Themis
Bar Review
A UWorld Company

LAW SCHOOL ESSENTIALS:

CONTRACTS

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CONTRACTS

I. FORMATION OF CONTRACTS

A binding contract is typically created through the process of offer and acceptance, when consideration is present, and when no valid defenses to contract exist.

A. DEFINITIONS AND OVERARCHING CONCERNS

1. Classification

Contracts can be classified as bilateral or unilateral.

a. Bilateral contracts

A bilateral contract is one in which a promise by one party is exchanged for a promise by the other party. The exchange of promises is enough to render them both enforceable.

b. Unilateral contracts

A unilateral contract is one in which one party promises to do something in return for an act of the other party (such as a monetary reward for finding a lost dog). Unlike in a bilateral contract, in a unilateral contract the offeree's promise to perform is insufficient to constitute an acceptance; the offeree must perform the act (find the lost dog) to accept the offer (of a monetary reward).

2. Enforceability

The absence of an essential element (such as capacity, consent, legality, form, etc.) may render the contract void, voidable, or unenforceable.

a. Void contracts

A void contract results in the entire transaction being regarded as a nullity, as if no contract existed between the parties.

b. Voidable contracts

A voidable contract operates as a valid contract, unless and until one of the parties takes steps to avoid it.

c. Unenforceable contracts

An unenforceable contract is a valid contract that cannot be enforced if one of the parties refuses to carry out its terms.

> **EXAM NOTE:** Remember that a **void** contract ***cannot*** be enforced, but a party may ***opt*** to avoid a **voidable** contract.

3. Applicable Law

The Uniform Commercial Code ("UCC") Article 2 governs transactions in goods. Although UCC Article 2 adopts much of the common law of contracts, it also codifies modifications relating to transactions in goods. Where the common law of contracts and UCC Article 2 differ, Article 2 prevails. For other types of contracts, such as those involving the sale of land or the provision of services, the common law as set forth in the Restatement (Second) of Contracts governs.

For a contract that involves both the sale of goods and a service, ask which of the two predominates. If the predominate purpose of the contract is the sale of goods, then then UCC governs the contract. If the predominate purpose of the contract is not a sale of goods, then the common law governs. However, in this situation, the provisions of the contract that relate primarily to the goods (e.g., warranties) are governed by the UCC.

Example: Bob hires Emeril to cater his party. The contract provides that Emeril will shop for the food and cook it. The contract involves both goods (the food) and a service (Emeril cooking the food). Because the service provided here (Emeril cooking your food) is the more important aspect of the contract, common law governs.

4. Freedom of Contract

Parties are generally free to structure a contract in any manner that they see fit. Where parties do not provide for a circumstance, contract law may impose a default.

B. MUTUAL ASSENT

For a contract to be formed, there must be a manifestation of mutual assent to the exchange, which occurs upon acceptance of a valid offer to contract.

1. Offer and Acceptance

a. Offer

An offer is an objective manifestation of a willingness by the offeror to enter into an agreement that creates the power of acceptance in the offeree. In other words, it is a communication that gives power to the recipient to conclude a contract by acceptance.

1) Intent

A statement is an offer only if the person to whom it is communicated could *reasonably interpret* it as an offer. It must express the **present intent** to be legally bound to a contract. The primary test of whether a communication is an offer is whether a reasonable person receiving the communication would believe that she could enter into an enforceable deal by accepting the offer. This test is an objective test, not a subjective one. (Note: A similar objective test applies to determine whether a statement is an acceptance.)

Example: Carol tells Andy, "I might be interested in buying your house." That would not be an offer because "I might" does not express a present intent to be bound.

2) Knowledge by the offeree

To have the power to accept the offer, the offeree must have knowledge of the offer.

3) Terms

The terms of the offer must be certain and definite. Under common law, all essential terms must be covered (subject matter, price, and quantity).

The UCC allows for a more liberal contract formation (i.e., a contract is formed if parties intend to contract and there is a reasonably certain basis for giving a remedy). As long as the parties intend to create a contract, the UCC "fills the gap" when a contract is silent as to terms other than quantity or subject matter, such as setting the place for delivery to be the seller's place of business, or even setting the price for the goods. Note that requirements (or

output) contracts satisfy UCC formation requirements even without naming specific quantities. The UCC also implies good faith as a term.

4) Language

The offer must contain words of promise, undertaking, or commitment (as distinguished from words that merely indicate intention to sell or interest in buying). The offer must also be targeted to a number of people who could actually accept.

If a return promise is requested, then the contract is a bilateral contract. If an act is requested, then the contract is a unilateral contract.

5) What is not an offer

Offers must be distinguished from statements of opinion or invitations to bargain.

Compare, for example, the question, "what is your lowest price?" with the response to that question "we can quote you $5 per gross for immediate acceptance." The first question is merely an inquiry, whereas the second statement is an offer.

Advertisements normally are considered invitations to receive offers from the public unless associated with a stated reward. An advertisement may constitute an offer when the advertisement clearly specifies who may accept, how acceptance is to be made, and leaves nothing further for negotiation.

EXAM NOTE: Be careful not to mistake a true offer for language that sounds like an offer but is actually just an invitation to receive offers. The more definite the statement (e.g., "I will sell you X for…"), the more likely it is to be an offer.

b. Termination of offers

An offer can be accepted only when it is still outstanding (i.e., before the offer is terminated). Offers can be terminated in the following ways.

1) Lapse of time in offer

If the offer specifies a date on which the offer terminates, then the time fixed by the offer controls. If the offer states that it will terminate after a specified number of days, the time generally starts to run from the time the offer is received, not sent, unless the offer indicates otherwise. If the offeree is aware (or should have been aware) that there is a delay in the transmittal of the offer, the offer expires when it would have expired had there been no delay.

If the offer does not set a time limit for acceptance, the power of acceptance terminates at the end of a reasonable period of time. What is reasonable is a question of fact and depends on a variety of factors, including the nature of the contract, the purpose and course of dealing between the parties, and trade usage. For an offer received by mail, an acceptance that is sent by midnight of the day of receipt generally has been made within a reasonable period of time. Unless otherwise agreed upon, if the parties bargain in person or via telephone, the time for acceptance does not ordinarily extend beyond the end of the conversation. Restatement (Second) of Contracts § 41.

2) Death or mental incapacity

An offer terminates upon the death or mental incapacity of the offeror, even when the offeree does not know of the death or mental incapacity. An

exception exists for an offer that is an option, which does not terminate upon death or mental incapacity because consideration was paid to keep the offer open during the option period, and the offer is therefore made irrevocable during that period.

Note that if an offer has been accepted, the death of the offeror will not necessarily terminate the contract.

3) Destruction or illegality

An offer involving subject matter that becomes destroyed or illegal is terminated on the happening of such an event.

4) Revocation

In general, an offer can be revoked by the offeror at any time prior to acceptance. An offer is revoked when the offeror makes a manifestation of an intention not to enter into the proposed contract. Restatement (Second) of Contracts § 42. A revocation may be made in any reasonable manner and by any reasonable means, and it is not effective until communicated. A revocation sent by mail is not effective until received.

Example: On day 1, A mails an offer to B. On day 2, A mails a revocation to B. If B receives the offer and accepts before receiving the revocation, a contract is formed.

At common law, a written revocation (as well as a written rejection or acceptance) is received when it comes into the possession of the person addressed or the person authorized to receive it on his behalf, or when it is deposited in some place he has authorized for deposit for this or similar communications. Restatement (Second) of Contracts § 68. Under the UCC, a person receives notice when: (i) it comes to that person's attention or (ii) it is duly delivered in a reasonable form at the place of business or where held out as the place for receipt of such communications. Receipt by an organization occurs at the time it is brought to the attention of the individual conducting the transaction or at the time it would have been brought to that individual's attention were due diligence exercised by the organization. UCC § 1-202.

If the offeree acquires reliable information that the offeror has taken definite action inconsistent with the offer, the offer is automatically revoked (i.e., a constructive revocation occurs). The offeror's power to revoke an offer is limited by the following items.

a) Option (promise not to revoke)

An option is an independent promise to keep an offer open for a specified period of time. Such promise limits the offeror's power to revoke the offer until after the period has expired, while also preserving the offeree's power to accept.

If the option is a promise not to revoke an offer to enter a new contract, the offeree must generally give separate consideration for the option to be enforceable. If the option is within an existing contract, no separate consideration is required. Note that in sale of goods contracts, however, a merchant's promise to keep an offer open need not be supported by consideration if it is in writing and signed.

b) Promissory estoppel

When the offeree detrimentally relies on the offeror's promise, the doctrine of promissory estoppel (*see* § I.C.3.b., *infra*) may make the offer irrevocable. It must have been reasonably foreseeable that such detrimental reliance would occur in order to hold the offeror to the offer.

c) Partial performance

If the offer is for a unilateral contract, the offeror cannot revoke the offer once the offeree has begun performance. Note, though, that the offeree must have had knowledge of the offer when she began the performance.

Once performance has begun, the offeree will have a reasonable time to complete performance. The offeree cannot be required to complete the performance, however.

d) UCC firm offer rule

Under the UCC, an offer to buy or sell goods is irrevocable if:

i) The offeror is a merchant;

ii) There are assurances that the offer is to remain open; and

iii) The assurance is contained in an authenticated writing (such as a signature, initials, or other inscription) from the offeror.

No consideration by the offeree is needed to keep the offer open under the UCC firm offer rule. UCC § 2-205.

i) Time period

If the time period during which the option is to be held open is not stated, a reasonable term is implied. However, irrevocability cannot exceed 90 days, regardless of whether a time period is stated or implied, unless the offeree gives consideration to validate it beyond the 90-day period.

ii) "Merchant" defined

For purposes of this rule, a merchant includes not only a person who regularly deals in the type of goods involved in the transaction or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction, but also any businessperson when the transaction is of a commercial nature. UCC § 2-104(1) cmt. 2.

5) Rejection by counteroffer

An offer is terminated by rejection. In other words, the offeree clearly conveys to the offeror that the offeree no longer intends to accept the offer. A rejection is usually **effective upon receipt**. An offeree cannot accept an offer once it has been terminated.

A counteroffer acts as a rejection of the original offer and creates a new offer. An exception exists for an option holder, who has the right to make counteroffers during the option period without terminating the original offer.

EXAM NOTE: Remember that a **counteroffer** is both a **rejection and a new offer.** Examine the offeree's statement closely. It may be a rejection, but it may also

be only an inquiry (e.g., "Is that a 2005 model car?") or merely indecision (e.g., "I'll keep your offer under advisement."); in either case the offer remains open.

6) Revival of offer

A terminated offer may be revived by the offeror. As with any open offer, the revived offer can be accepted by the offeree.

Example: A offers to paint B's house for $500. B rejects the offer. A states that the offer remains open. B can change her mind and accept the revived offer.

c. Acceptance

Only a party to whom an offer is extended may accept, and the acceptance forms a contract between the parties.

Generally, an offeree must know of the offer upon acceptance for it to be valid, and the terms of the acceptance must mirror the terms of the offer. For acceptance to be effective, the offeree must communicate the acceptance to the offeror.

1) Method of acceptance

The offeror, as master of the offer, can detail the manner of proper acceptance.

a) Bilateral versus unilateral offer

A **bilateral contract** is one in which a promise by one party is exchanged for a promise by the other. The exchange of promises is enough to render them both enforceable. An offer requiring a promise to accept can be accepted either with a return promise or by starting performance. Commencement of performance of a bilateral contract operates as a promise to render complete performance. Restatement (Second) of Contracts § 62.

A **unilateral contract** is one in which one party promises to do something in return for an act of the other party (e.g., a monetary reward for finding a lost dog). Unlike in a bilateral contract, in a unilateral contract, the offeree's promise to perform is insufficient to constitute acceptance. Acceptance of an offer for a unilateral contract **requires complete performance**. Once performance has begun, the offer is irrevocable for a reasonable period of time to allow for complete performance unless there is a manifestation of a contrary intent. However, the offeree is not bound to complete performance. In addition, while the offeror may terminate the offer before the offeree begins to perform, expenses incurred by the offeree in preparing to perform may be recoverable as reliance damages. Restatement (Second) of Contracts § 45.

EXAM NOTE: The offeree of a unilateral contract can accept only an offer that he is aware of. In other words, if the offeree does not become aware of the offer until after acting, then his acts do not constitute acceptance.

When there is doubt as to whether an offer may be accepted by a promise to perform or by performance, the offeree may accept the offer by either. Restatement (Second) of Contracts § 32.

b) Mailbox rule

An acceptance that is mailed within the allotted response time is effective **upon posting** (not upon receipt), unless the offer provides otherwise (e.g., where an offer requires acceptance by personal delivery on or before a specified date). The mailing must be properly addressed and include correct postage.

An acceptance is effective at dispatch; a rejection is effective upon receipt.

> **EXAM NOTE:** Keep in mind that the mailbox rule applies only to **acceptance,** and therefore it almost exclusively applies to bilateral contracts (where there is one promise in exchange for another promise), because unilateral contracts request action as acceptance.

i) Rejection following acceptance

If the offeree sends an acceptance and later sends a communication rejecting the offer, the acceptance will generally control even if the offeror receives the rejection first. If, however, the offeror receives the rejection first and detrimentally relies on the rejection, the offeree will be estopped from enforcing the contract.

ii) Acceptance following rejection

If a communication is sent rejecting the offer, and a later communication is sent accepting the contract, the mailbox rule will **not** apply, and the first one to be received by the offeror will prevail.

iii) Revocations effective upon receipt

Offers revoked by the offeror are effective upon receipt.

iv) Irrevocable offer

The mailbox rule does not apply if the offer is irrevocable, as is the case with an option contract, which requires that the acceptance be received by the offeror before the offer expires. Restatement (Second) of Contracts § 63(b), cmt. f.

v) Medium

If the acceptance is by "instantaneous two-way communication," such as telephone or traceable fax, it is treated as if the parties were in each other's presence. Restatement (Second) of Contracts § 64. There is little case law with regard to email and other forms of modern communication. However, the Restatement focuses on whether the medium of acceptance is reasonable (e.g., whether it is reliable, used by the offeror, used customarily in the industry, or used between the parties in prior transactions). Restatement (Second) of Contracts § 65.

c) Means of acceptance

The traditional view required acceptance to be delivered in the same manner as the offer (e.g., if the offer is sent by telegram, acceptance must also be sent by telegram).

The modern trend allows any reasonable method of acceptance. If the offeror specifically requires acceptance by a particular method, that method will generally control.

UCC § 2-206 provides that acceptance can be by any medium reasonable under the circumstances, unless a specific medium is unambiguously required by the offer.

2) Silence

Generally, silence does not operate as an acceptance of an offer, even if the offer states that silence qualifies as acceptance (or, more likely, implied acceptance), unless:

i) The offeree has reason to believe the offer could be accepted by silence, was silent, and intended to accept the offer by silence; or

ii) Due to previous dealings or pattern of behavior, it is reasonable to believe the offeree must notify the offeror if the offeree intends not to accept.

3) Notice

An offeree of a bilateral contract must give notice of acceptance (return promise). Because acceptance becomes valid when posted, a properly addressed letter sent by the offeree operates as an acceptance when mailed, even though the offeror has not yet received the notice.

Notice of acceptance of a unilateral contract is required only when the offeror is not likely to become aware that the act is being performed or if the offeror requests such notice in the offer. Notice would be required under the same circumstances when a bilateral contract was being accepted by performance.

d. Counteroffers and mirror-image rule

1) Common-law rule

Acceptance must mirror the terms of the offer. Any modifications of the terms of the offer act as a rejection of the offer and a making of a new offer. Mere suggestions or inquiries (including requests for clarification) in a response by the offeree do not amount to a counteroffer. A conditional acceptance will terminate the offer and act as a new offer from the original offeree.

2) UCC rule—battle of the forms

The UCC does not follow the mirror-image rule. Additional or different terms included in the acceptance of an offer generally do not constitute a rejection unless the offer expressly limits acceptance to the terms of the offer.

a) Between non-merchants or if only one party is a merchant

When the contract is for the sale of goods between non-merchants or between a merchant and a non-merchant, a definite and seasonable expression of acceptance or written confirmation that is sent within a reasonable time will operate as an acceptance of the original offer even if it states terms that are additional to or different from the offer unless the acceptance is made expressly conditional on the offeror's consent to the additional or different terms. The additional or different terms are treated as a proposal for addition to the contract that is to be separately accepted or rejected in order to become a part of the contract.

b) Both parties are merchants

When both parties are merchants, not only does an acceptance that contains additional terms create a contract, but such terms are also

treated as part of the contract unless the additional terms materially alter the agreement or unless the offeror objects within a reasonable time. When terms in the acceptance are different from similar terms in the offer (e.g., a different delivery date), some jurisdictions cancel out differing terms and use the provisions of the UCC as gap-fillers (called the "knockout rule"). Other jurisdictions use the terms of the acceptance to determine the scope of the agreement.

2. Excuse

a. Mistake

A legal mistake for which a court may grant a remedy is a belief that is not in accord with the facts as to a basic assumption on which the contract is based that materially affects performance of the contract. A wrong prediction about a future event is not a legal mistake.

1) Unilateral mistake

When only one of the parties is mistaken as to an essential element of the contract existing when the contract was made, and the mistaken party did not bear the risk of the mistake, either party can enforce the contract on its terms, **unless** the mistake relates to a basic assumption of the contract and has a material impact on the deal, and **either:**

i) The non-mistaken party knew or had reason to know that the other party was mistaken, or caused the mistake; or

ii) The mistake would make the contract unconscionable.

2) Mutual mistake

Mutual mistake occurs when both parties are mistaken as to an essential element of the contract. In such a situation, there must be a substantial difference between the deal as it was contemplated and the actual deal, with *no intent by the parties to take a risk on that element* of the transaction.

EXAM NOTE: Look for words such as "as is" that show that the buyer is assuming the risk.

3) Remedies

The contract is generally ***voidable*** by the party that was adversely affected by the mistake.

Example: Rescission of a contract to sell a cow was granted on grounds of mutual mistake when both parties completed the exchange of the cow on the mistaken understanding that the cow was barren. *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919 (1887).

a) Reformation

When a writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake of both parties as to the contents or effect of the writing, the court may at the request of a party reform the writing to express the agreement, except to the extent that rights of third parties such as good-faith purchasers for value will be unfairly affected. When reformation of the contract is available to cure a mistake, neither party can avoid the contract. Restatement (Second) of Contracts § 155.

b. Misunderstanding

Because a contract is a **meeting of the minds,** no contract exists when both parties do not intend the same meaning. If the parties think they are agreeing to the same terms, but in fact assent to different terms, and neither party knows or should know that there is a misunderstanding, then there is no contract.

c. Misrepresentation, nondisclosure, and fraud

A misrepresentation made in connection with an agreement may prevent the formation of the contract or make the contract voidable by the adversely affected party. The use of an "as is" provision can shift the risk to a buyer, in the absence of unconscionability.

1) Elements

A misrepresentation is an assertion about a material element of a contract that is contrary to the facts and that induces assent by the other party who justifiably relies on the assertion.

2) Nondisclosure

Nondisclosure of a known fact is tantamount to an assertion that the fact does not exist only if the party not disclosing the fact knows that:

i) Disclosure is necessary to prevent a previous assertion from being fraudulent;

ii) Disclosure would correct a mistake of the other party as to a basic assumption and the failure to disclose would constitute lack of good faith and fair dealing;

iii) Disclosure would correct a mistake of the other party as to the contents or effect of a writing evidencing their agreement; or

iv) The other party is entitled to know the fact because of a confidential or fiduciary relationship.

3) Types

A misrepresentation may be innocent, negligent, or fraudulent. Fraud exists if the misrepresentation is made:

i) Knowingly;

ii) Without confidence in the assertion (i.e., reckless disregard for its truth); or

iii) When the person making the assertion knows that no basis exists for the assertion.

a) Fraud in the factum

Fraud in the factum (or fraud in the execution) occurs when the fraudulent misrepresentation prevents a party from knowing the character or essential terms of the transaction. In such a case, no contract is formed, and the apparent contract is ***void*** (i.e., not enforceable against either party), unless reasonable diligence would have revealed the true terms of the contract.

b) Fraud in the inducement

Fraud in the inducement occurs when a fraudulent misrepresentation is used to induce another to enter into a contract. Such a contract is *voidable* by the adversely affected party if she justifiably relied on the misrepresentation in entering into the agreement.

c) Non-fraudulent misrepresentation

Even if non-fraudulent, a misrepresentation can still render a contract *voidable* by the adversely affected party. The misrepresentation must be *material* (i.e., information that would cause a reasonable person to agree or that the person making the misrepresentation knows would cause this particular person to agree) and the adversely affected party must have justifiably relied on the misrepresentation.

d. Undue influence and breach of confidential relationship

A higher standard of conduct is expected of a party to a contract who has the trust or confidence of the other party as a result of a special relationship.

1) Undue influence

Undue influence can occur in a relationship when one party is dominant and the other dependent, either due to lack of expertise or experience, or because the dependent person has diminished mental capacity. In general, the dominant party to the contract will be held to a higher standard of fairness and disclosure than he will in a contract between arms-length parties.

2) Confidential relationship

When one party to a contract has a fiduciary relationship to the other (such as trustee to beneficiary, lawyer to client, doctor to patient, financial advisor to client, and in some cases parent to child), the burden of proving that the contract is fair is usually placed upon the fiduciary.

e. Duress

Any wrongful act or threat that deprives a party of meaningful choice constitutes duress. When a party's agreement is the result of physical duress, the contract is void. When the duress is in the nature of a threat, the contract is voidable.

C. CONSIDERATION AND SUBSTITUTES

In addition to offer and acceptance, most courts require valuable consideration for an agreement to be enforceable. If either party has not given consideration, the agreement is not enforceable upon formation.

1. Bargain and Exchange

Valuable consideration is evidenced by a bargained-for change in the legal position between the parties. Most courts conclude consideration exists if there is a detriment to the promisee, irrespective of the benefit to the promissor. A minority of courts look to either a detriment or a benefit, not requiring both. The Second Restatement asks only whether there was a bargained-for exchange. Restatement (Second) of Contracts § 71.

a. Legal detriment and bargained-for exchange

For the legal detriment to constitute sufficient consideration, it must be bargained for in exchange for the promise. The promise must induce the detriment, and the detriment must induce the promise ("mutuality of consideration").

Consideration can take the form of:

i) A return promise to do something;

ii) A return promise to refrain from doing something legally permitted;

iii) The actual performance of some act; or

iv) Refraining from doing some act.

b. Gift distinguished

The test to distinguish a gift from valid consideration is whether the offeree could have **reasonably believed that the intent of the offeror was to induce the action.** If yes, then there is consideration, and the promise is enforceable.

A party's promise to make a gift is enforceable under the doctrine of promissory estoppel if the promisor/donor knows that the promise will induce substantial reliance by the promisee and the failure to enforce the promise will cause substantial injustice.

Example 1: A promises to give B $1,000 when B turns 21. The act of B attaining the age of 21 is not a bargained-for event and is thus not sufficient consideration. Note: There can be no reliance on the promise because B will turn 21 regardless of A's promise, so promissory estoppel does not apply.

Example 2: A offers B $1,000 if B quits smoking. A is bargaining for B to quit and thus B's act is sufficient consideration. Note: If B relied on A's promise of the payment, promissory estoppel also may apply.

2. Adequacy of Consideration

The basic concept of legal detriment is that there must be something of **substance,** either an act or a promise, which is given in exchange for the promise that is to be enforced.

a. Subjective value

The benefit to the promisor does not need to have an economic value. Regardless of the objective value of an item, as long as the promisor wants it, the giving of it will constitute adequate consideration (e.g., "a mere peppercorn is enough").

b. Preexisting duty rule

1) Common law

At common law, a promise to perform a preexisting legal duty does not qualify as consideration because the promisor is already bound to perform (i.e., there is no legal detriment). Note that if the promisor gives something in addition to what is already owed (however small) or varies the preexisting duty in some way (however slight), most courts find that consideration exists. Restatement (Second) of Contracts § 73.

Example 1: A borrower knows that he owes a lender $1,000 today. The borrower promises to repay the loan if the lender promises to lend the borrower an addition $100. The borrower has not provided consideration for the lender's promise.

Example 2: A borrower knows that he owes a lender $1,000 tomorrow. The borrower offers to pay the lender $900 today if the lender agrees to forego the additional $100. The lender accepts the offer. The borrower has provided the lender with consideration for the lender's promise.

2) Exception for a third party

There is an exception to the preexisting-duty rule when a third party offers a promise contingent upon performance of a contractual obligation by a party. Under the exception, the party's promise to the third party is sufficient consideration. Restatement (Second) of Contracts § 73.

Example: C contracts with P for P to install plumbing in a house being built by C for H. C subsequently becomes insolvent and walks away from the project. H contracts with P and promises to pay P the same amount P would have received from C if P installs the plumbing. P's completion of the job constitutes consideration for the promise by H, even though P was already contractually obligated to C to do the work.

c. Modification

1) Common law

At common law, modification of an existing contract must be supported by consideration. Agreements to modify a contract may still be enforced if:

i) There is a rescission of the existing contract by tearing it up or by some other outward sign, and then the entering into a new contract, whereby one of the parties must perform more than he was to perform under the original contract;

ii) There are unforeseen difficulties, and one of the parties agrees to compensate the other when the difficulties are discovered; or

iii) There are new obligations on both sides.

2) UCC and consideration

A merchant's promise to keep an offer open need not be supported by consideration if it is in an authenticated writing.

No consideration is necessary to modify a contract for the sale of goods, although there is a requirement of good faith by both parties. Thus, if one party is attempting to extort a modification, it will be ineffective under the UCC. Good faith requires honesty in fact in the conduct or transaction concerned.

EXAM NOTE: Be aware of the difference between common-law and UCC rules regarding contract modification. At common law, modifications require consideration; under the UCC, they require only good faith.

d. Accord and satisfaction

Under an accord agreement, one party to a contract agrees to accept different performance from the other party than what was promised in the existing contract. Generally, consideration is required for an accord to be valid.

When a creditor agrees to accept a lesser amount in full satisfaction of the debt, the original debt is discharged **only when there is some dispute** either as to the validity of the debt or the amount of the debt, **or where the payment is of a different type than called for under the original contract.**

A "satisfaction" is the performance of the accord agreement. It will discharge both the original contract and the accord contract.

EXAM NOTE: Accord and satisfaction are usually indicated on an exam when a debtor notes on a check conspicuously that a lesser payment is "**payment in full**." Remember that if the creditor endorses the check without seeing the debtor's notation, or without making another notation reserving the creditor's rights, the accord and satisfaction defense will generally prevail. The issue more commonly rests on whether the fact pattern indicates that a good-faith dispute exists.

If an accord is breached by the debtor, the creditor can sue on either the original contract **or** under the accord agreement.

e. Illusory promises

An illusory promise is one that essentially pledges nothing, because it is vague or because the promisor can choose whether or not to honor it. Such a promise is not legally binding.

Example: A promises "I will give B $100, at my option." B's promise is an illusory promise.

f. Requirements and output contracts

A requirements contract is a contract under which a buyer agrees to buy all it will require of a product from the other party. An output contract is a contract under which a seller agrees to sell all it manufactures of a product to the buyer. There is consideration in these agreements, as the promisor suffers a legal detriment. The fact that the party may go out of business does not render the promise illusory.

Under the UCC, any quantities under such a contract may not be unreasonably disproportionate to any stated estimates, or if no estimate is stated, to any normal or otherwise comparable prior requirements or output.

Good faith is required under the UCC with regard to requirements and output contracts. Thus, for example, if a buyer, in good faith, legitimately no longer needs the goods, it may cancel the contract.

g. Uncertain as to law or fact

Failing to assert a claim or defense that proves to be invalid does not constitute consideration, unless the claim or defense is in fact doubtful due to uncertainty of facts or law, or if the party failing to assert the claim or defense believes in good faith that it may be fairly determined to be valid. Restatement (Second) of Contracts § 74.

3. Modern Substitutes for Bargain

a. Past or "moral" consideration

Something given in the past is typically not good consideration because it could not have been bargained for, nor could it have been done in reliance upon the promise. There is a modern trend, however, toward enforcing such promises when necessary to "prevent injustice."

Example: P sees D's horse running free and knows that D is out of town. P feeds and houses the horse for two weeks awaiting D's return. When D returns, D thanks P and promises to pay P $50 at the end of the month. This promise is usually unenforceable as un-bargained-for "past consideration."

In the above example, however, P may be able to recover in quasi contract under a theory of unjust enrichment if P expected to be compensated and D received a benefit from P's actions.

b. Promissory estoppel

Promissory estoppel (or "equitable estoppel") acts as consideration when a party makes a promise that reasonably could be foreseen to induce reliance by the other party, the other party relies on that promise, and injustice can be avoided only by enforcing the promise. The remedy may be limited or adjusted as justice requires. Thus, a court might only partially enforce a contract, depending on the circumstances.

EXAM NOTE: Always consider whether there is a valid contract before considering promissory estoppel as the correct answer.

1) Charitable subscriptions

Although courts often claim to apply the doctrine of promissory estoppel to enforce promises to charitable institutions, they normally do not require evidence of reliance.

Example: If A promises to give a university $1,000,000, and the university purchases land in reliance upon the promise, then the promise is enforceable under the doctrine of promissory estoppel.

c. Debts barred by the statute of limitations

A new promise to pay a debt after the statute of limitations has run is enforceable without any new consideration.

D. DEFENSES TO FORMATION

1. Capacity to Contract

Parties to a contract must be competent (i.e., have the legal capacity to be held to contractual duties). Incompetency arises because of infancy, mental illness or defect, guardianship, intoxication, and corporate incapacity.

a. Infancy

1) Disaffirmance

Infants (in most states, individuals who are under the age of 18) do not have the capacity to contract. When a contract is made by an infant with a person who does not lack capacity, it is **voidable** by the infant but not by the other party. This means that the infant may either disaffirm (void) the contract and avoid any liability under it or choose to hold the other party to the contract. The disaffirmance must be effectuated either before the individual reaches the age of majority or within a reasonable time thereafter. If the contract is not disaffirmed within a reasonable time after the individual reaches the age of majority, then the individual is deemed to have ratified the contract. If the contract is disaffirmed, the individual must restore any benefits received under the contract, if possible. Restatement (Second) of Contracts § 14.

2) Liability for necessities

When necessities are furnished to the infant, the infant must pay for them, but the recovery by the person furnishing the necessities is limited to the **reasonable value** of the services or goods (not the agreed-upon price). Recovery is under a theory of quasi contract.

Food, shelter, and clothing are clearly necessities. Statutory exceptions may also encompass insurance contracts and student loans.

b. Mental illness

If a party is adjudicated mentally incompetent and is under guardianship, contracts made by the individual are ***void*.** On the other hand, if there has been no adjudication or guardianship, the contracts are ***voidable*** and may be disaffirmed if the person is unable to understand the nature and consequences of the transaction or unable to act in a reasonable manner with regard to the transaction, and the other party has reason to know of this fact. If a contract is made during a lucid period, the contract is fully enforceable, unless the person has been adjudicated incompetent. A mentally incompetent person would be liable for the reasonable value of necessities furnished by another party, as in the case of infants (*see* § I.D.1.a., *supra*).

c. Guardianship

If a party's property is under guardianship by reason of an adjudication (such as for mental illness or defect, habitual intoxication, narcotics addiction, etc.), that party has no capacity to contract.

d. Intoxication

Intoxication of a party to a contract resulting from alcohol or drugs renders a contract ***voidable*** if the person entering into the contract was unable to understand the nature of the transaction and the other party had reason to know of the intoxication. Generally, the intoxicated party would be liable in quasi contract for the fair value of the goods or services furnished.

e. Corporate incapacity

When a corporation acts *ultra vires* (outside its powers), the contract is voidable. Most states allow recovery in *quantum meruit* if one party performs on the contract.

2. Illegality

If the consideration or performance that is to occur under a contract is illegal, then the contract itself is illegal and is unenforceable. If a contract contemplates illegal conduct, it is void. If a contract becomes illegal after it is formed, the duty to perform under the contract is discharged. Note that a contract is "illegal" for contract purposes when it contravenes a statute or a rule of common law; it need not involve activity that results in criminal penalties.

Examples of illegal contracts include contracts that are usurious, against public policy (e.g., contracts in restraint of marriage), for the commission of a tort or crime, or in restraint of trade.

a. Effect of illegality

Illegal transactions are not recognized or enforceable, restitution is not awarded for consideration, and no remedy is available for partial performance.

b. Exceptions

1) Ignorance

Where one party is justifiably ignorant of the facts making the contract illegal, that party may recover if the other party to the contract acted with knowledge of the illegality.

2) Party lacks illegal purpose

If only one party has an illegal purpose, the other party can recover if he did not know of the illegal purpose or knew of the illegal purpose but did not facilitate that purpose and the purpose does not involve serious moral turpitude.

Example: A seller of gambling equipment can recover the price, as long as he did not become involved in illegal gambling using the equipment. *This is true even if the seller knows of the illegal purpose.*

3) Divisible contracts

Some contracts can be easily separated into legal and illegal parts so that recovery is available on the legal part(s) only.

Example: The reasonable portion of a non-compete covenant can be enforced.

4) *Pari delicto* (equally at fault)

When the parties are at equal fault, neither party can claim breach of the contract by the other. If the parties are not *in pari delicto,* the "less guilty" party may be able to recover consideration from the other.

3. Unconscionability

A court may modify or refuse to enforce a contract or part of a contract on the grounds that it is "unconscionable." UCC § 2-302.

An entire contract or a contract provision is substantively unconscionable when it is so unfair to one party that no reasonable person in the position of the parties would have agreed to it. The contract or a contract provision must have been offensive at the time it was made. Unconscionability may also be applied to prevent unfair surprise. Boilerplate contract provisions that are inconspicuous, hidden, or difficult for a party to understand have been held unconscionable. Courts have also applied the doctrine of unconscionability where the process of bargaining was so unfair that the weaker party had no meaningful choice (i.e., procedural unconscionability), such as a contract of adhesion (i.e., a take-it-or-leave-it contract). Under either type of unconscionability, there usually is greatly unequal bargaining power between the parties.

The question of whether a contract is unconscionable is a question of law for the court to decide; the issue does not go to the jury.

4. Public Policy

Even if a contract is neither illegal nor unconscionable, it may be unenforceable if it violates a significant public policy (e.g., contracts in restraint of marriage, contracts for the commission of a tort, or contracts that unreasonably restrain trade).

E. IMPLIED-IN-FACT CONTRACTS AND QUASI CONTRACTS

1. Implied-In-Fact Contracts

When a person verbally expresses assent to an offer, the resulting agreement is characterized as an express contract. When a person's assent to an offer is inferred solely from the person's conduct, the resulting agreement is typically labeled an "implied-in-fact" contract. To be contractual bound, a person must not only intend the conduct but also know or have reason to know that his conduct may cause the offeror to understand that conduct as assent to the offer.

Example: B joins a tour group that is walking through a downtown area learning about landmark buildings. Although B knows that members of the group have each paid the guide $15, he believes that his presence does not add to the guide's existing duties to the group. The tour guide can charge B the same fee paid by other members of the tour group because B's assent to the payment of the fee can be inferred from his conduct in joining the group.

2. Implied-In-Law ("Quasi") Contracts

When a person confers a **measurable benefit** on another, the person has **acted without gratuitous intent** (e.g., reasonably expected compensation), and allowing the other to **keep the benefit without cost is unfair,** the court can imply a "quasi contract" (or implied-in-law contract) as a method of recovery. The unfairness may arise when the recipient had the opportunity to decline the benefit but instead knowingly accepted it, or the actor had an excuse for not giving the recipient such an opportunity, such as in an emergency. This type of contract prevents unjust enrichment in cases not only in which there is no contract, but also in which there is a failed contract or a divisible contract.

When a quasi contract is implied, a promise is implied that requires the defendant to make restitution to the plaintiff, such as damages equal to the fair value of the benefit.

Example: Gardner arrives to install a sprinkler in Bill's neighbor's yard, but he accidentally starts to work in Bill's yard. Bill looks out the window and sees Gardner installing a sprinkler in his own yard and does nothing. If Gardner sued Bill, the court would find a contract implied-in-law, and the court would have the discretion to set the amount of compensation, usually the fair market value of the benefit that was conferred.

F. PRE-CONTRACT OBLIGATIONS

1. Option Contract

Generally, an offer is revocable at any time, even if the offeror has agreed to keep the offer open for a specified time. An offer can be made irrevocable, however, if the offeror promises to keep the offer open for a specific period of time *and* that promise is supported by consideration. An option contract is then formed, and the offeree usually pays an agreed amount to the offeror in order to make the offer irrevocable.

2. Construction Contracts and Promissory Estoppel

In the construction industry, an agreement not to revoke a sub-bid offer is enforceable under the theory of promissory estoppel. It would be unjust to permit the subcontractor to revoke a bid after inducing justifiable and detrimental reliance in the general contractor.

Because the sub-bid is only an outstanding offer, the **general contractor is not bound** to accept it upon becoming the successful bidder for the general contract. A general contractor can enter into a subcontract with another for a lower price.

G. WARRANTIES IN SALE-OF-GOODS CONTRACTS

UCC Article 2 allows not only for express warranties, but also for the implied warranties of merchantability and fitness for a particular purpose.

1. Express Warranty

Any promise, affirmation, description, or sample that is part of the basis of the bargain is an express warranty, unless it is merely the seller's opinion or commendation of the

value of the goods. The use of a sample or model will create a warranty that the goods the buyer is to receive will be like the proffered sample or model.

Note that an express warranty can be made subsequent to the contract for sale. Technically, this would modify the original agreement, and under the UCC, no consideration is needed to make a modification enforceable.

Disclaimer clauses that conflict with express warranties are **ignored.**

EXAM NOTE: A seller's opinion will not create an express warranty.

2. Implied Warranty of Merchantability

A warranty of merchantability is implied whenever the seller is a merchant. To be merchantable, goods must be fit for their ordinary purpose and pass without objection in the trade under the contract description. A breach of this warranty must have been present at the time of the sale.

Unless the circumstances indicate otherwise, the warranty can be disclaimed by use of "as is," "with all faults," or similar language that makes plain that there is no implied warranty. The disclaimer may be oral, but it must use the term "merchantability" and must be conspicuous if in writing.

If the buyer, before entering into the contract, has examined the goods or a sample or model as fully as the buyer desires, or has refused to examine the goods, there is no implied warranty with respect to defects that an examination ought to have revealed to the buyer.

3. Implied Warranty of Fitness for a Particular Purpose

A warranty that the goods are fit for a particular purpose is implied whenever the seller has reason to know (from any source, not just the buyer) that the buyer has a particular use for the goods and the buyer is relying upon the seller's skill to select the goods.

Note that this warranty will apply to any seller (i.e., the seller need not be a merchant for it to apply).

An implied warranty of fitness for a particular purpose can be disclaimed by general language (including by the use of "as is"), but the **disclaimer must be in writing and be conspicuous.**

II. THIRD-PARTY BENEFICIARY CONTRACTS

A third-party beneficiary contract results when the parties to a contract intend that the performance by one of the parties is to benefit a third person who is not a party to the contract.

A. CREDITOR AND DONEE BENEFICIARIES

The Restatement (First) of Contracts classifies third-party beneficiaries as creditor or donee beneficiaries. If performance of a promise would satisfy an actual or supposed or asserted duty of the promisee to a third party, and the promisee did not intend to make a gift to the third party, then the third party is called a **creditor beneficiary.** A creditor beneficiary has the right to sue either the promisor or promisee to enforce the contract.

Example: A agrees to paint B's house in return for B's promise to pay $500 to C, because A owes C $500. C is an intended beneficiary and can recover the $500 from B.

If the promisee entered the contract for the purpose of conferring a gift on a third party, the third-party **"donee beneficiary"** is given the right to sue the promisor.

Example: A pays B to build a house for C. C is a donee beneficiary of the contract between A and B.

The Restatement (Second) of Contracts abandons the "donee beneficiary" and "creditor beneficiary" categories. Instead, a third party can recover if she is an "intended beneficiary." Otherwise, she is said to be an "incidental beneficiary," with no rights to enforce the contract.

B. INTENDED BENEFICIARIES

An intended beneficiary is one to whom the promisee wishes to make a gift of the promised performance or to satisfy an obligation to pay money owed by the promisee to the beneficiary. The promisee must have an intention (explicit or implicit) to benefit the third party, otherwise the beneficiary is incidental.

Example: If A agrees to paint B's house in return for B's promise to pay $500 to C, C is an intended beneficiary and can recover the $500 from B.

C. INCIDENTAL BENEFICIARIES

An incidental beneficiary is one who benefits from a contract even though there is no contractual intent to benefit that person. An incidental beneficiary has no rights to enforce the contract.

Example: A promises to buy B a car from dealership C. The dealership is an incidental beneficiary with no grounds upon which to recover if A reneged on the promise.

D. VESTING OF BENEFICIARY'S RIGHTS

Only an intended beneficiary has a right to bring an action on the contract. An intended beneficiary of a "gift promise" (a donee beneficiary) may sue only the promisor. If the promisee tells the donee beneficiary of the contract and should reasonably foresee reliance, and the beneficiary does so rely to her detriment, promissory estoppel would apply. An intended beneficiary to whom the promisee owed money (a creditor beneficiary) may sue either the promisor or the promisee, or both, on the underlying obligation, but only one recovery is allowed.

1. When Rights Vest

The rights of an intended beneficiary vest when the beneficiary:

i) **Materially changes position in justifiable reliance** on the rights created;

ii) **Expressly assents** to the contract at one of the parties' request; or

iii) **Files a lawsuit** to enforce the contract.

2. Effect of Vesting on Original Parties

Once the beneficiary's rights have vested, the original parties to the contract are both bound to perform the contract. Any efforts by the promisor or the promisee to rescind or modify the contract after vesting are void, **unless the third party agrees** to the rescission or modification.

E. DEFENSES

The promisor can raise any defense against the third-party beneficiary that the promisor had against the original promisee. Therefore, the beneficiary also becomes liable for counterclaims on the contract that the promisor could establish against the promisee. This liability can never exceed the amount that the promisor owes under the contract.

Example: A agrees to paint B's house in return for B's promise to pay $500 to C, to whom A owes $500. If the statute of limitations (or any other contractual defense) precludes A

(the promisee) from recovering against B (the promisor), it will also preclude C (the intended creditor beneficiary) from recovering against B on the contract.

The promisor may not assert any defenses that the promisee would have had against the intended beneficiary.

Example: In the example above, if the statute of limitations precluded C from recovering against A on the debt A owed to C, that would not affect B's obligation to C.

III. ASSIGNMENT OF RIGHTS AND DELEGATION OF DUTIES

A. DEFINITIONS

"Assignment" is the **transfer of rights** under a contract, and **"delegation"** is the **transfer of duties and obligations** under a contract.

B. ASSIGNMENT OF RIGHTS

Almost all contract rights can be assigned. Partial assignments are permissible, as is the assignment of future or unearned rights.

1. Limitations on Assignment

An assignment is not allowed, however, if it materially increases the duty or risk of the obligor or materially reduces the obligor's chance of obtaining performance. In addition, a contract provision can render an otherwise allowable assignment void (e.g., "any assignment of rights under this contract is void") and unenforceable by the assignee against the obligor. By contrast, a contract provision that merely prohibits an assignment (e.g., "An assignment of rights under this contract is prohibited"), while giving rise to an action for breach against the assignor, does not operate to prevent the assignor from assigning those rights (the assignor retains the power to make an assignment) nor the assignee from suing the obligor. Unless circumstances indicate the contrary, the prohibition on the assignment of a contract (e.g., "this contract may not be assigned"), does not affect the assignment of contract rights, but only bars the delegation of duties.

NOTE: Courts often narrowly interpret a prohibition provision, such as by finding that such a provision only applies to a specific contractual right, and that the assignment in question thus did not violate the provision.

2. Requirements

No formalities are needed for an assignment, but there must be a present intent to transfer the right immediately. No consideration is needed, but the lack of consideration would affect revocability of the assignment.

Distinguish promise of a future payment: A promise by a party to a contract to pay to monies received pursuant to the contract to third party is not an assignment of the party's contractual rights, but a promise of a future payment. As a consequence, the third party is not an assignee of the contract.

3. Rights of the Assignee

An assignee **takes all of the rights of the assignor as the contract stands at the time of the assignment** but takes **subject to any defenses that could be raised against the assignor.** The rights of the assignee are subject to set-off if the transaction giving rise to the set-off occurred prior to the time the obligor was given notice of the assignment. The assignee is also subject to any modification of the contract made prior to the time the obligor obtained notice of the assignment. Thus,

payment by the obligor to the assignor can be raised as a defense, provided the payment was made before the obligor had notice of the assignment.

A subsequent assignment of the same right(s) revokes any prior *revocable* assignment. If the first assignment was an *irrevocable* assignment, the first assignee will have priority over the second assignee, unless the second assignee is a bona fide purchaser for value without notice of the first assignment, in which case, the assignee who obtains payment from the obligor or judgment first will have priority. If the second assignee knows about a prior assignment, he is estopped from asserting claim over the first assignee even if he would have otherwise prevailed.

C. DELEGATION OF DUTIES

1. In General

Generally, obligations under a contract can be delegated, unless the other party to the contract has a substantial interest in having the delegating individual perform (for example, in a personal services contract involving taste or a special skill) or when delegation is prohibited in the contract.

When obligations are delegated, the **delegator is not released from liability,** and recovery can be had against the delegator if the delegatee does not perform.

2. Novation

A novation is the substitution of a new contract for an old one, where the original obligor is released from his promises under the original agreement. A novation may be express or implied after delegation if (i) the original obligor repudiates liability to the original promise, **and** (ii) the obligee subsequently accepts performance of the original agreement from the delegatee, without reserving rights against the obligor.

3. Effect of Delegation of Performance under the UCC

Under UCC § 2-210(5), any delegation of performance under a contract for the sale of goods may be treated by the other party as creating reasonable grounds for insecurity. The other party may, without prejudice to her rights against the delegator, demand assurances from the delegatee (pursuant to UCC § 2-609, discussed at § VII.B.2.-3., *infra*).

IV. STATUTE OF FRAUDS

A. WRITING REQUIRED

Generally, oral contracts are enforceable. However, contracts that fall within the Statute of Frauds are ***unenforceable*** unless they are ***in writing.*** The writing must:

i) Be signed by the party to be charged (i.e., the person against whom enforcement is sought); and

ii) Contain the essential elements of the deal.

The writing need not be formal (i.e., receipts or correspondence can serve as memoranda). The essential elements may be in more than one writing only if one of the writings references the other(s). The writing need not be delivered. Even if it is lost or destroyed, it still operates to satisfy the Statute of Frauds, and its prior existence can be proved by oral evidence.

EXAM NOTE: Note that a memorandum sufficient to satisfy the Statute of Frauds does not need to be written at the time a promise is made. The memorandum also does not have to be addressed to the promisee to be enforceable by the promisee.

B. TYPES OF CONTRACTS WITHIN THE STATUTE OF FRAUDS

Most states require that these five categories of contracts be in writing:

Marriage - A contract made upon consideration of marriage;

Suretyship - A contract to answer for the debt or duty of another;

Land - A contract for the sale of an interest in land;

One year - A contract that cannot be performed within one year from its making; and

UCC - Under the UCC, a contract for the sale of goods for a price of $500 or more.

> **EXAM NOTE:** You can remember which types of contracts are governed by the Statute of Frauds by using the mnemonic **MS. LOU** (Marriage, Suretyship, Land, One year, UCC).

1. Marriage Provision

Any agreement in consideration of marriage is within the Statute of Frauds, except mutual promises by the two to marry each other.

2. Suretyship Provision

a. Rule

Suretyship is a three-party contract, wherein one party (surety) promises a second party (obligee) that the surety will be responsible for any debt of a third party (principal) resulting from the principal's failure to pay as agreed. A suretyship induces the second party to extend credit to the third party. A promise to answer for the debt of another must generally be in writing to be enforceable.

> **EXAM NOTE:** Remember that the surety must promise the **creditor or obligee,** not just the principal, that she will pay the debt of the principal.

b. Exceptions

1) Indemnity contracts

Indemnity contracts (i.e., a promise to reimburse for monetary loss) do not fall within the Statute of Frauds.

2) Main purpose exception

In addition, if the main purpose of the surety in agreeing to pay the debt of the principal is for the surety's own economic advantage, rather than for the principal's benefit, the contract will not fall within the Statute of Frauds, and an oral promise by the surety will be enforceable.

3. Land Contracts

a. Types

A promise to transfer or buy *any interest in land* is within the Statute of Frauds. The Statute of Frauds does not apply to the conveyance itself (which is governed by separate statutes everywhere) but rather to a *contract providing for* the subsequent conveyance of land.

The following transfers are excluded from the rule: licenses, leases, and assignments of mortgages. However, the one-year rule does apply to such transfers. Consequently, a lease, license, or easement for **more than one year** must be in writing.

b. Part performance

Even if an oral contract for the transfer of an interest in real property is not enforceable at the time it is made, **subsequent acts** by either party that show the existence of the contract may make it enforceable, even without a memorandum. Such acts include:

i) Payment of all or part of the purchase price;

ii) Possession by the purchaser; or

iii) Substantial improvement of the property by the purchaser.

c. Full performance

When a party to an oral contract who has promised to convey real property performs, that party can enforce the other party's oral promise unless the promise is itself the transfer of a real property interest.

Example: During a face-to-face conversation, a seller agrees to transfer land to the buyer in exchange for the buyer's promise to pay $50,000 to the seller. The seller tenders the deed to the buyer and the buyer accepts the deed. The seller can enforce the buyer's oral promise to pay $50,000 to the seller.

4. One-Year Provision

Contracts that **cannot** be performed within one year due to the constraints of the terms of the agreement must be in writing. The year starts **the day after** the contract is made. It is the time that the contract is made that is important, not the length of performance.

Note that the fact that a contract is not completed within one year does not mean that it is voidable under the Statute of Frauds. For the Statute of Frauds to apply, the *actual terms* of the contract must make it impossible for performance to be completed within one year.

Full performance will generally take the contract out of the Statute of Frauds. While part performance would not take the contract out of the Statute of Frauds, restitution would be available to the party who performed.

EXAM NOTE: The test is whether the contract can be performed within one year, not whether it is likely to be performed within one year.

5. Sale of Goods for $500 or More

a. Sufficiency of the writing

When the price of goods is at least $500, the UCC requires a memorandum of the sale that must:

i) Indicate that a contract has been made;

ii) Identify the parties;

iii) Contain a quantity term; and

iv) Be signed by the party to be charged.

The memorandum needs to be signed only by the party being sued; it does not need to be signed by both parties.

A mistake in the memorandum or the omission of other terms does not destroy its validity. An omitted term can be proved by parol evidence.

Enforcement is limited to the quantity term actually stated in the memorandum.

> **EXAM NOTE:** To satisfy the Statute of Frauds, the above terms must be in writing, but that writing need not be an actual contract. It doesn't even need to be contained on one piece of paper—a series of correspondence between the parties may suffice.

b. Exceptions

1) Specially manufactured goods

No writing is required if the goods are to be specially manufactured for the buyer, are not suitable for sale to others, and the seller has made "either a substantial beginning of their manufacture or commitments for their procurement." UCC § 2-201.

2) Payment and acceptance by seller

A contract is outside the UCC Statute of Frauds to the extent that payment has been made and accepted. UCC § 2-201(3)(c). When a portion of the purchase price for a single item has been paid, most courts treat the contract as enforceable.

3) Receipt and acceptance by buyer

A contract is outside the UCC Statute of Frauds to the extent that goods are received and accepted. UCC § 2-201(3)(c). Acceptance of a part of a commercial unit is acceptance of the entire unit. UCC § 2-606(2).

4) Failure to respond to memorandum (where both parties are merchants)

If both parties are merchants and a memorandum sufficient against one party is sent to the other party, who has reason to know its contents, and that receiving party does not object in writing **within 10 days,** the contract is enforceable against the receiving party even though he has not signed it.

c. Modifications

Under UCC § 2-209(3), the requirements of the UCC Statute of Frauds must be satisfied if the contract as modified is within its provisions. Any of the above exceptions would apply, though, to take a modification out of the Statute of Frauds.

The UCC would also enforce a provision in a contract for the sale of goods that required a modification to be in writing. Thus, even if the contract was for a sale of goods valued at less than $500 or involved one of the exceptions discussed above, if the contract specifically provided that any modification be in writing, the UCC would enforce that requirement. (*See* UCC § 2-902(2).) Note that under a common-law contract, a provision requiring a modification to be in writing even though the modification would not otherwise fall within the Statute of Frauds would not be enforceable.

V. PAROL EVIDENCE

As a general rule, evidence of prior or contemporaneous agreements is not admissible to contradict the terms of a written agreement when all of the terms are completely integrated into the four corners of the agreement. In order to invoke the parol evidence rule, it must be shown that the parties intended to adopt the writing as their entire agreement.

A. INTENT OF THE PARTIES

The intent of the parties determines whether there is total, partial, or no integration. Parol evidence cannot be used to contradict any term of a writing that is the final and complete expression of the agreement between the parties, and no evidence can be introduced as to any additional promises or representations made prior to the time of the writing. A merger clause (a clause in the agreement that states that the agreement contains all the terms) is evidence of the intent to integrate.

A partially integrated agreement can be supplemented, but a completely integrated agreement cannot. The rule does not prevent a party from proving that the agreement was not final, any defects in formation, or anything that helps interpret ambiguous terms.

B. OPERATION OF THE PAROL EVIDENCE RULE

1. Contradictory Evidence

Evidence that contradicts the writing is inadmissible unless it is determined that there was no intent to integrate the agreement of the parties into the writing.

2. Supplemental Evidence

Evidence that supplements a contract that is partially integrated is admissible if it is consistent with the writing and does not contradict the terms.

Patterns of previous conduct between the parties may be admissible to show a typical course of dealing.

3. Separate Deal

Even when there is full integration, evidence may be offered if it represents a distinct and separate contract.

4. Ambiguity

Evidence may be admitted for the purpose of interpreting or clarifying an ambiguity in the agreement. This can include evidence of trade usage or even local custom to show that a particular word or phrase had a particular meaning.

5. Proving a Defense

Evidence may be admitted to prove a defense such as fraud in the inducement, mistake, failure of consideration, or failure of a condition, or to prove that the contract is void or voidable.

6. Condition Precedent

Parol evidence may also be admitted to prove a condition precedent to the existence of the contract.

7. Subsequent Agreements

The parol evidence rule does not apply to evidence of agreements between the parties subsequent to execution of the writing.

Example: Handyman has a contract with Eric to refinish Eric's deck for $300. While there, Eric asks him if he could also fix the gutter for $60. If Eric does not pay Handyman for fixing the gutter, Handyman can introduce extrinsic evidence.

8. Where Parties Attach Different Meanings

Under the Restatement (Second) of Contracts, when the parties have attached different meanings to a term in a contract, the meaning that controls will be the

meaning attached by one of them, if at the time the agreement was made that party did not know of any different meaning attached by the other, and the other party knew the meaning attached by the first party.

C. UCC PAROL EVIDENCE RULE

Under UCC § 2-202, with regard to sales contracts, no evidence is admissible to show prior written or oral agreements, or contemporaneous oral agreements contradicting the contract. However, a contract can be explained or supplemented by evidence of trade usage, or course of dealings or performance. Unless the contract is found to be a complete and exclusive statement of terms, evidence of consistent additional terms may be admitted.

EXAM NOTE: Remember, evidence that would be naturally omitted from a contract and does not contradict the terms of the contract usually is admissible. Any evidence that contradicts the contract will not be admissible.

VI. CONDITIONS

A condition is a future and uncertain event that must take place before a party's rights or obligations are created, destroyed, or enlarged.

Conditions must be distinguished from promises, which may be the difference between a minor breach and a complete prevention of the other party's duty to perform. If the contractual provision purports to be a statement by the party required to perform, the provision is a promise; if it is a statement by the non-performing party, it is a condition. Ambiguity is usually resolved in favor of a promise over a condition.

EXAM NOTE: Remember, the failure of a **condition** relieves a party of the **obligation** to perform; the failure of a **promise** constitutes **breach**.

A condition may be express (clearly stated in the agreement), or implied (presumed based on the nature of a transaction).

A. TYPES OF CONDITIONS

1. Express Conditions

Express conditions are expressed in the contract. Words in the contract such as "on condition that" or "provided that" are typical example of express conditions. Express conditions must be complied with literally; substantial performance will not suffice. Arbitration clauses are enforceable, except when a consumer might be waiving important substantive rights.

EXAM NOTE: Express conditions must be explicit. A court will not enforce a condition if the language creating the condition is ambiguous. However, where the condition is explicit, it will be strictly enforced.

2. Implied Conditions

Implied conditions that are deemed to be part of the contract because the nature of the agreement suggests that the parties truly intended the condition but failed to expressly include it, are "implied in fact" conditions. These are distinguished from "constructive" or "implied in law" conditions, which are supplied by a court if reasonable under the circumstances. Restatement (Second) of Contracts § 226 cmt. c.

Example: If a banquet hall is leased for a wedding on a certain date, and the building burns before that date, the law would imply the hall's existence as a condition to the payment of the lease price and would excuse the lessor from liability.

The most common types of court-supplied implied conditions are called "constructive conditions of exchange" and arise most frequently in construction and employment contracts. A court will imply that the builder or employee must perform first (at least "substantially") before the other side's performance (the payment of money) becomes due. In addition to good faith, the UCC implies a duty of cooperation on the parties when performance of one party is dependent upon the cooperation of the other party. If a party fails to cooperate, the other party may suspend her own performance without being in breach. UCC § 2-311(3).

Substantial performance is all that is required to satisfy an implied condition.

B. TIMING OF CONDITIONS

Performance by one or both of the parties may be made expressly conditional in the contract, and the conditions may precede the obligation to perform (**condition precedent**) or may discharge the duty to perform after a particular event occurs (**condition subsequent**).

Example: A agrees to hire B if B passes the bar exam. B agrees to work as a clerk for C until B passes the bar exam. B's passing the bar exam is a condition precedent to being hired by A, and a condition subsequent to B's employment with C.

If the condition is precedent, the plaintiff has the burden of proving that the condition occurred in order to recover; if the condition is subsequent, the defendant must prove the happening of the condition to avoid liability.

A condition is only a condition subsequent if it discharges a duty that is already absolute.

C. SATISFACTION OF CONDITIONS

The approach to determine whether a condition is satisfied is usually an objective standard based upon whether a reasonable person would be satisfied. In most contracts, it is easy to conclude that all conditions have been satisfied. In contracts based upon aesthetic taste, however, the occurrence of the condition may be more difficult to determine.

1. Satisfaction Clause

When the aesthetic taste of a party determines whether the other party's performance is satisfactory (e.g., painting a family portrait), satisfaction is determined under a subjective standard. Under this standard, if the party is honestly dissatisfied, even if the dissatisfaction is unreasonable, the condition has not been met. However, the party's dissatisfaction must be in good faith, or a claim of dissatisfaction can be a breach, such as when a party is asserting dissatisfaction merely to avoid its own contractual obligation. There is a preference for the objective standard when the matter subject to a party's satisfaction involves the quality of non-unique goods or workmanship, rather than aesthetic taste. Restatement (Second) of Contracts § 228.

2. Time-of-Payment Clause

A clause in a contract making payment conditioned on the occurrence of an event is usually construed as a mere guide as to time for payment rather than as an absolute condition that must occur before payment is due.

D. DISPUTES ABOUT PERFORMANCE

1. Bilateral Contract

A party to a bilateral contract cannot recover until performance is tendered to the other party.

2. Partial Performance

a. Meaning

The doctrine of substantial performance provides that a party who substantially performs can recover on the contract even though full performance has not been tendered. If a breach of a constructive condition is minor, it will not negate substantial performance. If a breach is material, however, it will negate substantial performance.

b. Applicability

No recovery is allowed for a willful breach, which implies some attempt to cheat the other party or to provide less than was called for by the contract. The doctrine of substantial performance does ***not*** apply either to express conditions or to contracts for the sale of goods.

c. Damages

In general, the party who substantially performed the contract can recover the contract price minus any amount that it will cost the other party to obtain complete performance as had been promised.

3. Strict Performance Under the UCC

Under the UCC, the basic obligations of a seller are to **transfer ownership** of the goods to the buyer and to **tender goods** conforming to the warranty obligations. In general, the UCC requires "perfect tender," and substantial performance will not suffice. Substantial performance does apply under the UCC to installment contracts (*see* § VI.D.5.b., *infra*) and when the parties agree that it applies. In addition, the UCC provides that if a buyer rejects goods as nonconforming and time still remains to perform under a contract, the seller has a right to cure and to tender conforming goods (*see* § VII.F.1.b., *infra*).

a. Transferring ownership

The UCC implies a warranty of title in all sales contracts, providing that the seller automatically warrants that (i) he is conveying good title, (ii) the transfer is rightful, and (iii) the goods are delivered free from any security interest of which the buyer has no knowledge at the time of the contract. Actual knowledge by the buyer of a security interest on the goods will nullify the warranty of title.

The UCC permits disclaimer of the warranty of title, but such disclaimer must be by specific language or circumstances that give the buyer reason to know that the seller does not claim rightful title or that the seller is only purporting to sell such right as the seller or a third person possesses.

b. Tendering goods

The seller must tender the goods in accordance with the contract provisions or in accordance with the code provisions if the contract is silent on tender.

1) Time of tender

In the absence of a specific contract provision otherwise, the goods must be tendered within a reasonable time after the contract is made. UCC § 2-309.

2) Manner of tender

Unless otherwise provided in the contract, the goods are to be delivered in one delivery, unless the circumstances give either party a right to make or

demand delivery in lots (as where a party would clearly have no room to store the goods if delivered all at once). UCC § 2-307.

3) Place of tender

Unless otherwise provided in the contract, the place of tender will be the seller's place of business (or residence, if the seller has no place of business), unless the goods are identified and the parties know that they are at some other location, in which case that location will be the place of tender. UCC § 2-308.

4) Method of tender

The four methods of tender are:

a) Seller's place of business

If the goods are tendered at the seller's place of business, the seller must place the goods at the disposition of the buyer and give the buyer notice, if notice is necessary to enable the buyer to take delivery.

b) Shipment contract

If the contract is a shipment contract, the seller must deliver the goods to the carrier, make a proper contract for their shipment, obtain and deliver any document necessary for the buyer to obtain possession of the goods, and give the buyer notice that the goods have been shipped.

c) Destination contract

If the contract is a destination contract, the seller must deliver the goods to a particular place (specified in the contract) and tender them there by holding the goods at the buyer's disposition and giving the buyer notice.

d) Goods in the hands of a bailee

The seller must bargain for a negotiable document of title or obtain acknowledgment from the bailee of the buyer's rights in the goods.

4. Buyer's Obligations

When a conforming tender is made, the buyer is obligated to accept and pay the price under the contract. Rejection amounts to breach of contract. A buyer has the right to inspect the goods to determine if the seller's obligations have been met.

5. Divisible or Installment Contracts

a. Common law

A divisible or installment contract is one in which the obligations imposed on the contracting parties can be separated into corresponding pairs of part performances such that each pair constitutes **agreed equivalents**. Recovery is limited to the performance promised for the corresponding portion of the contract that has been performed. Damages may be recoverable for breach of other obligations under other portions of the contract.

b. UCC

Special rules apply to installment contracts for the sale of goods. The most important difference between installment contracts and other contracts is that the perfect-tender rule does not apply; instead, the right to reject is determined by a "substantial conformity" standard. UCC § 2-612.

1) Multiple shipments

Under the UCC, an installment contract is defined as one in which the goods are to be delivered in a number of shipments, and each shipment is to be separately accepted by the buyer. Parties cannot vary or contract out of this definition under the code. Payment by the buyer is due upon each delivery, unless the price cannot be apportioned.

2) Nonconforming segment

If the seller makes a nonconforming tender or tenders nonconforming goods under one segment of an installment contract, the buyer can reject only if the nonconformity:

i) Substantially impairs the value of that shipment to the buyer; and

ii) Cannot be cured.

3) Remaining segments

Where there is a nonconforming tender or a tender of nonconforming goods under one segment of an installment contract, the buyer may cancel the contract only if the nonconformity **substantially impairs** the value of the entire contract to the buyer.

E. SUSPENSION OR EXCUSE OF CONDITIONS

If a condition is suspended, the condition is restored upon expiration of the suspension. If the condition is excused, then the party having the benefit of the condition can never raise it as a defense.

1. Waiver

A party whose duty is subject to the condition can waive the condition, either by words or by conduct. Courts will find waiver of a condition only if the condition is not a material part of the agreement.

The condition may be reinstated if:

i) The waiving party communicates a retraction of the waiver before the condition is due to occur; and

ii) The other party has not already suffered detrimental reliance.

2. Wrongful Interference

A duty of good faith and fair dealing is implied into **all** (both common-law and UCC) contracts. Included in this duty is a duty not to hinder the other party's performance and a duty to cooperate, where necessary. Accordingly, if the party whose duty is subject to the condition wrongfully interferes with the occurrence of that condition, the condition is excused, and the party wrongfully interfering has an absolute duty to perform.

3. Election

A party who chooses to continue with a contract after a condition is broken effectively elects to waive that condition.

4. Estoppel

A party who indicates that a condition will not be enforced may be estopped from using that condition as a defense if the other party reasonably relied on the impression that the condition had been waived.

VII. BREACH OF CONTRACT AND REMEDIES

A. BREACH OF CONTRACT

Once a duty to perform exists, nonperformance is a breach of contract unless the duty is discharged (e.g., by agreement, statute, inability to perform, etc.).

1. Common Law

Under common law, a material breach of contract (i.e., when the non-breaching party does not receive the substantial benefit of her bargain) allows the non-breaching party to withhold any promised performance and to pursue remedies for the breach, including damages. If the breach is minor (i.e., the breaching party has substantially performed), the non-breaching party is entitled to any remedies that would apply to the non-material breach. If a minor breach is accompanied by an anticipatory repudiation (*see* § VII.B, *infra*), the non-breaching party may treat the breach as a material breach.

The party who commits a material breach of his contract obligations cannot sue for contract damages, but he would ordinarily be entitled to the fair value of any benefit conferred on the non-breaching party.

> **EXAM NOTE:** Keep in mind that under a minor breach, the non-breaching party may be able to recover damages, but also still must perform under the contract. If the breach is material, the non-breaching party does not need to perform.

2. UCC

In general, under the UCC, the seller must strictly perform all obligations under the contract, or be in breach. The doctrine of substantial performance applies only in the context of installment contracts or where the parties so provide in their contract.

B. ANTICIPATORY BREACH

The doctrine of anticipatory breach is applicable when a promisor repudiates a promise before the time for performance arises or elapses. The repudiation must be **clear and unequivocal** (as opposed to mere insecurity, which results in a demand for assurances), and it may be by conduct or words.

1. Non-Breaching Party's Options

Repudiation excuses the occurrence of any condition that would otherwise prevent the repudiating party's duty from being absolute. Upon repudiation, the promisee can treat the repudiation as a breach or ignore it and demand performance. If the repudiation is ignored, continued performance by the promisee must be suspended if the performance would increase the damages of the promisor.

a. Limitation on options—only payment due

Where the only performance left is the payment of money, the aggrieved party must wait until performance is due before filing suit. In this limited situation, repudiation is not treated as an anticipatory breach.

2. Retraction of Repudiation

At common law, repudiation may be retracted until such time as the promisee (i) acts in reliance on the repudiation, (ii) signifies acceptance of the repudiation, or (iii) commences an action for breach of contract. Notice of the retraction must be sufficient enough to allow for the performance of the promisee's obligations. Under the UCC, repudiation can be retracted if the other party has not canceled the contract or materially changed position.

3. Inapplicability to Unilateral Contracts

The doctrine of anticipatory repudiation **does not apply to a unilateral contract** when the offeror withdraws the offer once the offeree has begun to perform since offeree is not required to complete her performance.

4. Prospective Inability to Perform—Right to Demand Assurances

A party's expectations of performance by the other party may be diminished by an event that occurs after the contract was made. A party may request **adequate assurances of performance,** which, under the UCC, must be made in writing. Until such assurances are given, the requesting party may suspend performance. If those assurances are not provided within a reasonable time (30 days is the maximum time period under the UCC), the party can treat the failure to provide assurances as a breach by anticipatory repudiation. Even then, the repudiating party can still retract his repudiation until his next performance is due, unless the other party has already materially changed his position or otherwise indicated that he considers the repudiation final.

EXAM NOTE: Do not excuse a party from performing solely on the ground that the party does not expect the other party to perform.

a. UCC—merchants

Under the UCC, between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered is determined according to commercial standards. Thus, for example, if a supplier writes to a manufacturer demanding assurances of financial solvency, and the manufacturer provides its latest audited financial statements as well as a satisfactory credit report from its banker, that would likely constitute adequate assurances of its financial status.

b. Acceptance of improper delivery or payment

The acceptance of any improper delivery or payment does not preclude an aggrieved party from demanding adequate assurance of future performance.

c. UCC—insolvency

1) Remedies when the buyer is insolvent

If the buyer becomes insolvent before the delivery of the goods, the seller can stop goods in transit and refuse delivery except for cash.

2) Remedies when the seller is insolvent

A buyer who has paid for identified goods may recover the goods if the seller became insolvent within 10 days after receipt of the first installment of the contract price. Any rights of the buyer, though, may be subordinate to rights of the seller's secured creditors.

C. DAMAGES FOR BREACH OF CONTRACT

The primary objective of contract damages is to put the non-breaching party in the same position as if no breach had occurred. It awards both the gains prevented by the breach and the losses sustained as a direct result of the breach.

1. Expectancy Damages

a. In general

Expectancy damages are those that arise naturally and obviously from the breach and are normally measured by the **market value of the promised performance less the consideration promised** by the non-breaching party.

Example: B breaches a contract with A to fix A's car for $500. A finds another mechanic, C, to fix A's car for $700, which is the market value. A can recover $200 from B.

1) Construction contracts

In construction contracts, the general measure of damages for failing to perform a construction contract is the difference between the contract price and the cost of construction by another builder.

2) Sale of goods contracts

Damages for failing to deliver goods are measured by the difference between the contract price and the market value of the goods (or the cost of cover) (*see* § VII.F.1, *infra,* for a more detailed discussion of a buyer's damages under the UCC).

3) Real estate contracts

Damages for failing to perform a real estate sale contract also are measured by the difference between the contract price and the market value.

b. Partial performance

A partially performing party can generally recover for work performed, plus expectancy damages for the work not yet performed.

Example: B agrees to paint A's house for $500, which covers $400 in supplies and labor and $100 in profit. After B paints half of the house and incurs $200 in costs, A breaches. B can recover the $200 of costs already incurred, and the $100 of profit, but not the remaining $200 of costs not yet incurred.

If at the time of a breach the only remaining duties of performance are (i) those of the party in breach and (ii) for the payment of money in installments not related to one another, then breach by non-performance as to less than the whole, whether or not accompanied or followed by a repudiation, does not give rise to a claim for damages for total breach and is a partial breach of contract only. Restatement (Second) of Contracts § 243.

1) Construction contracts

In construction contracts, damages for defective or incomplete construction are measured by the cost of repair or completion. The general measure of damages for failing to perform a construction contract is the difference between the contract price and the cost of construction by another builder.

2) Sale of goods contracts

By contrast, in contracts for the sale of goods, damages for nonconformity with the contract generally are measured by the difference between the value of the goods as warranted and the actual value of the tendered nonconforming goods (*see* § VII.F.1, *infra*).

The purpose of both measures is to place the plaintiff in as good a position as if the defendant had performed the contract according to its specifications.

c. Quantum meruit

The term "quantum meruit" describes the measure of damages for recovery on a contract that is "implied in fact" (*see* § I.E, *supra*). To recover under quantum meruit, one must show that the recipient:

i) **Acquiesced** in the provision of services;

ii) **Knew** that the provider expected to be compensated; and

iii) Was **unjustly enriched.**

2. Consequential Damages and Foreseeability

a. Consequential damages

Consequential damages are **reasonably foreseeable losses** to a non-breaching party that go beyond expectancy damages, such as loss of profits.

b. Foreseeability

Under *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. Ch. 1854), damages are recoverable if they were the natural and probable consequences of breach, or if they were "in the contemplation of the parties at the time the contract was made," or were otherwise foreseeable.

c. Causation

A defendant can defend on the ground that the losses that the plaintiff seeks to recover would have occurred whether or not the defendant breached the contract.

d. Certainty

In order to recover damages, a plaintiff must prove the dollar amount of the damages with reasonable certainty. Courts are hesitant to award damages for lost profits, as they are difficult to prove. When lost profits are considered too speculative, courts often limit a party's recovery to reliance damages.

e. Limitation by agreement

When parties to a contract expressly exclude or limit consequential damages, their agreement is generally enforceable. However, courts may refuse to enforce such limitations if there is bad faith, unconscionability, a lack of bargain, or a public policy reason not to enforce the agreement. Restatement (Second) of Contracts § 351, cmt. a.

3. Liquidated Damages and Penalties

A provision for liquidated damages will be enforced, and not construed as a penalty, if the amount of damages is difficult to estimate at the time that the contract is entered into and the amount stipulated in the contract is reasonable in relation to either the actual damages suffered or the damages that might be anticipated at the time the contract was made.

Although a contract may fix the amount of damages that are recoverable in the event of a breach, because a party may not be penalized for breach, penalty clauses are unenforceable.

4. Punitive Damages

Punitive damages are very rarely available in contract actions. Some statutes apply them for the purpose of punishing fraud, violation of fiduciary duty, acts of bad faith, and for deterrence.

5. Nominal Damages

Damages do not need to be alleged in a cause of action for breach. If no damages are alleged or none are proved, the plaintiff is still entitled to a judgment for "nominal" damages (e.g., one dollar).

6. Mitigating Damages

A party to a contract has the obligation of avoiding or mitigating damages to the extent possible by taking such steps as to not involve undue risk, expense, or inconvenience. The non-breaching party is held to a standard of reasonable conduct in preventing loss.

A failure to take reasonable steps to mitigate damages will defeat only a claim for consequential damages. It will not deprive a non-breaching party of the opportunity to claim damages measured by the difference between the contract and market prices.

Note: The failure to mitigate does not bar recovery; it only reduces the amount that may be recovered. Note that reasonable expenses as a result of efforts to mitigate damages can be recovered, even if not connected to a successful mitigation attempt.

D. RESTITUTION AND RELIANCE RECOVERIES

1. Restitutionary Damages

Restitutionary damages restore to the plaintiff whatever benefit was conferred upon the defendant prior to the breach and when it would be unjust for the defendant to retain that benefit. Under some circumstances, restitutionary damages may be recovered even though the plaintiff would have suffered a loss had the defendant not breached.

Thus, if A contracts with B to paint B's house for $500, and B repudiates the contract after A has done some, but not all, of the painting, and A shows that the fair value of the work that has been done is actually $1,000, most courts allow recovery of restitutionary damages ($1,000) on the theory that otherwise the defendant would be profiting from the breach.

If, however, at the time of the defendant's breach the plaintiff has **fully performed the contract** and the defendant owes only money and not some other kind of performance, the plaintiff is not permitted to recover restitutionary damages and is limited to expectancy damages (generally the contract price minus the cost of completion).

Restitutionary damages are also available in quasi contract (*see* § I.E.2., *supra*) when there is no contract between the parties or when a contract is unenforceable, and a lack of any recovery would be unjust given that a benefit was conferred on the other party. Recovery would be limited to the fair value of the benefit conferred.

2. Reliance Damages

Reliance damages may be recovered when the non-breaching party incurs expenses in reasonable reliance upon the promise that the other would perform. Unlike with restitutionary damages, with reliance damages, there is no requirement that the defendant benefit from the plaintiff's expenditures. These types of damages are often

awarded when the consideration for a contract is based on promissory estoppel. The court can also limit the remedy as justice requires.

E. SPECIFIC PERFORMANCE, DECLARATORY JUDGMENT

1. Specific Performance

When damages are an inadequate remedy, the non-breaching party may pursue the equitable remedy of specific performance.

a. Factors considered

In determining whether damages are adequate, consider the:

i) Difficulty of proving damages with reasonable certainty;

ii) Difficulty of procuring a suitable substitute performance by means of money awarded as damages; and

iii) Likelihood that an award of damages will be collected.

b. Real property

Contracts involving the transfer of an interest in real property may be enforced by an order of specific performance because every parcel of **real property is considered unique.**

c. UCC

Specific performance may be granted when the goods are rare or unique or in other circumstances, such as for breach of a requirements contract in which there is not another convenient supplier.

d. Limitations

Even if the remedy of damages is inadequate, specific performance will not be granted when the court cannot supervise enforcement. Thus, courts do not grant specific enforcement of contracts for personal services, although they may restrain the breaching party from working for another.

In addition, equitable defenses such as laches (prejudicial delay in bringing the action) or unclean hands (where the non-breaching party is guilty of some wrongdoing in the transaction at issue) would be available to the breaching party.

2. Declaratory Judgment

If the rights and obligations of the parties under a contract are unclear, and an actual dispute exists between the parties concerning those rights and obligations, either party may bring a declaratory judgment action to obtain an adjudication of those rights and duties. Declaratory judgment is not available, however, to resolve moot issues or theoretical problems that have not risen to an actual dispute.

F. REMEDIES UNDER THE UCC

The following sections more specifically address the remedies that are available to buyers and sellers under the UCC.

1. Buyer's Remedies

When the seller's time for performance arises, the seller may:

i) Do **nothing** (breach by the seller);

ii) Make a **nonconforming tender** (breach by the seller);

iii) Make a **conforming tender** (performance by the seller).

a. Failure to tender

Under the UCC, the buyer has several alternative remedies if the seller fails to tender the goods:

1) Damages

Recover the market price minus the contract price. The market price is the price that existed at the time of the breach at the place where tender was to occur under the contract.

The UCC also permits recovery for incidental and consequential damages resulting from the seller's breach. Consequential damages may be limited or excluded under the UCC unless such limitation or exclusion would be unconscionable. UCC § 2-719.

2) Cover

Purchase similar goods elsewhere and recover the replacement price minus the contract price.

3) Specific performance

Demand specific performance for **unique** goods.

4) Replevin

The buyer can obtain identified, undelivered goods from the seller if similar goods are unavailable in the marketplace, but only if:

i) The seller becomes insolvent within 10 days of receiving full or partial payment from the buyer; or

ii) The goods were at least partially paid for by the buyer and only for family, personal, or household purposes.

b. Nonconforming tender

Under the UCC, if either the tender or the goods are nonconforming, the buyer has the **right to accept or reject** all or part of the goods. (Note that a buyer has more restrictive options in installment contracts, as discussed in § VI.D.5., *supra*.)

The buyer has the **right to inspect** the goods before deciding whether to accept or reject. Payment does not constitute "acceptance" if there is no right of inspection before payment (e.g., C.O.D., C.I.F., or C & F contracts).

1) Rejection

a) Valid rejection

A valid rejection requires that the buyer:

i) Give notice to the seller;

ii) Within a reasonable time;

iii) Before acceptance.

b) Retain possession

The buyer must retain possession of rejected goods for a reasonable time to allow the seller to reclaim them.

c) Perishable and non-perishable goods

In the absence of other instructions from the seller, the buyer may store non-perishable goods at the seller's expense, reship them to the seller, or sell them for the seller's account. If the goods are perishable and the seller has no local agent to whom the goods can be returned, in the absence of other instructions from the seller, the buyer is required to sell the goods on the seller's behalf.

d) Remedies

The same remedies are available to the buyer after rejection as if no tender was made by the seller (i.e., damages (including incidental and consequential damages, unless properly limited or excluded), cover, specific performance, or replevin).

Note that a failure to give notice of the breach to the seller within a reasonable time after the buyer discovers or should have discovered the breach will preclude the buyer from any remedies.

2) Acceptance

Under the UCC, the buyer accepts goods by:

i) Expressly stating acceptance;

ii) Using the goods; or

iii) Failing to reject the goods.

The buyer can revoke acceptance (which amounts to rejection), if acceptance was with a reasonable expectation that the seller would cure and the seller did not cure, or if the defect was hidden. The revocation must occur within a reasonable time after the nonconformity or defect was or should have been discovered, and notice must be given to the seller.

3) Right to cure

The seller has a right to cure a defective tender if:

i) The time for performance under the contract has not yet elapsed; or

ii) The seller had reasonable grounds to believe the buyer would accept despite the nonconformity.

The seller must give notice of the intent to cure and make a new tender of conforming goods. If the seller had reasonable grounds to believe that the buyer would accept despite the nonconformity, the tender must be made within a reasonable time. Once cured, the tender is considered proper and valid.

2. Seller's Remedies

a. Right to price upon acceptance

Under the UCC, the price is due after the goods are physically delivered to the buyer and the buyer has an opportunity to inspect, unless the contract provides otherwise. If the buyer refuses to pay the price, the seller may sue for the price set forth in the contract. If the contract omits a price term, the UCC supplies a reasonable price at the time for delivery. If the contract provides that the parties will agree to a price in the future and they do not so agree, the UCC would impose a reasonable price.

b. Right to reclaim goods

If the buyer was insolvent when the goods were delivered and the price is not paid, the seller can recover the goods if demand is made in 10 days, as long as no good-faith sub-purchaser has bought the goods from the buyer. In a C.O.D. (cash on delivery) sale, the seller can reclaim the goods if the buyer's check bounces.

c. Wrongful rejection

If the buyer wrongfully rejects, the seller has three alternative remedies and would also be entitled to incidental damages.

1) Collect damages

The seller would ordinarily be entitled to the contract price minus the market price at the time and place for tender, together with any incidental damages, less any expenses saved as a result of the buyer's breach.

If that measure does not put the seller in as good a position as performance would have done, then the measure of damages will be the profit (including reasonable overhead) that the seller would have made from full performance by the buyer, together with any incidental damages, less any payments received or the proceeds of a resale of the goods.

2) Resell the goods

If the seller elects to resell and sue for the contract price minus the resale price, the resale must be (i) only of goods identified in the contract, and (ii) commercially reasonable.

3) Recover the price

The seller can recover the price after rejection only if the goods are not saleable in the seller's ordinary course of business.

The price is the price as defined in the contract or, if no price is defined in the contract, a reasonable price. The seller can retain deposits paid by the buyer up to the amount stated in a liquidated-damages clause, or, in the absence of such a provision, 20% of the value of performance or $500, whichever is less.

4) Incidental damages

Note that in **addition to** any of the three remedies listed above, the seller is entitled to recover incidental damages (including storage and shipping costs).

d. Lost volume seller

The seller can recover for lost profits if the seller has a large capacity to sell goods, the seller would have made a sale if the buyer hadn't breached, and the seller sold the goods to someone else. Because of the high capacity the seller has to sell the goods, the seller can recover for lost profits, which are calculated as the contract price minus the seller's costs.

3. Risk of Loss

a. General rules

The UCC assumes that the risk of loss is on the seller until some event occurs (i.e., the delivery obligations under the contract) that shifts the risk to the buyer.

If the goods are identified and the contract authorizes the seller to ship the goods by carrier, the event necessary to shift the risk of loss is dependent upon whether the contract is a "shipment" or "destination" contract (*see* § VI.D.3.b, *supra,*

regarding shipment and destination contracts). If the contract is a "shipment" contract, risk of loss passes to the buyer when the seller gives possession of the goods to the carrier and makes a proper contract for their shipment. If the contract is a "destination" contract, risk of loss passes to the buyer when the seller tenders at the place specified in the contract.

If the contract does not require the transfer of the goods by carrier, risk of loss passes to the buyer upon the taking of physical possession if the seller is a merchant; otherwise, risk passes on tender of delivery, unless otherwise agreed.

b. Special rules

Remember these three special rules regarding risk of loss:

i) If the seller delivers nonconforming goods, the risk of loss remains on the seller until the buyer accepts or there is a cure;

ii) If the buyer rightfully revokes acceptance, the risk of loss shifts back to the seller to the extent of any lack of insurance coverage by the buyer;

iii) If the buyer repudiates or breaches after the goods have been identified but before the risk of loss shifts, the risk of loss is immediately shifted to the buyer to the extent of any lack of insurance coverage on the part of the seller.

c. Effect of placement of risk of loss

When risk of loss is on the buyer and the goods are lost or destroyed, the buyer will be liable for the contract price of the goods. If risk of loss is on the seller and the goods are lost or destroyed, the seller is liable for damages for non-delivery or must tender replacement goods.

4. Stoppage in Transit

A seller can stop the goods in transit due to the buyer's insolvency, but if due to the buyer's breach, goods can be stopped in transit only if shipped in carload lots.

The seller cannot stop goods in transit once the:

i) Buyer has received the goods;

ii) Carrier or warehouseman has acknowledged the buyer's rights;

iii) Goods have been reshipped by carrier; or

iv) Title has been given or negotiated to the buyer.

5. Insurable Interest

a. Seller's insurable interest

Under UCC Article 2, the seller retains an insurable interest as long as the seller retains title to the goods or has a security interest in them. Unless the contract specifies otherwise, the title passes from the seller to the buyer when the seller completes his or her delivery obligations. At that point, the seller's insurable interest ceases unless the seller retains a security interest in the goods.

b. Buyer's insurable interest

The UCC provides that the buyer obtains an insurable interest in the goods as soon as the goods are "identified to the contract."

6. Title and Good-Faith Purchasers

a. Entrusting provision

The UCC provides that entrustment of goods by the owner to one who sells goods of that kind gives to the transferee the power to convey good title to a buyer in ordinary course. A "buyer in ordinary course of business" is one who in good faith and without knowledge of a third party's ownership rights or security interest buys from someone selling goods of that kind.

b. Voidable title

When the true owner of goods sells them to another, but the sale is voidable because of fraud, because of lack of capacity, or because it was a cash sale and the buyer failed to pay or paid with a dishonored check, the buyer may transfer good title to a good-faith purchaser.

VIII. DISCHARGE

The promisor may not be liable for nonperformance if some supervening event or change in circumstances arises after formation of the contract that discharges the promisor's duty to perform.

A. IMPOSSIBILITY

The defense of impossibility is permitted only when performance is impracticable because of extreme and unreasonable difficulty or expense. The impossibility must be in the nature of the thing to be done (objective impossibility) and not in the inability of the promisor to do it (subjective impossibility).

The defense of impossibility usually is valid if:

i) Performance becomes illegal after the contract is made;

ii) The specific subject matter of the contract is destroyed;

iii) The performing party in a personal-services contract dies or becomes incapacitated.

Note that a party may recover in quasi contract for any benefit that was conferred prior to impossibility.

EXAM NOTE: If the contract is to perform services that can be delegated, it is not discharged by the death or incapacity of the party who was to perform the services.

The defense of impracticability is permitted when the subject matter of the contract is not destroyed but it is impracticable to perform.

The defense is valid if:

i) An unforeseeable event has occurred;

ii) Non-occurrence of the event is a basic assumption on which the contract was made;

iii) The event made performance impracticable;

iv) The party who is seeking discharge is not at fault; and

v) The party seeking discharge did not bear the risk.

B. FRUSTRATION OF PURPOSE

The doctrine of frustration of purpose applies when unforeseen events arise that make a contract impossible to perform, entitling the frustrated party to rescind the contract without paying damages.

Example: A contracts with B to buy a commercial building to rent, and while the sale is pending, the building is condemned by the city as unsafe for any use. A can back out of the purchase without obligation.

C. IMPRACTICABILITY OF PERFORMANCE UNDER THE UCC

The UCC implies three conditions into contracts for the sale of goods, which must be satisfied before performance is excused: (i) a contingency has occurred; (ii) the contingency has made performance impracticable; and (iii) the nonoccurrence of that contingency was a basic assumption upon which the contract was made.

1. Total Impracticability

Impracticability of performance provides an excuse (defense) for nonperformance of the contract similar to impossibility at common law. This excuse exists when:

i) Goods identified at the time of contracting are **destroyed**;

ii) Performance becomes **illegal**; or

iii) Performance has been made **"impracticable."**

The excuse applies only when the event was not foreseeable and when nonoccurrence of the event was a basic assumption of the contract.

2. Partial Impracticability

When impracticability affects only part of the seller's ability to perform, the goods actually produced must be apportioned among all the buyers with whom the seller has contracted. The buyer, however, may refuse to accept and may cancel the contract.

When the agreed method of transportation or payment becomes impracticable, (i) the performing party must use a commercially reasonable substitute if available, and (ii) substitute performance must be accepted.

D. RESCISSION

The non-defaulting party to a contract can cancel or rescind the contract, which requires a return of any deposits or other benefit conferred on the other party.

Rescission can also occur by the mutual agreement of the parties. The surrender of rights under the original contract by each party is consideration for the rescission by mutual agreement.

In cases of third-party beneficiaries, a contract is **not** discharged by mutual rescission if the rights of the third-party beneficiary have already vested.

E. RELEASE

A release is a writing that manifests an intent to discharge another party from an existing duty. For common-law contracts, the release must generally be supported by consideration to discharge the duty.

Under the UCC, however, a claim or right can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party. No consideration is needed to support the release.