would miss the variety that I had enjoyed so much.”

Soon, however, Maureen found that the senior partner was providing her with opportunities that many litigation paralegals seldom enjoy. The medium-sized firm had very few associate attorneys, so most of the sophisticated legal work was done by partners or legal assistants. “She encouraged me to take on difficult research assignments and eventually let me draft motions in limine, oppositions, and the points and authorities to support them. After about 6 months of pretrial preparation on one big case, she decided to take me to court to sit ‘second chair’ during trial. It was the most amazing experience, and it gave me a big boost in confidence.”

The partner also involved Maureen in occasional contract negotiations, which was a small part of the attorney’s practice. Maureen found that she enjoyed negotiations more than she ever would have imagined. “I never realized how much research and preparation goes into successful negotiations. And I enjoyed the partner’s style—which was to reach a resolution satisfactory to all parties.”

Eventually, a firm client approached Maureen about going to work for his publishing company's legal department. He wanted a legal assistant with litigation experience who could also assist in contract negotiations. “The salary he offered was so good, I could hardly resist it. It turns out that he had cleared the idea with the law firm before he ever approached me. I guess they said ‘O.K.’ because his company was a major client of the firm. Of course, they couldn’t really stop him from talking to me, in any event.”

Maureen accepted the new job, but within 2 years she was promoted to a new position in which she concentrates exclusively on negotiating major book contracts with authors and their agents. “In some ways I miss the litigation, but my current job gives me far more responsibility—and a lot more money! Of course, I could always go back to working for a law firm if I really miss litigation that much.”

Promises to Perform Pre-existing Duties

Courts will not enforce a contract in which the consideration is a promise to fulfill a pre-existing duty, such as paying child support. The reason is that in making a contract to pay child support, the parent would be gaining some new consideration—a bribe, of sorts—to do something already required by law. It would violate public policy to enforce a contract to perform a pre-existing duty because it would make the court an accomplice to the possible evasion of that legal duty. The same principle applies to contracts to stop selling illegal drugs or to clear brush as already required by a city ordinance.

Accord and Satisfaction

The pre-existing duty that bars enforcement of a new contract can even be a duty arising from an earlier contract; for example, to paint a house. However, if the alleged duty itself is in dispute—that is, one of the parties denies in good faith that he has such a duty—the courts may enforce a new contract in the form of an
An **accord and satisfaction** is a new contract entered into in settlement of some dispute, in which the parties agree to the new arrangement in lieu of any rights and obligations they claimed against each other.

A **detriment** is something given up by a party to a contract as consideration for the other party.

A **benefit** is something received by a party to a contract as consideration from the other party.

An **illusory contract** is conduct or words that appear to form a contract, but do not because one or more of the parties fails to make a true commitment to do anything.

**Consideration As Detriment or Benefit**

To be valid, the consideration must be a **detriment** to the party surrendering that consideration (whether land, money, or the pleasure of drinking alcohol) or a **benefit** to the party receiving that consideration. The detriment must be something that the party was not legally obligated to surrender and the benefit must be something that the other party had no legal right to receive (prior to their contract). Because there must be mutuality of consideration, each party to the contract must incur a legal detriment and receive a legal benefit. Of course, one party's detriment becomes the other party's benefit, and vice versa.

**Statute of Frauds**

Legislation commonly known as the **Statute of Frauds** was first enacted by England’s Parliament in 1677. At that time, plaintiffs and defendants were not permitted to testify in lawsuits because their testimony was presumed to be biased and, therefore, untrustworthy. Without their testimony, it was often impossible to prove that an oral contract had been made. Thus, Parliament adopted **An Act for Prevention of Frauds and Perjuries**, requiring that certain contracts be in writing.

In American courts, of course, both plaintiffs and defendants are permitted to testify and oral agreements are generally enforceable. But the modern-day **Statute of Frauds** (hereafter, the “Statute”) still requires that certain agreements...
of special importance be in writing. The most common agreements within the Statute are:

- contracts to transfer an interest in real estate
- contracts that cannot be performed within 1 year
- contracts to guarantee the debt of another person

Oral agreements to do these things are generally not enforceable.

Under the Statute, the original agreement need not be in writing so long as a subsequent written memorandum of the agreement has been made before either party goes to court seeking enforcement. The written memorandum or agreement does not have to conform to any special form or style of language. It is sufficient if it satisfies these four requirements:

- identifies the subject matter of the agreement
- identifies with reasonable certainty the promises made
- identifies the parties to the agreement
- bears the signature of the party trying to disclaim the agreement (or the signature of his agent)

The written agreement might even be formed by a combination of documents, none of which would establish a contract by itself—an accumulation of business correspondence between the parties, for example.

### EXCEPTIONS TO THE STATUTE OF FRAUDS

The courts are very reluctant to apply the Statute of Frauds in a manner that results in great injustice. There are a number of exceptions that allow the enforcement of an oral agreement in spite of the Statute.

The Statute applies to executory contracts only. A contract that has been fully performed by the parties will not be rescinded by the courts simply because it was not in writing. When only one party has performed its obligations, the Statute will bar enforcement of the original agreement against the other party who has not yet performed. However, the court may impose the remedy of a quasi contract to prevent unjust enrichment of the nonperforming party. There are other exceptions to the Statute.

Under the Statute, almost any agreement affecting interests in real property must be in writing. This includes deeds, mortgages, purchase-options, easements, leases for a duration in excess of 1 year, and agreements employing a broker for the sale or purchase of real property. However, an oral agreement for the transfer of real property may be enforced if the party seeking enforcement has justifiably and substantially “changed her position” in reliance upon the oral agreement—that is, she has done something that burdens her so much that a great injustice would result from nonenforcement. To avail herself of this exception, however, most states would require that she paid part of the purchase price and had either taken possession or begun improvements on the property. In other words, her “change in position” must have been justifiable, substantial, made in good faith, and made in reliance upon an oral promise that later was broken.

A contract that by its own terms cannot be fully performed within 1 year falls within the Statute and must be in writing. The “performance” standard applied by the courts is one of possibility, not probability. A contract to employ a person “for life” need not be in writing because the employee could die within the year and the contract be fully performed. An oral contract to employ the same person for “1 year and 1 day” would be unenforceable because it cannot possibly be performed within 1 year. The 1-year “clock” starts running at the time the contract is made, not when performance begins.
A surety is one who guarantees to pay the debt of another in the event that person fails to pay.

A suretyship is the legal relationship among the debtor, the creditor, and the surety, under which the surety guarantees payment.

A guaranty is the contract by which one becomes the surety for the debt of another.

The parol evidence rule prohibits the introduction of evidence of prior speech or conduct to contradict or change the terms of a written contract.

An oral contract that has been fully performed by one party is enforceable even though the other party cannot perform his obligations within 1 year. A professional athlete who made a 3-year, $300,000 oral agreement for a commercial product endorsement—perhaps 36 monthly appearances on television—would be held to that 3-year agreement if she received the full $300,000 up front and the advertiser had performed all other obligations under the agreement. However, if the advertiser had paid less than $300,000 during the first 365 days, the athlete could repudiate the contract as a violation of the Statute of Frauds. Under those circumstances, however, the court might impose a remedy of quasi contract to ensure the advertiser receives a reasonable benefit for the amount of money actually paid to the athlete.

Someone who guarantees the debt of another person is a surety. In closely held corporations, for example, major stockholders and corporate officers sometimes guarantee the corporation's repayment of loans, pledging their personal assets even though it is a debt of the corporation, not of their own. The Statute requires that contracts of suretyship be in writing. This rule applies only when there are three parties and two separate contracts: one contract between the debtor and the creditor and a second contract between the creditor and the surety. (It is a characteristic of suretyship that the creditor is a party to both contracts—otherwise, the creditor would have no legal standing to enforce the debt against both the debtor and the surety.) Also, the promise of a surety must be collateral for the debt of another person—that is, a promise to pay only upon an actual default by the principal debtor. An oral promise made to a debtor (e.g., “I’ll make your monthly payments, if you can’t”) is not a suretyship, and is outside the Statute of Frauds. Whether such an oral promise is enforceable by the debtor depends upon whether all essential elements of a contract are present.

There is one circumstance in which an oral contract of suretyship will be enforced. That exception occurs when the main purpose of offering the guaranty is to gain a benefit or advantage for the surety, not for the debtor. Parents who want to kick a deadbeat adult child out of their house might offer a guaranty to induce a landlord to rent an apartment to their daughter. Because the guaranty is primarily for their own benefit, their oral promise is enforceable.

Oral Understandings and the Parol Evidence Rule

Generally speaking, a written contract is presumed to be the complete, final agreement between the parties. The parol evidence rule ("parol" means oral or spoken) prevents either party from contradicting the plain language of the written agreement. Although not strictly a rule of evidence, the rule gets its name from the exclusion of testimony in court about earlier oral agreements between the parties before the contract was put in writing. There is a legal presumption that when the parties reduced their agreement to writing, they put the whole thing in writing. There is also the likelihood that the parties intentionally changed the terms as they were negotiating the written agreement. Hence, evidence of prior oral agreements is excluded because those oral agreements are not relevant to the ultimate contract put down on paper. In effect, the written contract is defined “on its face”—by its own terms. Testimony to show that the parties conducted their dealings in a different manner prior to signing the contract will not be heard to contradict the written words.

Suppose the parol evidence is offered not to contradict some provision of the written agreement, but to add a provision on some issue not addressed. While
the general rule is that such evidence is not admissible, an exception is made if it appears that the parties did not intend that the writing represent their entire agreement. Even terms that are essential to the contract (such as price and quantity) may be left to an oral understanding, while other terms (specifications for machinery, for example) are put in writing. If part of the agreement is in writing and the remainder is strictly oral, parol evidence will be admitted to establish the oral terms of the intended agreement.

In some cases, the parties to a contract do not feel it necessary to include all the details of routine business practices. For example, if a grocery company and a dairy farm reach a written agreement for the wholesale purchase of fresh milk, is it necessary to state in the contract that the milk will be kept cold during the delivery process? Would a court find it reasonable that the parties intended that the milk be delivered warm? Parol evidence would be admissible to establish usage and custom in the grocery and dairy businesses. In the same vein, parol evidence may be offered to explain ambiguous language in the contract. The purpose of such evidence is not to contradict or change the terms of the contract, but simply to understand what the parties intended by the language actually used.

Many contracts drafted by attorneys contain integration clauses that state explicitly that the written document is the entire agreement and that it cannot be modified or changed except by a later written agreement signed by the parties. Such an integration clause goes beyond the parol evidence rule, because it bars subsequent oral agreements that otherwise could supplement or modify a written contract.

Parol evidence may be offered to show that a party to the agreement lacked the capacity to make the contract (due to age, intoxication, mental deficiency, etc.). It may be offered also to show fraud, mistake, undue influence, or duress in the making of the contract. Each of these situations can be grounds for setting aside the entire agreement.

**Assignment of Contracts**

Unless restricted by the terms of the contract itself, each party to an agreement usually has the right and power of assignment—the transfer of all rights under the contract to another person. For example, if we contract to buy our neighbor’s boat for cash, we can change our minds and possibly get out of the deal by assigning our purchase rights to another buyer willing to pay the same price in cash. Our neighbor gets the full benefit of his bargain (the agreed-upon price, in cash), so he has no reasonable basis for objecting to the assignment.

However, an assignment must not increase the duties or risks of the other original party to the contract. In some cases, the duties and risks are so closely identified with the original parties to the bargain that assignment is not permitted. Insurance contracts are an excellent example. A healthy young person cannot assign his life insurance policy to an elderly person in ill health. Contracts for debt are another example. A prosperous person of good credit cannot assign his right to borrow against a line of credit to someone with no means to pay the debt. Employment contracts are not assignable because the employee-employer relationship is such a unique and personal one. In many contracts, however, the identity of the other party is not a material issue.

When a valid assignment is made, the original party to the contract (the assignor) still owes the obligation of performance under the contract. The assignee has assumed only the rights of the assignor. So, the assignor is still “on the hook”...
if the assignee fails to perform. As a practical matter, however, in most situations the assignee can receive the benefits of those rights only if he performs the obligations of the assignor.

For example, if we enter into a contract to buy a house from Jamal, we could change our minds and assign our purchase rights to Gerald. If Gerald wants to exercise his assigned purchase rights, he will have to pay to Jamal the money that we promised to pay for the house—he cannot get it free or for anything less than what we promised. But if Gerald also changes his mind and does not go through with the deal, Jamal could require us, the original buyers/assignors, to pay the agreed-upon price and receive the house.

If Gerald exercises his assigned rights by buying the house, we will no longer have any obligations under the original contract. This is because the seller has received the benefits of his original bargain: The house has been sold and the seller has received the agreed-upon price.

Some contracts specifically prohibit assignment without consent of the other party. For obvious reasons, most leases prohibit an actual assignment without written consent of the landlord. Some courts have ruled, however, that a landlord’s refusal to consent to an assignment must not be arbitrary, but must instead have some reasonable basis related to the purpose of the contract (e.g., the ability of an assignee/tenant to pay the rent).

Discharge is the release of a party from an obligation under a contract.

Performance is the act of fulfilling a duty or obligation under a contract.

Breach of contract is the failure, without legal excuse, to perform any act promised in a contract.

A material breach is one that deprives the other party of the substantial benefit for which he bargained.

Discharge is the legal release from a contractual obligation. Most contractual obligations are discharged by fulfilling the promises made (known as performance). If Andy promises to mow the lawn at Bob’s house within the next 3 days in exchange for $5.00, Andy’s promise is performed when he finishes mowing the lawn within the time allowed. When Andy finishes mowing Bob’s lawn, he is discharged from that obligation by his own timely performance of the promise. Breach of contract is the failure to perform a contractual duty; if Andy goes on a fishing trip instead of mowing Bob’s lawn as promised, Andy has breached their contract.

Everyone wants to be discharged from their contracts because no one wants unfulfilled contracts and potential lawsuits hanging forever like swords over their heads. The ideal discharge is by timely performance—all parties should be happy with the result and no one has a claim for breach. But discharge can also result:

- from a prior material breach or repudiation by the other party
- by operation of law
- from new circumstances that make performance impossible
- by agreement between the parties

**DISCHARGE BY MATERIAL BREACH**

Although any breach can give rise to a cause of action for damages, a breach must be a material breach if it is to discharge the other party from his obligations. A material breach deprives the injured party of the substance of what he bargained for—hence, it is a substantial breach. If Mary agreed to deliver groceries to Jim’s house every week, using her own car, would it be a substantial breach if she used
An implied covenant is a promise not stated in words, but is reasonably inferred from the terms of the contract and is necessary to the purpose of the contract.

Breach of Good Faith and Fair Dealing

In most jurisdictions, every contract contains an implied covenant of good faith and fair dealing. An implied covenant is a promise that is not spelled out in so many words, but arises naturally and logically from the explicit promises each party makes to the other—perhaps no more than their promises to make a contract between them. The law presumes that the parties enter into a contract with a sincere intent to see the objectives of their agreement realized. Conduct that defeats or obstructs the purpose of the contract suggests that the promises were made with reservation or even with an intent to defraud. Violation of this implied covenant is a breach of the underlying contract.

An essential element of an implied covenant is “good faith.” Case law, however, provides no clear definition of good faith. Black’s Law Dictionary, Sixth Edition, states that good faith “encompasses, among other things, an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage...”1 Most people can probably discern good faith from the circumstances and their own common sense.

Under this implied covenant, one party to a contract must not do any intentional act that prevents the other party from performing his promises under the contract. In fact, each party has an affirmative duty to be cooperative and to facilitate the performance of all obligations under the contract. Any unreasonable conduct that obstructs the other party’s ability to perform satisfactorily is a breach of the duty of good faith. This breach can excuse the innocent party from his obligation to perform under the contract.

Rejection of a Tender of Performance

In the typical bilateral contract, one party might tender performance (i.e., offer to do what she has promised). If the other party rejects that tender, it might be a repudiation of the contract. A repudiation would be a breach of the contract and would discharge the tendering party from her duty to perform what she has promised to do. Refusal of a tender of performance is only one form of repudiation. If someone simply says, “I’ve changed my mind—the deal’s off,” a repudiation has occurred.

This concept of a “tender of performance” is recognized on the paper currency printed by the U.S. Government. Look at any Federal Reserve Note—the older "greenback" gold and silver certificates are no longer printed—and you will find these words: “This note is legal tender for all debts, public and private.” By law, the tender of payment with Federal Reserve Notes must be accepted in payment of any debt within the United States. Consequently, merchants who refuse “any bill larger than $20” often are breaching their implied contracts for the sale of gasoline, restaurant meals, etc. Theoretically, that breach relieves the customer of any obligation to pay (it would make an interesting case for small claims court).

DISCHARGE BY OPERATION OF LAW

Occasionally, a contractual duty will be discharged by operation of law. This can happen in a variety of ways. If the promised act becomes illegal—because of a
new statute, for example—the promisor is relieved from her duty to perform. If a landlord and tenant-to-be enter into a lease whereby the landlord will modify the building for the tenant’s use as a dog kennel, both the landlord and the tenant will be discharged from their obligations under that contract if the city council changes the zoning code to prohibit dog kennels at that location. This is known as a discharge by operation of law. A debtor’s discharge in bankruptcy is also by operation of law. And, then, there is the rejection of payment by “legal tender” (discussed previously).

**DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE**

A classic example of impossibility is the destruction of the subject of the contract. If George agrees to sell his yacht to Samantha, but the yacht is lost at sea before the transaction is completed, George is discharged from his obligation under their contract. He need not build a new yacht for Samantha because that was not their contract, and it is now impossible to deliver the original yacht. On the other hand, if a shipbuilder contracts to build a yacht that is destroyed by fire before completion, he is still obligated to fulfill his obligation to build the yacht. The fact that it is now far more burdensome for the shipbuilder will not excuse him from performing the contract. His promise was to build and deliver a *new* yacht, and that promise can be performed even if the first attempt is destroyed by fire.

**DISCHARGE BY AGREEMENT BETWEEN THE PARTIES**

One party’s duty under a contract will be excused when the other party waives the performance of that duty. This often happens when time extensions are granted or when one party does not object to the failure of the other party to perform as spelled out in the contract—especially if the nonobjecting party continues to perform his or her own obligations. In some cases, the parties might sign a written agreement that waives specified duties under the original contract. A novation is related to the concept of rescission because it is a new contract that is substituted for the original contract, which is extinguished. A novation might be a new contract between the original parties or it might also substitute a new party in place of one of the parties to the original contract. The original contract is extinguished, so all obligations under it are also discharged.

**LEGAL REMEDIES FOR BREACH OF CONTRACT**

Because a material breach deprives the aggrieved party of the benefit of her bargain, she is relieved of her own obligations under the contract. She is entitled also to receive monetary damages for any injury caused by the breach. More importantly, the injured party usually has a choice of several alternative remedies. The most common remedies for a material breach of contract are:

- rescission (cancellation) of the contract
- a court order requiring the wrongdoer to fulfill the contract
- restitution (e.g., a refund of the purchase price)
- monetary damages
The most fundamental remedy for a material breach is **rescission** of the contract—the innocent party may choose to treat the contract as void *from its inception*. Upon rescission, all parties are legally returned to their position before the contract was made, and the offending party has lost all rights it might have held under the contract. In some cases, a party will sue for rescission—which means that it asks the court to determine that a material breach has occurred and that the injured party should not be held to any promise it has made.

However, an injured party might decide that performance of the contract is to its own benefit, in spite of the breach. In that case, it may sue for **specific performance**. If a court grants a judgment on an action for specific performance, the breaching party will be under court order to do what the contract requires of him. This sometimes happens when “seller’s remorse” causes homeowners to breach their agreement to sell their house. In an action for specific performance, the issues before the court would be:

- Was there a valid contract to sell the house?
- Did the seller (or buyer) fail and refuse to complete the transaction?
- Was there a legal justification for not completing the transaction?

If the court finds that a breach occurred, it can order that the transaction go forward on the terms already agreed upon by the seller and buyer. An action for specific performance is not available for “personal services,” such as an employment contract. The theory is that employees and independent contractors offer unique services that others cannot provide and that employees do not become the property of their employers—one cannot become an indentured servant.

An action for **restitution** asks the court to restore to the injured party the consideration she gave to the breaching party. If she had delivered a good faith deposit of $5,000 when executing a contract to buy a house, she could ask the court to return her deposit on the grounds that the seller has reneged on his promise to sell the house. Restitution would get her money back, but she might have other damages resulting from her inability to actually buy and take possession of the property, as promised in the contract—for example, incidental damages for hotel bills.

A fourth alternative is a lawsuit for monetary damages. This can be a difficult, time-consuming, and often very expensive option. It is more complicated than a suit for specific performance because the victim of the breach must prove both the breach and the resulting damages. Damages can be very difficult to establish and legal bills can escalate during the effort to do so.

### Monetary Damages for Breach of Contract

If a manufacturer in Dallas delivers a defective printing press—which it sold for $100,000—to a print shop in Detroit, the print shop is entitled to **compensatory damages** equal to the difference between the value of the press it paid for and the value of the press it received. If the print shop reasonably spends $10,000 to have another print shop do some of its printing jobs while the press is being repaired, it would be entitled to an additional $10,000 because it would not have spent the additional $10,000 if the original press had not been defective.

**Consequential damages** might be awarded to compensate for other losses or injuries caused indirectly by the breach. If the delay in repairing the printing press cost the innocent party $3,000 in lost sales, that amount could be awarded in consequential damages, if those lost sales were foreseeable to the breaching party.

**Compensatory damages** are a monetary award by the court that compensates the victim for his actual injuries, and no more.

**Consequential damages** result from consequences of a breach of contract, which are not the direct result of the breach itself, but are reasonably foreseeable to the breaching party.

**Rescission** is the nullification of a contract by repudiating it or by court judgment.

**Specific performance** is a remedy in which the court compels a party to perform its obligations under a contract.

**Restitution** is returning to the injured party the consideration he has given under a contract that the other party has breached.
Punitive damages (also known as exemplary damages) are not ordinarily available in a breach of contract action. However, if the offending party committed a *tort* as well as a breach of contract, punitive damages could be awarded if the defendant’s conduct was willful, wanton, fraudulent, or malicious. (Torts and punitive damages are discussed in Chapter 12.) In our printing press example, if the seller accepted payment with the intention of skipping town and never delivering the press to the buyer, punitive damages could be awarded.

**The Rights of Third-Party Beneficiaries to Sue for Breach**

If two parties make a contract with the specific intent to benefit someone else, that **third-party beneficiary** may sue either party to the contract for breach. The most common contract with intended third-party beneficiaries is a contract between an insurance company and an insured party that names some other person as beneficiary under that insurance policy. It is common for mortgage holders to require that they be named as a beneficiary under a fire insurance policy. They could sue the homeowner for failure to keep that policy in force. They could also sue the insurance company if it refused to pay a valid claim under the policy.

Other examples of intended third-party beneficiaries are college students for whom their parents have leased an apartment, children whose divorced or separated parents have made a child support agreement, and creditors of a business that has been sold to a new owner who guaranteed in the purchase contract that all creditors would be paid.

An *unintended* third-party beneficiary would be the stranger injured in an automobile accident who makes a claim against the insurance company of the driver at fault. That driver’s insurance policy (the contract) did not name the stranger as a beneficiary; she is an incidental beneficiary. As an unintended beneficiary, the stranger has no legal standing to sue for breach of the contract. The logic behind this rule of law is that the policy was purchased by the driver, not for the benefit of the stranger, but to protect the driver from having to pay damages in case of an accident.

**Commercial Contracts under the Uniform Commercial Code**

The *Uniform Commercial Code* (UCC) is a uniform statement of commercial law (governing credit transactions and the sale and leasing of goods) that has been enacted by every state except Louisiana.
certainty about each party’s rights and obligations under a contract because each state would have its own rules of contract law. Businesses in New Jersey, for example, might avoid dealings with Montana companies because the volume of business might not justify the legal fees necessary to sort out the differences in New Jersey and Montana contract law. Without the UCC, an attorney would have to be familiar with the contract law of all 50 states, or a business operating nationwide would have to retain 50 lawyers. That chaotic situation would generate more business for lawyers than for merchants. It is a tribute to the state legislators of our nation (most of whom are lawyers) that they have adopted a single uniform code for contract law—less business for attorneys, but more business for the nation.

A substantial amount of contract law (e.g., real estate contracts) is beyond the scope of the UCC, and therefore is governed by other statutes or the common law of each state. Contracts for employment, insurance, intellectual property rights (e.g., patents and copyrights), and all “service contracts” are also outside the scope of the UCC. The discussion in this chapter has been based on general contract law, not specifically the Uniform Commercial Code.

A QUESTION OF ETHICS

Jeff Ingram is a senior legal assistant in the transactional law department of a large firm. For the past several days, he has been deeply involved in the revision of a complicated contract for the client’s purchase of a trucking company. His supervising attorney, Jack Morris, has asked Jeff to sit in on each negotiating session as the terms of the sale are hammered out with the seller’s attorney. During those sessions, Jeff takes notes and marks up the latest draft to reflect the changes the attorneys have agreed upon. After each session, Jeff and the word processor work together preparing the next draft for the attorneys to review.

The purchase agreement finally appears to be complete. Jeff is reading through the agreement one more time to catch any grammatical or syntax errors that might have resulted from all the revisions. He notes that a brief statement of great importance to the seller appears to have been dropped out. Jeff reviews his notes but cannot find anything to indicate that the seller conceded on that point. When Jeff mentions the missing provision to Jack, the attorney replies, “I think we made that change on the second day.” Jeff feels certain the seller never agreed to drop that provision, but it would be advantageous to the firm’s client if it were not included. What should Jeff and Jack do about their differing memories of the contract terms?

Practice Tip

More paralegals work with cases involving breach of contract than with the negotiation and drafting of contracts. In part, this is because litigation is so often the result. When a serious breach occurs, paralegals become involved in a variety of ways. One of the most significant is reviewing files and gathering evidence to show that a breach did, or did not, actually occur. The same files might show that the complaining party was actually the first to breach the contract. If a breach has occurred, paralegals play a major role in gathering data to show the extent of damages resulting from that breach. Accounting skills can be particularly useful for that task. For all of the foregoing purposes, an enormous quantity of documents might need to be reviewed, indexed, and summarized and possibly entered into a computer database.

Intellectual property is a form of personal property (e.g., literary works, inventions, computer software, etc.) that is the result of higher cognitive processes.

CHAPTER SUMMARY

- Most contractual relationships are determined privately by the makers of each contract.
- Government determines some contractual relationships, especially in marriage and employment relationships.
- Contracts are either express or implied.
- Contracts between two persons are either bilateral or unilateral.
- Contracts are executory until all parties have fulfilled all promises.
- The courts may impose a legal remedy known as quasi contract to prevent unjust enrichment.
All contracts require the following elements:
- capacity of the parties
- legal purpose
- meeting of the minds
- consideration

Minors and incompetents often have the power to avoid their contracts.

A void contract is null from its inception.

A voidable contract is one that can become null under certain circumstances.

Courts will not enforce contracts that violate public policy.

A counteroffer is a rejection of an original offer.

Legally sufficient consideration may be any of the following:
- money
- a promise to act
- a promise to forbear
- real or personal property of value

There must be mutual consideration.

The Statute of Frauds requires certain types of contracts to be in writing.

The parol evidence rule prohibits oral testimony to alter the terms of a written contract.

Parol evidence may be admissible for limited purposes (e.g., clarifying ambiguities in a written contract).

An assignment of a contract transfers only the rights of the assignor, who remains obligated by his promises.

Discharge from a contractual obligation may be by performance, breach, operation of law, or agreement of the parties.

A breach must be material to release the other party from her obligations.

Every contract contains an implied covenant of good faith and fair dealing.

Remedies for breach include rescission, specific performance, damages, or restitution.

The Uniform Commercial Code governs contracts for the sale of personal property, including the trade in goods and merchandise between businesses.

**KEY TERMS**

- accord and satisfaction
- adjudicated
- annulment
- assignee
- assignment
- assignor
- avoid
- benefit
- bilateral contract
- boilerplate language
- breach of contract
- compensatory damages
- consequential damages
- consideration
- contract of adhesion
- counteroffer
- detriment
- discharge
- disclaimer
- executory contract
- express contract
- forbearance
- guaranty
- illusory contract
ACTIVITIES AND ASSIGNMENTS

1. In this chapter’s opening vignette, we read of the Kinskis’ attempt to have a surrogate mother carry a child conceived in vitro, and the surrogate’s attempt to deny the Kinskis of any parental rights. Prepare to discuss the following issues:
   • Did Irena, as Angelica’s surrogate birth mother, have a legal interest at stake (known as “standing to sue”) so that she could sue for custody of Angelica?
   • What about Angelica’s interests in this case? Who speaks for the interests of the newborn Angelica—or the interests of any unborn child? Is the child merely a pawn in a contest between adults who have their own selfish interests at stake?
   • Is the surrogacy contract enforceable?

2. Relying upon your own general knowledge, prepare a list of government-imposed contractual duties-to-the-employee that an employer assumes upon hiring that person (example: overtime pay).

3. Over a period of 1 week, collect examples of printed contracts of adhesion (for video rental, parking, theater admission, auto repair, credit card charges, etc.). Prepare a chart depicting the key provisions for each type of contract. Leave a column for comments about those key provisions. Do any of them appear to be so one-sided that a court might hold them to be unenforceable?

4. Keep a list of the implied contracts that you enter into during a period of 1 week (example: gasoline purchase). Keep a separate list of unwritten express contracts that you enter into during the same period (example: theater admission). Be prepared to explain why each contract falls within one category or the other.

5. Draft a simple contract for the purchase of a pet dog (for companionship—not for breeding or showing). Include a contingency for examination by a veterinarian.

6. Review again Krebs v. Ryan Oldsmobile, 843 P2d. 312 (1992), which is excerpted in this chapter. Then respond to the following:
   • Why did the trial court (the Montana District Court) decide that the whistleblower statute did not apply to Krebs? Why did the Montana Supreme Court disagree?
   • At the conclusion of its opinion, the Supreme Court concluded: “This matter is affirmed in part and reversed in part and remanded to the District Court for a trial . . .” Which part of the trial court’s decision was affirmed and which reversed?
   • What happens next? What does the Supreme Court mean when it says, “remanded to the District Court for trial . . .”?

END NOTES