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# Chapter 8

## Contracts

### LEARNING OBJECTIVES

After reading this chapter, you should understand the following:

1. What role contracts play in society today
2. What a contract is
3. The sources of contract law
4. Some basic contract taxonomy
5. The required elements of a contract: mutual assent, consideration, legality, and capacity
6. The circumstances when a contract needs to be in writing to be enforceable
7. The remedies for breach of contract

The two fundamental concepts considered the twin cornerstones of business relationships are contract and tort. Although both involve the concept of duty, creation of the duty differs in a manner that is important to business. The parties create *contract* duties through a bargaining process. The key element in the process is control; individuals are in control of a situation because they have the freedom to decide whether to enter into a contractual relationship. *Tort* duties, in contrast, are obligations the law imposes. Despite the obvious difficulty in controlling tort liability, an understanding of tort theory is important because it is a critical factor in strategic planning and risk management.

## 8.1 General Perspectives on Contracts

### LEARNING OBJECTIVES

1. Understand the role of contract in society: it moves society from status to contract.
2. Know the definition of a contract.
3. Recognize the sources of contract law: the common law, the UCC, and the Convention on the International Sale of Goods—a treaty (the CISG).
4. Understand some fundamental contract taxonomy and terminology.

### The Role of Contract in Society

Contract is probably the most familiar legal concept in our society because it is so central to a deeply held conviction about the essence of our political, economic, and social life. In common parlance, the term is used interchangeably with agreement, bargain, undertaking, or deal; but whatever the word, it embodies our notion of freedom to pursue our own lives together with others. Contract is central because it is the means by which a free society orders what would otherwise be a jostling, frenetic anarchy. So commonplace is the concept of contract—and our freedom to make contracts with each other—that it is difficult to imagine a time when contracts were rare, an age when people’s everyday associations with one another were not freely determined. Yet in historical terms, it was not so long ago that contracts were rare, entered into if at all by very few. In “primitive” societies and in the medieval Europe from which our institutions sprang, the relationships among people were largely fixed; traditions spelled out duties that each person owed to family, tribe, or manor. Though he may have oversimplified, Sir Henry Maine, a nineteenth-century historian, sketched the development of society in his classic book *Ancient Law*. As he put it:

(F)rom a condition of society in which all the relations of Persons are summed up in the relations of Family, we seem to have steadily moved towards a phase of social order in which all these relations arise from the free agreement of Individuals. . . . Thus the status of the Slave has disappeared—it has been superseded by the contractual relation of the servant to his master. . . . The status of the Female under Tutelage . . . has also ceased to exist. . . . So too the status of the Son under Power has no true place in the law of modern European societies. If any civil obligation binds together the Parent and the child of full age, it is one to which only contract gives its legal validity.... If then we employ Status, agreeably with the usage of the best writers, to signify these personal conditions [arising from ancient legal

privileges of the Family] only, we may say that the movement of the progressive societies has hitherto been a movement *from Status to Contract*. Sir Henry Maine, *Ancient Law* (1869), 180–82.

This movement was not accidental. It went hand-in-glove with the emerging industrial order; from the fifteenth to the nineteenth centuries, as England, especially, evolved into a booming mercantile economy with all that that implies—flourishing trade, growing cities, an expanding monetary system, commercialization of agriculture, mushrooming manufacturing—contract law was created of necessity.

Contract law did not develop, however, according to a conscious, far-seeing plan. It was a response to changing conditions, and the judges who created it frequently resisted, preferring the quieter, imagined pastoral life of their forefathers. Not until the nineteenth century, in both the United States and England, did a full-fledged law of contracts arise together with modern capitalism.

## Contract Defined

As usual in the law, the legal definition of “**contract**<sup>1</sup>” is formalistic. The Restatement says: “A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” (*Restatement (Second) of Contracts*, Section 1) Similarly, the Uniform Commercial Code says: “‘Contract’ means the total legal obligation which results from the parties’ agreement as affected by this Act and any other applicable rules of law.” (Section 1-201(11)) A short-hand definition is: “A contract is a legally enforceable promise.”

## Economic View of Contract Law

In *An Economic Analysis of Law* (1973), Judge Richard A. Posner (a former University of Chicago law professor) suggests that contract law performs three significant economic functions. First, it helps maintain incentives to individuals to exchange goods and services efficiently. Second, it reduces the costs of economic transactions because its very existence means that the parties need not go to the trouble of negotiating a variety of rules and terms already spelled out. Third, the law of contracts alerts the parties to trouble spots that have arisen in the past, thus making it easier to plan the transactions more intelligently and avoid potential pitfalls.

1. A legally enforceable promise

## Sources of Contract Law

There are four basic sources of contract law: the Constitution, federal and state statutes, federal and state case law, and administrative law. For our purposes, the most important of these, and the ones that we will examine at some length, are **case law**<sup>2</sup> and statutes.

### Case (Common) Law and the Restatement of Contracts

Because contract law was forged in the common-law courtroom, hammered out case by case on the anvil of individual judges, it grew in the course of time to formidable proportions. By the early twentieth century, tens of thousands of contract disputes had been submitted to the courts for resolution, and the published opinions, if collected in one place, would have filled dozens of bookshelves. Clearly this mass of case law was too unwieldy for efficient use. A similar problem had developed in the other leading branches of the common law. Disturbed by the profusion of cases and the resulting uncertainty of the law, a group of prominent American judges, lawyers, and teachers founded the American Law Institute in 1923 to attempt to clarify, simplify, and improve the law. One of its first projects, and ultimately one of its most successful, was the drafting of the **Restatement of the Law of Contracts**<sup>3</sup>, completed in 1932. A revision—the *Restatement (Second) of Contracts*—was undertaken in 1946 and finally completed in 1979.

The Restatements (others exist in the fields of torts, agency, conflicts of laws, judgments, property, restitution, security, and trusts) are detailed analyses of the decided cases in the field. These analyses are made with an eye to discerning the various principles that have emerged from the courts, and to the maximum extent possible, the Restatements declare the law as the courts have determined it to be. The Restatements, guided by a Reporter (the director of the project) and a staff of legal scholars, go through several so-called “tentative” drafts—sometimes as many as fifteen or twenty—and are screened by various committees within the American Law Institute before they are eventually published as final documents.

The *Restatement of Contracts* won prompt respect in the courts and has been cited in innumerable cases. The Restatements are not authoritative, in the sense that they are not actual judicial precedents, but they are nevertheless weighty interpretive texts, and judges frequently look to them for guidance. They are as close to “black letter” rules of law as exist anywhere in the American legal system for judge-made (common) law.

2. Law decided by judges as recorded and published in cases

3. An organized codification of the common law of contracts

## Statutory Law: The Uniform Commercial Code

Common law contract principles govern contracts for real estate and for services, obviously very important areas of law. But in one area the common law has been superseded by an important statute: the **Uniform Commercial Code (UCC)**<sup>4</sup>, especially **Article 2**<sup>5</sup>, which deals with the sale of goods.

### A Brief History

The UCC is a model law developed by the American law Institute and the National Conference of Commissioners on Uniform State Laws; it has been adopted in one form or another in all fifty states, the District of Columbia, and the American territories. It is the only “national” law not enacted by Congress.

Before the UCC was written, commercial law varied, sometimes greatly, from state to state. This first proved a nuisance and then a serious impediment to business as the American economy became nationwide during the twentieth century. Although there had been some uniform laws concerned with commercial deals—including the Uniform Sales Act, first published in 1906—few were widely adopted and none nationally. As a result, the law governing sales of goods, negotiable instruments, warehouse receipts, securities, and other matters crucial to doing business in an industrial, market economy was a crazy quilt of untidy provisions that did not mesh well from state to state.

Initial drafting of the UCC began in 1942 and was ten years in the making, involving the efforts of hundreds of practicing lawyers, law teachers, and judges. A final draft, promulgated by the Institute and the Conference, was endorsed by the American Bar Association and published in 1951.

Pennsylvania enacted the code in its entirety in 1953. It was the only state to enact the original version, because the Law Revision Commission of the New York State legislature began to examine it line by line and had serious objections. Three years later, in 1956, a revised code was issued. This version, known as the 1957 Official Text, was enacted in Massachusetts and Kentucky. In 1958, the Conference and the Institute amended the Code further and again reissued it, this time as the 1958 Official Text. Sixteen states, including Pennsylvania, adopted this version.

4. The modern American state statutory law governing commercial transactions.

5. That part of the Uniform Commercial Code dealing with the sale of goods.

But in so doing, many of these states changed particular provisions. As a consequence, the Uniform Commercial Code was no longer so uniform. Responding to this development the American Law Institute established a permanent editorial board to oversee future revisions of the code. Various subcommittees went to work redrafting, and a 1962 Official Text was eventually published. Twelve more states

adopted the code, eleven of them the 1962 text. By 1966, only three states and two territories had failed to enact any version: Arizona, Idaho, Louisiana, Guam, and Puerto Rico.

Meanwhile, non-uniform provisions continued to be enacted in various states, particularly in Article 9, to which 337 such amendments had been made. In 1971, a redraft of that article was readied and the 1972 Official Text was published. By that time, Louisiana was the only holdout. Two years later, in 1974, Louisiana made the UCC a truly national law when it enacted some but not all of the 1972 text (significantly, Louisiana has not adopted Article 2). One more major change was made, a revision of Article 8, necessitated by the electronics revolution that led to new ways of transferring investment securities from seller to purchaser. This change was incorporated in the 1978 Official Text, the version that remains current.

From this brief history, it is clear that the UCC is now a basic law of relevance to every business and business lawyer in the United States, even though it is not entirely uniform because different states have adopted it at various stages of its evolution—an evolution that continues still.

### **The Basic Framework of the UCC**

The UCC embraces the law of “commercial transactions,” a term of some ambiguity. A commercial transaction may seem to be a series of separate transactions; it may include, for example, the making of a contract for the sale of goods, the signing of a check, the endorsement of the check, the shipment of goods under a bill of Lading, and so on. However, the UCC presupposes that each of these transactions is a facet of one single transaction: the sale of and payment for goods. The Code deals with phases of this transaction from start to finish. These phases are organized according to the following “articles”:

- *Sales* (Article 2)
- *Commercial Paper* (Article 3)
- *Bank Deposits and Collections* (Article 4)
- *Letters of Credit* (Article 5)
- *Bulk Transfers* (Article 6)
- *Warehouse Receipts, Bills of Lading, and Other Documents of Title* (Article 7)
- *Investment Securities* (Article 8)
- *Secured Transactions; Sales of Accounts and Chattel Paper* (Article 9)

We now turn our attention to the sale—the first facet, and the cornerstone, of the commercial transaction. Sales law is a special type of contract law in that Article 2 applies only to the sale of goods, defined (Section 2-105) in part as “all things . . .

which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid. . . .” The only contracts and agreements covered by Article 2 are those relating to the present or future sale of goods.

In certain cases, the courts have difficulty in determining the nature of the object of a sales contract. The problem: How can goods and services be separated in contracts calling for the seller to deliver a combination of goods and services? This difficulty frequently arises in product liability cases in which the buyer sues the seller for breach of one of the UCC warranties. For example, you go to the hairdresser for a permanent and the shampoo gives you a severe scalp rash. May you recover damages on the grounds that either the hairdresser or the manufacturer breached an implied warranty in the sale of goods?

When the goods used are incidental to the service, the courts are split on whether the plaintiff should win. Compare *Epstein v. Giannattasio*, 197 A.2d 342 (Conn. 1963), in which the court held that no sale of goods had been made because the plaintiff received a treatment in which the cosmetics were only incidentally used, with *Newmark v. Gimbel's Inc.*, 258 A.2d 697 (N.J. 1969), in which the court said “[i]f the permanent wave lotion were sold ... for home consumption . . . unquestionably an implied warranty of fitness for that purpose would have been an integral incident of the sale.” The New Jersey court rejected the defendant’s argument that by actually applying the lotion to the patron’s head the salon lessened the liability it otherwise would have had if it had simply sold her the lotion.

In two areas, state legislatures have taken the goods vs. services issue out of the courts’ hands and resolved the issue through legislation. One area involves restaurant cases, in which typically the plaintiff charges that he became ill because of tainted food. UCC Section 2-314(1) states that any seller who is regularly a merchant of the goods sold impliedly warrants their merchantability in a contract for their sale. This section explicitly declares that serving food or drink is a sale, whether they are to be consumed on or off the premises.

The second type of case involves blood transfusions, which can give a patient hepatitis, a serious and sometimes fatal disease. Hospitals and blood banks obviously face large potential liability under the UCC provision just referred to on implied warranty of merchantability. Because medical techniques cannot detect the hepatitis virus in any form of blood used, hospitals and blood banks would be in constant jeopardy, without being able to take effective action to minimize the danger. Most states have enacted legislation specifically providing that blood supplies to be used in transfusions are a service, not goods, thus relieving the suppliers and hospitals of an onerous burden.

### Three Basic Contract Types: Sources of Law

With this brief description of the UCC, it should now be clear that the primary sources of law for the three basic types of contracts are:

- Real estate: common law;
- Services: common law;
- Sale of goods: UCC (as interpreted by the courts).

Common law and UCC rules are often similar. For example, both require good faith in the performance of a contract. However, there are two general differences worth noting between the common law of contracts and the UCC's rules governing the sales of goods. First, the UCC is more liberal than the common law in upholding the existence of a contract. For example, in a sales contract (covered by the UCC), "open" terms—that is, those the parties have not agreed upon—do not require a court to rule that no contract was made. However, open terms in a *nonsales* contract will frequently result in a ruling that there is no contract. Second, although the common law of contracts applies to every person equally, under the UCC "merchants" occasionally receive special treatment. By "merchants" the UCC means persons who have special knowledge or skill who deal in the goods involved in the transaction.

### The Convention on Contracts for the International Sale of Goods

A **Convention on Contracts for the International Sale of Goods (CISG)**<sup>6</sup> was approved in 1980 at a diplomatic conference in Vienna. (A convention is a preliminary agreement that serves as the basis for a formal treaty.) The Convention has been adopted by several countries, including the United States.

The Convention is significant for three reasons. First, the Convention is a uniform law governing the sale of goods—in effect, an international Uniform Commercial Code. The major goal of the drafters was to produce a uniform law acceptable to countries with different legal, social and economic systems. Second, although provisions in the Convention are generally consistent with the UCC, there are significant differences. For instance, under the Convention, consideration (discussed below) is not required to form a contract and there is no Statute of Frauds (a requirement that some contracts be evidenced by a writing to be enforceable—also discussed below). Finally, the Convention represents the first attempt by the US Senate to reform the private law of business through its treaty powers, for the Convention preempts the UCC if the parties to a contract elect to use the CISG.

6. An international body of contract law.

## Basic Contract Taxonomy

Contracts are not all cut from the same die. Some are written, some oral; some are explicit, some not. Because contracts can be formed, expressed, and enforced in a variety of ways, a taxonomy of contracts has developed that is useful in lumping together like legal consequences. In general, contracts are classified along these dimensions: explicitness, mutuality, enforceability, and degree of completion. **Explicitness** is concerned with the degree to which the agreement is manifest to those not party to it. **Mutuality** takes into account whether promises are exchanged by two parties or only one. **Enforceability** is the degree to which a given contract is binding. **Completion** considers whether the contract is yet to be performed or the obligations have been fully discharged by one or both parties. We will examine each of these concepts in turn.

### Explicitness

#### Express Contract

An **express contract**<sup>7</sup> is one in which the terms are spelled out directly; the parties to an express contract, whether written or oral, are conscious that they are making an enforceable agreement. For example, an agreement to purchase your neighbor's car for \$500 and to take title next Monday is an express contract.

#### Implied Contract

An **implied contract**<sup>8</sup> is one that is inferred from the actions of the parties. Although no discussion of terms took place, an implied contract exists if it is clear from the conduct of both parties that they intended there be one. A delicatessen patron who asks for a "turkey sandwich to go" has made a contract and is obligated to pay when the sandwich is made. By ordering the food, the patron is implicitly agreeing to the price, whether posted or not.

#### Contract Implied in Law: Quasi-contract

Both express and implied contracts embody an actual agreement of the parties. A **quasi-contract**<sup>9</sup>, by contrast, is an obligation said to be "imposed by law" in order to avoid unjust enrichment of one person at the expense of another. In fact, a quasi-contract is not a contract at all; it is a fiction that the courts created to prevent injustice. Suppose, for example, that a carpenter mistakenly believes you have hired him to repair your porch; in fact, it is your neighbor who has hired him. One Saturday morning he arrives at your doorstep and begins to work. Rather than stop him, you let him proceed, pleased at the prospect of having your porch fixed for free (since you have never talked to the carpenter, you figure you need not pay his

7. A contract in words, orally or in writing.

8. A contract not expressed by inferred from the parties' actions.

9. A contract imposed on a party when there was none, to avoid unjust enrichment.

bill). Although it is true there is no contract, the law implies a contract for the value of the work.

## Mutuality

The garden-variety contract is one in which the parties make mutual promises. Each is both promisor and promisee; that is, each pledges to do something and each is the recipient of such a pledge. This type of contract is called a **bilateral contract**<sup>10</sup>. But mutual promises are not necessary to constitute a contract. **Unilateral contracts**<sup>11</sup>, in which only one party makes a promise, are equally valid but depend upon performance of the promise to be binding. If Charles says to Fran, “I will pay you five dollars if you wash my car,” Charles is contractually bound to pay once Fran washes the car. Fran never makes a promise, but by actually performing she makes Charles liable to pay. A common example of a unilateral contract is the offer “\$50 for the return of my lost dog.” Frances never makes a promise to the offeror, but if she looks for the dog and finds it, she is entitled to the \$50.

## Enforceability

Not every agreement between two people is a binding contract. An agreement that is lacking one of the legal elements of a contract is said to be **void**<sup>12</sup>—that is, not a contract at all. An agreement that is illegal—for example, a promise to commit a crime in return for a money payment—is void. Neither party to a void “contract” may enforce it.

By contrast, a **voidable contract**<sup>13</sup> is one that is unenforceable by one party but enforceable by the other. For example, a minor (any person under eighteen, in most states) may “avoid” a contract with an adult; the adult may not enforce the contract against the minor, if the minor refuses to carry out the bargain. But the adult has no choice if the minor wishes the contract to be performed. (A contract may be voidable by both parties if both are minors.) Ordinarily, the parties to a voidable contract are entitled to be restored to their original condition. Suppose you agree to buy your seventeen-year-old neighbor’s car. He delivers it to you in exchange for your agreement to pay him next week. He has the legal right to terminate the deal and recover the car, in which case you will of course have no obligation to pay him. If you have already paid him, he still may legally demand a return to the *status quo ante* (previous state of affairs). You must return the car to him; he must return the cash to you.

A voidable contract remains a valid contract until it is voided. Thus, a contract with a minor remains in force unless the minor decides he does not wish to be bound by

10. A contract where each party makes a promise to the other.

11. A contract that is accepted by the performance of the requested action, not by a promise.

12. An agreement that never was a contract.

13. A contract that can be annulled.

it. When the minor reaches his majority, he may “ratify” the contract—that is, agree to be bound by it—in which case the contract will no longer be voidable and will thereafter be fully enforceable.

An **unenforceable contract**<sup>14</sup> is one that some rule of law bars a court from enforcing. For example, Tom owes Pete money, but Pete has waited too long to collect it and the statute of limitations has run out. The contract for repayment is unenforceable and Pete is out of luck, unless Tom makes a new promise to pay or actually pays part of the debt. (However, if Pete is holding collateral as security for the debt, he is entitled to keep it; not all rights are extinguished because a contract is unenforceable.)

### Degree of Completion

In medieval England, contract—defined as set of promises—was not an intuitive concept. The courts gave relief to one who wanted to collect a debt, for in such a case the creditor presumably had already given the debtor something of value, and the failure of the debtor to pay up was seen as manifestly unjust. But the issue was less clear when neither promise had yet been fulfilled. Suppose John agrees to sell Humphrey a quantity of wheat in one month. On the appointed day, Humphrey refuses to take the wheat or to pay. The modern law of contracts holds that a valid contract exists and that Humphrey is required to pay John.

An agreement consisting of a set of promises is called an **executory contract**<sup>15</sup> before either promise is carried out. Most executory contracts are enforceable. If one promise or set of terms has been fulfilled—if, for example, John had delivered the wheat to Humphrey—the contract is called **partially executed**<sup>16</sup>. A contract that has been carried out fully by both parties is called an **executed contract**<sup>17</sup>.

#### KEY TAKEAWAYS

Contract is the mechanism by which people in modern society make choices for themselves, as opposed to being born or placed into a status as is common in feudal societies. A contract is a legally enforceable promise. The law of contract is the common law (for contracts involving real estate and services), statutory law (the Uniform Commercial Code for contract involving the sale or leasing of goods), and treaty law (the Convention on the International Sale of Goods). Contracts may be described based on the degree of their explicitness, mutuality, enforceability, and degree of completion.

14. A contract for which the non-breaching party has not remedy for its breach.
15. A contract that has yet to be completed.
16. A contract in which one party has performed, or partly performed, and the other has not.
17. A contract that has been completed.

## EXERCISES

1. What did Sir Henry Maine mean when he wrote of society's movement "from status to contract?"
2. Are all promises "contracts"?
3. What is the source of law for contracts involving real estate? For contracts involving the sale of goods?
4. In contract taxonomy, what are the degrees of explicitness, mutuality, enforceability, and of completion?

## 8.2 Contract Formation

### LEARNING OBJECTIVES

1. Understand the elements of common-law contracts: mutuality of agreement (offer and acceptance), consideration, legality, and capacity.
2. Learn when a contract must be in writing—or evidenced by some writing—to be enforceable.

Although it has countless wrinkles and nuances, contract law asks two principal questions: did the parties create a valid, enforceable contract? What remedies are available when one party breaks the contract? The answer to the first question is not always obvious; the range of factors that must be taken into account can be large and their relationship subtle. Since people in business frequently conduct contract negotiations without the assistance of a lawyer, it is important to attend to the nuances to avoid legal trouble at the outset. Whether a valid enforceable contract has been formed depends in turn on whether:

1. The parties reached an agreement (offer and acceptance);
2. Consideration was present (some “price was paid for what was received in return);
3. The agreement was legal;
4. The parties entered into the contract with capacity to make a contract; and
5. The agreement is in the proper form (something in writing, if required).

### The Agreement: Offer and Acceptance

The core of a legal contract is the agreement between the parties. That is not merely a matter of convenience; it is at the heart of our received philosophical and psychological beliefs. As the great student of contract law, Samuel Williston, put it:

It was a consequence of the emphasis laid on the ego and the individual will that the formation of a contract should seem impossible unless the wills of the parties concurred. Accordingly we find at the end of the eighteenth century, and the beginning of the nineteenth century, the prevalent idea that there must be a “meeting of the minds” (a new phrase) in order to form a contract. (1921, p. 365)

Although agreements may take any form, including unspoken conduct between the parties (UCC Section 2-204(1)), they are usually structured in terms of an *offer* and an *acceptance*. Note, however, that not every agreement, in the broadest sense of the word, need consist of an offer and acceptance, and it is entirely possible, therefore, for two persons to reach agreement without forming a contract. For example, people may agree that the weather is pleasant or that it would be preferable to go out for Chinese food rather than seeing a foreign film; in neither case has a contract been formed. One of the major functions of the law of contracts is to sort out those agreements that are legally binding—those that are contracts—from those that are not.

In interpreting agreements, courts generally apply an **objective standard**<sup>18</sup>. The *Restatement (Second) of Contracts* defines agreement as a “*manifestation of mutual assent by two or more persons to one another.*” (Section 3) The UCC defines agreement as “the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance.” (Section 1-201(3)) The critical question is what the parties said or did, not what they thought they said or did.

The distinction between objective and subjective standards crops up occasionally when one person claims he spoke in jest. The vice president of a manufacturer of punchboards, used in gambling, testified to the Washington State Game Commission that he would pay \$100,000 to anyone who found a “crooked board.” Barnes, a bartender, who had purchased two that were crooked some time before, brought one to the company office, and demanded payment. The company refused, claiming that the statement was made in jest (the audience before the commission had laughed when the offer was made). The court disagreed, holding that it was reasonable to interpret the pledge of \$100,000 as a means of promoting punchboards:

(I)f the jest is not apparent and a reasonable hearer would believe that an offer was being made, then the speaker risks the formation of a contract which was not intended. It is the objective manifestations of the offeror that count and not secret, unexpressed intentions. If a party’s words or acts, judged by a reasonable standard, manifest an intention to agree in regard to the matter in question, that agreement is established, and it is immaterial what may be the real but unexpressed state of the party’s mind on the subject. *Barnes v. Treece*, 549 P.2d 1152 (Wash. App. 1976).

18. Judging something as an outsider would understand it; not subjective.

19. The proposal upon which the contract is based.

An **offer**<sup>19</sup> is a manifestation of willingness to enter into a bargain such that it would be reasonable for another individual to conclude that assent to the offer would complete the bargain. Offers must be communicated and must be definite; that is, they must spell out terms to which the offeree can assent.

To constitute an agreement, there must be an **acceptance**<sup>20</sup> of the offer. The offeree must manifest his assent to the terms of the offer in a manner invited or required by the offer. Complications arise when an offer is accepted indirectly through correspondence. Although offers and revocations of offers are not effective until received, an acceptance is deemed accepted when sent if the offeree accepts in the manner specified by the offeror.

If the offeror specifies no particular mode, then acceptance is effective when transmitted as long as the offeree uses a reasonable method of acceptance. It is implied that the offeree can use the same means used by the offeror or a means of communication customary to the industry. For example, the use of the postal service was so customary that acceptances are considered effective when mailed, regardless of the method used to transmit the offer. Indeed, the so-called “mailbox rule” (the acceptance is effective upon dispatch) has an ancient lineage, tracing back nearly two hundred years to the English courts. *Adams v. Lindsell*, 1 Barmwell & Alderson 681 (K.B. 1818).

## Consideration

**Consideration**<sup>21</sup>, is the quid pro quo (something given or received for something else) between the contracting parties in the absence of which the law will not enforce the promise or promises made. Consider the following three “contracts”:

1. Betty offers to give a book to Lou. Lou accepts.
2. Betty offers Lou the book in exchange for Lou’s promise to pay \$15. Lou accepts.
3. Betty offers to give Lou the book if Lou promises to pick it up at Betty’s house. Lou accepts.

The question is which, if any, is a binding contract? In American law, only situation 2 is a binding contract, because only that contract contains a set of mutual promises in which each party pledges to give up something to the benefit of the other.

The question of what constitutes a binding contract has been answered differently throughout history and in other cultures. For example, under Roman law, any contract that was reduced to writing was binding, whether or not there was consideration in our sense. Moreover, in later Roman times, certain promises of gifts were made binding, whether written or oral; these would not be binding in the United States. And in the Anglo-American tradition, the presence of a seal was once sufficient to make a contract binding without any other consideration. In most states, the seal is no longer a substitute for consideration, although in some states it

20. A manifestation of the willingness to be bound by the terms of the offer.

21. The surrender of any legal right in return for the promise of some benefit; the “price” paid for what is received.

creates a presumption of consideration. The Uniform Commercial Code has abolished the seal on contracts for the sale of goods.

The existence of consideration is determined by examining whether the person against whom a promise is to be enforced (the **promisor**<sup>22</sup>) received something in return from the person to whom he made the promise (the **promisee**<sup>23</sup>). That may seem a simple enough question. But as with much in the law, the complicating situations are never very far away. The “something” that is promised or delivered cannot just be anything: a feeling of pride, warmth, amusement, friendship; it must be something known as a **legal detriment**<sup>24</sup>—an act, a forbearance, or a promise of such from the promisee. The detriment need not be an actual detriment; it may in fact be a benefit to the promisee, or at least not a loss. At the same time, the “detriment” to the promisee need not confer a tangible benefit on the promisor; the promisee can agree to forego something without that something being given to the promisor. Whether consideration is legally sufficient has nothing to do with whether it is morally or economically adequate to make the bargain a fair one. Moreover, legal consideration need not even be certain; it can be a promise contingent on an event that may never happen. Consideration is a *legal* concept, and it centers on the giving up of a *legal* right or benefit.

Consideration has two elements. The first, as just outlined, is whether the promisee has incurred a legal detriment. (Some courts—although a minority—take the view that a bargained-for legal benefit to the promisor is sufficient consideration.) The second is whether the legal detriment was *bargained for*: did the promisor specifically intend the act, forbearance, or promise in return for his promise? Applying this two-pronged test to the three examples given at the outset of the chapter, we can easily see why only in the second is there legally sufficient consideration. In the first, Lou incurred no legal detriment; he made no pledge to act or to forbear from acting, nor did he in fact act or forbear from acting. In the third example, what might appear to be such a promise is not really so. Betty made a promise on a condition that Lou come to her house; the intent clearly is to make a gift. Betty was not seeking to induce Lou to come to her house by promising the book.

22. The one who makes a promise.

23. The one to whom a promise is made.

24. The giving up by a person of that which she had a right to retain.

25. To be prohibited from denying a promise when another has subsequently relied upon it.

There is a widely recognized exception to the requirement of consideration. In cases of promissory estoppel, the courts will enforce promises without consideration. Simply stated, **promissory estoppel**<sup>25</sup> means that the courts will stop the promisor from claiming that there was no consideration. The doctrine of promissory estoppel is invoked in the interests of justice when three conditions are met: (1) the promise is one that the promisor should reasonably expect to induce the promisee to take action or forbear from taking action of a definite and substantial character; (2) the action or forbearance is taken; and (3) injustice can be avoided only by enforcing the promise.

Timko served on the board of trustees of a school. He recommended that the school purchase a building for a substantial sum of money, and to induce the trustees to vote for the purchase, he promised to help with the purchase and to pay at the end of five years the purchase price less the down payment. At the end of four years, Timko died. The school sued his estate, which defended on the ground that there was no consideration for the promise. Timko was promised or given nothing in return, and the purchase of the building was of no direct benefit to him (which would have made the promise enforceable as a unilateral contract). The court ruled that under the three-pronged promissory estoppel test, Timko's estate was liable. *Estate of Timko v. Oral Roberts Evangelistic Assn.*, 215 N.W.2d 750 (Mich. App. 1974).

## Illegality

In general, illegal contracts are unenforceable. The courts must grapple with two types of illegalities: (1) statutory violations (e.g., the practice of law by a non-lawyer is forbidden by statute), and (2) violations of public policy not expressly declared unlawful by statute, but so declared by the courts.

## Capacity

A contract is a meeting of minds. If someone lacks mental **capacity**<sup>26</sup> to understand what he is assenting to—or that he is assenting to anything—it is unreasonable to hold him to the consequences of his act.

The general rule is that persons younger than eighteen can avoid their contracts. Although the age of majority was lowered in most states during the 1970s to correspond to the Twenty-sixth Amendment (ratified in 1971, guaranteeing the right to vote at eighteen), some states still put the age of majority at twenty-one. Legal rights for those under twenty-one remain ambiguous, however. Although eighteen-year-olds may assent to binding contracts, not all creditors and landlords believe it, and they may require parents to cosign. For those under twenty-one, there are also legal impediments to holding certain kinds of jobs, signing certain kinds of contracts, marrying, leaving home, and drinking alcohol. There is as yet no uniform set of rules.

The exact day on which the disability of minority vanishes also varies. The old common law rule put it on the day before the twenty-first birthday. Many states have changed this rule so that majority commences on the day of the eighteenth (or twenty-first) birthday.

26. The mental state of mind sufficient to understand that a contract is made and its consequences.

A minor's contract is voidable, not void. A child wishing to avoid the contract need do nothing positive to disaffirm; the defense of minority to a lawsuit is sufficient. Although the adult cannot enforce the contract, the child can (which is why it is said to be voidable, not void).

When the minor becomes an adult, he has two choices: he may ratify the contract or **disaffirm**<sup>27</sup> it. She may ratify explicitly; no further consideration is necessary. She may also do so by implication—for instance, by continuing to make payments or retaining goods for an unreasonable period of time. (In some states, a court may ratify the contract before the child becomes an adult. In California, for example, a state statute permits a movie producer to seek court approval of a contract with a child actor in order to prevent the child from disaffirming it upon reaching majority and suing for additional wages. As *quid pro quo*, the court can order the producer to pay a percentage of the wages into a trust fund that the child's parents or guardians cannot invade.) If the child has not disaffirmed the contract while still a minor, she may do so within a reasonable time after reaching majority.

In most cases of disavowal, the only obligation is to return the goods (if he still has them) or repay the consideration (unless it has been dissipated). However, in two situations, a minor might incur greater liability: contracts for necessities and misrepresentation of age.

### **Contract for Necessities**

At common law, a “necessity” was defined as an essential need of a human being: food, medicine, clothing, and shelter. In recent years, however, the courts have expanded the concept, so that in many states today necessities include property and services that will enable the minor to earn a living and to provide for those dependent on him. If the contract is executory, the minor can simply disaffirm. If the contract has been executed, however, the minor must face more onerous consequences. Although he will not be required to perform under the contract, he will be liable under a theory of “quasi-contract” for the reasonable value of the necessity.

### **Misrepresentation of Age**

In most states, a minor may misrepresent his age and disaffirm in accordance with the general rule, because that's what kids do, misrepresent their age. That the adult reasonably believed the minor was also an adult is of no consequence in a contract suit. But some states have enacted statutes that make the minor liable in certain situations. A Michigan statute, for instance, prohibits a minor from disaffirming if he has signed a “separate instrument containing only the statement of age, date of

27. To legally disavow or avoid a contract.

signing and the signature.” And some states “estop” him from claiming to be a minor if he falsely represented himself as an adult in making the contract. “Estoppel” is a refusal by the courts on equitable grounds to listen to an otherwise valid defense; unless the minor can return the consideration, the contract will be enforced.

Contracts made by an *insane* or *intoxicated* person are also said to have been made by a person lacking capacity. In general, such contracts are voidable by the person when capacity is regained (or by the person’s legal representative if capacity is not regained).

### Form

As a general rule, a contract need not be in writing to be enforceable. An oral agreement to pay a high-fashion model \$1 million to pose for a photograph is as binding as if the language of the deal were printed on vellum and signed in the presence of twenty bishops. For centuries, however, a large exception has grown up around the **Statute of Frauds**<sup>28</sup>, first enacted in England in 1677 under the formal name “An Act for the Prevention of Frauds and Perjuries.” The purpose of the Statute of Frauds is to prevent the fraud that occurs when one party attempts to impose upon another a contract that did not in fact exist. The two sections dealing with contracts read as follows:

[Sect. 4] ...no action shall be brought whereby to charge any executor or administrator upon any special promise, to answer damages out of his own estate; (2) or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person; (3) or to charge any person upon any agreement made upon consideration of marriage; (4) or upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them; (5) or upon any agreement that is not to be performed within the space of one year from the making thereof; (6) unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.

[Sect. 17] ...no contract for the sale of any goods, wares and merchandizes, for the price of ten pounds sterling or upwards, shall be allowed to be good, except the buyer shall accept part of the goods so sold, and actually receive the same, or give something in earnest to bind the bargain, or in part of payment, or that some note or memorandum in writing of the said bargain be made and signed by the parties to be charged by such contract, or their agents thereunto lawfully authorized.

28. A rule requiring that certain contracts be evidenced by some writing, signed by the person to be bound, to be enforceable.

Again, as may be evident from the title of the act and its language, the general purpose of the law is to provide evidence, in areas of some complexity and importance, that a contract was actually made. To a lesser degree, the law serves to caution those about to enter a contract and “to create a climate in which parties often regard their agreements as tentative until there is a signed writing.”  
(*Restatement (Second) of Contracts* Chapter 5, statutory note)

The Statute of Frauds has been enacted in form similar to the seventeenth century act in most states. However, in the twentieth century Section 7 was replaced by a section Uniform Commercial Code. The UCC requires contracts for the sale of goods for \$500 or more and for the sale of securities to be in writing.

### KEY TAKEAWAYS

A contract requires mutuality—an offer and an acceptance of the offer; it requires consideration—a “price” paid for what is obtained; it requires that the parties to the contract have legal capacity to know what they are doing; it requires legality. Certain contracts—governed by the statute of frauds—are required to be evidenced by some writing, signed by the party to be bound. The purpose here is to avoid the fraud that occurs when one person attempts to impose upon another a contract that did not really exist.

### EXERCISES

1. What are the required elements of a contract?
2. When was the Statute of Frauds first enacted, by whom, and why?
3. Basically, what does the Statute of Frauds require?

## 8.3 Remedies

### LEARNING OBJECTIVES

1. Know the types of damages: compensatory and punitive.
2. Understand specific performance as a remedy.
3. Understand restitution as a remedy.
4. Recognize the interplay between contract and tort as a cause of action.

Monetary awards (called “damages”), specific performance, and restitution are the three principle remedies.

In view of the importance given to the intention of the parties in forming and interpreting contracts, it may seem surprising that the remedy for every breach is not a judicial order that the obligor carry out his undertakings. But it is not. Of course, some duties cannot be performed after a breach: time and circumstances will have altered their purpose and rendered many worthless. Still, although there are numerous occasions on which it would be theoretically possible for courts to order the parties to carry out their contracts, the courts will not do it. In 1897, Justice Oliver Wendell Holmes, Jr., declared in a famous line that “the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it.” By that he meant simply that the common law looks more toward compensating the promisee for his loss than toward compelling the promisor to perform—a person always has the power, though not the right, to breach a contract. Indeed, the law of remedies often provides the parties with an incentive to break the contract. In short, the promisor has a choice: to perform or pay. The purpose of contract remedies is, for the most part, to compensate the non-breaching party for the losses suffered—to put the non-breaching party in the position he, she, or it would have been in had there been no breach.

### Compensatory Damages

One party has the right to **damages**<sup>29</sup> (money) when the other party has breached the contract unless, of course, the contract itself or other circumstances suspend or discharge that right. **Compensatory damages**<sup>30</sup> is the general category of damages awarded to make the non-breaching party whole.

29. Money paid by one party to another to discharge a liability.

30. Money paid to compensate the non-breaching party for the loss suffered as a result of the breach.

## Consequential Damages

A basic principle of contract law is that a person injured by breach of contract is not entitled to compensation unless the breaching party, at the time the contract was made, had reason to foresee the loss as a probable result of the breach. The leading case, perhaps the most studied case in all the common law, is *Hadley v. Baxendale*, decided in England in 1854. Joseph and Jonah Hadley were proprietors of a flour mill in Gloucester. In May 1853, the shaft of the milling engine broke, stopping all milling. An employee went to Pickford and Company, a common carrier, and asked that the shaft be sent as quickly as possible to a Greenwich foundry that would use the shaft as a model to construct a new one. The carrier's agent promised delivery within two days. But through an error the shaft was shipped by canal rather than by rail and did not arrive in Greenwich for seven days. The Hadleys sued Joseph Baxendale, managing director of Pickford, for the profits they lost because of the delay. In ordering a new trial, the Court of Exchequer ruled that Baxendale was not liable because he had had no notice that the mill was stopped:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. *Hadley v. Baxendale* (1854), 9 Ex. 341, 354, 156 Eng.Rep. 145, 151.

This rule, it has been argued, was a subtle change from the earlier rule that permitted damages for any consequences as long as the breach caused the injury and the plaintiff did not exacerbate it. But the change was evidently rationalized, at least in part, by the observation that in the “usual course of things,” a mill would have on hand a spare shaft, so that its operations would not cease. R. J. Danzig, “*Hadley v. Baxendale: A Study in the Industrialization of the Law*,” *Journal of Legal Studies* 4, no. 249 (1975): 249.

This sub-set of compensatory damages is called **consequential damages**<sup>31</sup>—damages that flow as a foreseeable consequence of the breach. For example, if you hire a roofer to fix a leak in your roof, and he does a bad job so that the interior of your house suffers water damage, the roofer is liable not only for the poor roofing job, but also for the ruined drapes, damaged flooring and walls, and so on.

31. Damages that flow as a foreseeable but indirect result of the breach of contract.

### Nominal Damages

If the breach caused no loss, the plaintiff is nevertheless entitled to a minor sum, perhaps one dollar, called **nominal damages**<sup>32</sup>. When, for example, a buyer could purchase the same commodity at the same price as that contracted for, without spending any extra time or money, there can be no real damages in the event of breach.

### Incidental Damages

Suppose City College hires Prof. Blake on a two-year contract, after an extensive search. After one year the professor quits to take a job elsewhere, in breach of her contract. If City College has to pay \$5000 more to find a replacement for year, Blake is liable for that amount—that's compensatory damages. But what if it costs City College \$1200 to search for, bring to campus and interview a replacement? City College can claim that, too, as **incidental damages**<sup>33</sup> which include additional costs incurred by the non-breaching party after the breach in a reasonable attempt to avoid further loss, even if the attempt is unsuccessful.

### Punitive Damages

**Punitive damages**<sup>34</sup> are those awarded for the purpose of punishing a defendant in a civil action, in which criminal sanctions may be unavailable. They are not part of the compensation for the loss suffered; they are proper in cases in which the defendant has acted willfully and maliciously and are thought to deter others from acting similarly. Since the purpose of contract law is compensation, not punishment, punitive damages have not traditionally been awarded, with one exception: when the breach of contract is also a tort for which punitive damages may be recovered. Punitive damages are permitted in the law of torts (in most states) when the behavior is malicious or willful (reckless conduct causing physical harm, deliberate defamation of one's character, a knowingly unlawful taking of someone's property), and some kinds of contract breach are also tortuous—for example, when a creditor holding collateral as security under a contract for a loan sells the collateral to a good-faith purchaser for value even though the debtor was not in default, he has breached the contract and committed the tort of **conversion**<sup>35</sup>. Punitive damages may be awarded, assuming the behavior was willful and not merely mistaken.

Punitive damages are not fixed by law. The judge or jury may award at its discretion whatever sum is believed necessary to redress the wrong or deter like conduct in the future. This means that a richer person may be slapped with much heavier punitive damages than a poorer one in the appropriate case. But the judge in all

32. A token amount of money paid when the breach has caused no loss.

33. Money paid to the non-breaching party in an attempt to avoid further loss on account of the breach.

34. Money awarded to the non-breaching party in excess of any loss suffered to punish the breaching party.

35. The wrongful taking of someone's property by another; the civil equivalent of theft.

cases may **remit**<sup>36</sup> (lower) some or all of a punitive damage award if he or she considers it excessive.

Punitive damage claims have been made in cases dealing with the refusal by insurance companies to honor their contracts. Many of these cases involve disability payments, and among the elements are charges of tortious conduct by the company's agents or employees. California has been the leader among the state courts in their growing willingness to uphold punitive damage awards despite insurer complaints that the concept of punitive damages is but a device to permit plaintiffs to extort settlements from hapless companies. Courts have also awarded punitive damages against other types of companies for breach of contract.

### Specific Performance

**Specific performance**<sup>37</sup> is a judicial order to the promisor that he undertake the performance to which he obligated himself in a contract. Specific performance is an alternative remedy to damages and may be issued at the discretion of the court, subject to a number of exceptions. (When the promisee is seeking enforcement of a contractual provision for forbearance—a promise that the promisor will refrain from doing something—an injunction, a judicial order not to act in a specified manner, may be the appropriate remedy.) Emily signs a contract to sell Charlotte a gold samovar, a Russian antique of great sentimental value because it once belonged to Charlotte's mother. Emily then repudiates the contract while still executory. A court may properly grant Charlotte an order of specific performance against Emily. Specific performance is an attractive but *limited* remedy: it is only available for breach of contract to sell a unique item (real estate is always unique).

### Restitution

As the word implies, **restitution**<sup>38</sup> is a restoring to one party of what he gave to the other. Therefore, only to the extent that the injured party conferred a benefit on the other party may the injured party be awarded restitution.

36. A judicial reduction in the amount of a damage award (the noun is *remission*).

37. An order directing a person to deliver the exact property (real or personal) that she contracted to sell to the buyer.

38. To restore to one party what was delivered to the other.

If the claimant has given the other party a sum of money, there can be no dispute over the amount of the restitution interest. Tom gives Tim \$100 to chop his tree into firewood. Tim repudiates. Tom's restitution interest is \$100. But serious difficulties can arise when the benefit conferred was performance. The courts have considerable discretion to award either the cost of hiring someone else to do the work that the injured party performed (generally, the market price of the service) or the value that was added to the property of the party in breach by virtue of the claimant's performance. Mellors, a gardener, agrees to construct ten fences around Lady Chatterley's flower gardens at the market price of \$2,500. After erecting three,

Mellors has performed services that would cost \$750, market value. Assume that he has increased the value of the Lady's grounds by \$800. If the contract is repudiated, there are two measures of Mellors's restitution interest: \$800, the value by which the property was enhanced; or \$750, the amount it would have cost Lady Chatterley to hire someone else to do the work. Which measure to use depends on who repudiated the contract and for what reason.

### Tort vs. Contract Remedies

Frequently a contract breach may also amount to tortious conduct. A physician warrants her treatment as perfectly safe but performs the operation negligently, scarring the patient for life. The patient could sue for malpractice (tort) or for breach of warranty (contract). The choice involves at least four considerations:

1. *Statute of limitations.* Most statutes of limitations prescribe longer periods for contract than for tort actions.
2. *Allowable damages.* Punitive damages are more often permitted in tort actions, and certain kinds of injuries are compensable in tort but not in contract suits—for example, pain and suffering.
3. *Expert testimony.* In most cases, the use of experts would be the same in either tort or contract suits, but in certain contract cases, the expert witness could be dispensed with, as, for example, in a contract case charging that the physician abandoned the patient.
4. *Insurance coverage.* Most policies do not cover intentional torts, so a contract theory that avoids the element of willfulness would provide the plaintiff with a surer chance of recovering money damages.

#### KEY TAKEAWAYS

The purpose of remedies in contract is, usually, to put the non-breaching party in the position he or she would have been in had there been no breach. The remedies are: compensatory damages (money paid to compensate the non-breaching party for the losses caused by the breach), which also include sub-categories of incidental and nominal damages; punitive damages (to punish the breaching party) are sometimes allowed where the breach is egregious and intentional.

## EXERCISES

1. What are compensatory damages?
2. When is specific performance an appropriate remedy? Will it be used to require a person to perform a service (such as properly repair a leaky roof)?
3. When is restitution used?
4. How could a breach of contract also be a tort, and when is one cause of action chosen over the other?
5. What is the purpose of punitive damages?

## 8.4 Cases

### Objective Intention

Lucy v. Zehmer

84 S.E.2d 516 (Va. 1954)

Buchanan, J.

This suit was instituted by W. O. Lucy and J. C. Lucy, complainants, against A. H. Zehmer and Ida S. Zehmer, his wife, defendants, to have specific performance of a contract by which it was alleged the Zehmers had sold to W. O. Lucy a tract of land owned by A. H. Zehmer in Dinwiddie county containing 471.6 acres, more or less, known as the Ferguson farm, for \$50,000. J. C. Lucy, the other complainant, is a brother of W. O. Lucy, to whom W. O. Lucy transferred a half interest in his alleged purchase.

The instrument sought to be enforced was written by A. H. Zehmer on December 20, 1952, in these words: "We hereby agree to sell to W. O. Lucy the Ferguson farm complete for \$50,000.00, title satisfactory to buyer," and signed by the defendants, A. H. Zehmer and Ida S. Zehmer.

The answer of A. H. Zehmer admitted that at the time mentioned W. O. Lucy offered him \$50,000 cash for the farm, but that he, Zehmer, considered that the offer was made in jest; that so thinking, and both he and Lucy having had several drinks, he wrote out "the memorandum" quoted above and induced his wife to sign it; that he did not deliver the memorandum to Lucy, but that Lucy picked it up, read it, put it in his pocket, attempted to offer Zehmer \$5 to bind the bargain, which Zehmer refused to accept, and realizing for the first time that Lucy was serious, Zehmer assured him that he had no intention of selling the farm and that the whole matter was a joke. Lucy left the premises insisting that he had purchased the farm....

In his testimony Zehmer claimed that he "was high as a Georgia pine," and that the transaction "was just a bunch of two doggoned drunks bluffing to see who could talk the biggest and say the most." That claim is inconsistent with his attempt to testify in great detail as to what was said and what was done....

If it be assumed, contrary to what we think the evidence shows, that Zehmer was jesting about selling his farm to Lucy and that the transaction was intended by him to be a joke, nevertheless the evidence shows that Lucy did not so understand it but considered it to be a serious business transaction and the contract to be binding on the Zehmers as well as on himself. The very next day he arranged with his brother to put up half the money and take a half interest in the land. The day after that he employed an attorney to examine the title. The next night, Tuesday, he was back at Zehmer's place and there Zehmer told him for the first time, Lucy said, that he wasn't going to sell and he told Zehmer, "You know you sold that place fair and square." After receiving the report from his attorney that the title was good he wrote to Zehmer that he was ready to close the deal.

Not only did Lucy actually believe, but the evidence shows he was warranted in believing, that the contract represented a serious business transaction and a good faith sale and purchase of the farm.

In the field of contracts, as generally elsewhere, "We must look to the outward expression of a person as manifesting his intention rather than to his secret and unexpressed intention. The law imputes to a person an intention corresponding to the reasonable meaning of his words and acts."

At no time prior to the execution of the contract had Zehmer indicated to Lucy by word or act that he was not in earnest about selling the farm. They had argued about it and discussed its terms, as Zehmer admitted, for a long time. Lucy testified that if there was any jesting it was about paying \$50,000 that night. The contract and the evidence show that he was not expected to pay the money that night. Zehmer said that after the writing was signed he laid it down on the counter in front of Lucy. Lucy said Zehmer handed it to him. In any event there had been what appeared to be a good faith offer and a good faith acceptance, followed by the execution and apparent delivery of a written contract. Both said that Lucy put the writing in his pocket and then offered Zehmer \$5 to seal the bargain. Not until then, even under the defendants' evidence, was anything said or done to indicate that the matter was a joke. Both of the Zehmers testified that when Zehmer asked his wife to sign he whispered that it was a joke so Lucy wouldn't hear and that it was not intended that he should hear.

The mental assent of the parties is not requisite for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial except when an unreasonable meaning which he attaches to his manifestations is known to the other party.

“\* \* \* The law, therefore, judges of an agreement between two persons exclusively from those expressions of their intentions which are communicated between them. \* \* \*.” [Citation]

An agreement or mutual assent is of course essential to a valid contract but the law imputes to a person an intention corresponding to the reasonable meaning of his words and acts. If his words and acts, judged by a reasonable standard, manifest an intention to agree, it is immaterial what may be the real but unexpressed state of his mind.

So a person cannot set up that he was merely jesting when his conduct and words would warrant a reasonable person in believing that he intended a real agreement.

Whether the writing signed by the defendants and now sought to be enforced by the complainants was the result of a serious offer by Lucy and a serious acceptance by the defendants, or was a serious offer by Lucy and an acceptance in secret jest by the defendants, in either event it constituted a binding contract of sale between the parties....

Reversed and remanded.

### CASE QUESTIONS

1. What objective evidence was there to support the defendants' contention that they were just kidding when they agreed to sell the farm?
2. Suppose the defendants really did think the whole thing was a kind of joke. Would that make any difference?
3. As a matter of public policy, why does the law use an objective standard to determine the seriousness of intention, instead of a subjective standard?
4. It's 85 degrees in July and 5:00 p.m., quitting time. The battery in Mary's car is out of juice, again. Mary says, "Arrgh! I will sell this stupid car for \$50!" Jason, walking to his car nearby, whips out his checkbook and says, "It's a deal. Leave your car here. I'll give you a ride home and pick up your car after you give me the title." Do the parties have a contract?

### Consideration: Preexisting Obligation

Denney v. Reppert

432 S.W.2d 647 (Ky. 1968)

R. L. Myre, Sr., Special Commissioner.

The sole question presented in this case is which of several claimants is entitled to an award for information leading to the apprehension and conviction of certain bank robbers....

On June 12th or 13th, 1963, three armed men entered the First State Bank, Eubank, Kentucky, and with a display of arms and threats robbed the bank of over \$30,000 [about \$208,000 in 2010 dollars]. Later in the day they were apprehended by State Policemen Garret Godby, Johnny Simms and Tilford Reppert, placed under arrest, and the entire loot was recovered. Later all of the prisoners were convicted and Garret Godby, Johnny Simms and Tilford Reppert appeared as witnesses at the trial.

The First State Bank of Eubank was a member of the Kentucky Bankers Association which provided and advertised a reward of \$500.00 for the arrest and conviction of each bank robber. Hence the outstanding reward for the three bank robbers was \$1,500.00 [about \$11,000 in 2010 dollars]. Many became claimants for the reward and the Kentucky State Bankers Association being unable to determine the merits of the claims for the reward asked the circuit court to determine the merits of the various claims and to adjudge who was entitled to receive the reward or share in it. All of the claimants were made defendants in the action.

At the time of the robbery the claimants Murrell Denney, Joyce Buis, Rebecca McCollum and Jewell Snyder were employees of the First State Bank of Eubank and came out of the grueling situation with great credit and glory. Each one of them deserves approbation and an accolade. They were vigilant in disclosing to the public and the peace officers the details of the crime, and in describing the culprits, and giving all the information that they possessed that would be useful in capturing the robbers. Undoubtedly, they performed a great service. It is in the evidence that the claimant Murrell Denney was conspicuous and energetic in his efforts to make known the robbery, to acquaint the officers as to the personal appearance of the criminals, and to give other pertinent facts.

The first question for determination is whether the employees of the robbed bank are eligible to receive or share in the reward. The great weight of authority answers in the negative. [Citation] states the rule thusly:

‘To the general rule that, when a reward is offered to the general public for the performance of some specified act, such reward may be claimed by any person who

performs such act, is the exception of agents, employees and public officials who are acting within the scope of their employment or official duties. \* \* \*.'...

At the time of the robbery the claimants Murrell Denney, Joyce Buis, Rebecca McCollum, and Jewell Snyder were employees of the First State Bank of Eubank. They were under duty to protect and conserve the resources and moneys of the bank, and safeguard every interest of the institution furnishing them employment. Each of these employees exhibited great courage, and cool bravery, in a time of stress and danger. The community and the county have recompensed them in commendation, admiration and high praise, and the world looks on them as heroes. But in making known the robbery and assisting in acquainting the public and the officers with details of the crime and with identification of the robbers, they performed a duty to the bank and the public, for which they cannot claim a reward.

The claims of Corbin Reynolds, Julia Reynolds, Alvie Reynolds and Gene Reynolds also must fail. According to their statements they gave valuable information to the arresting officers. However, they did not follow the procedure as set forth in the offer of reward in that they never filed a claim with the Kentucky Bankers Association. It is well established that a claimant of a reward must comply with the terms and conditions of the offer of reward. [Citation]

State Policemen Garret Godby, Johnny Simms and Tilford Reppert made the arrest of the bank robbers and captured the stolen money. All participated in the prosecution. At the time of the arrest, it was the duty of the state policemen to apprehend the criminals. Under the law they cannot claim or share in the reward and they are interposing no claim to it.

This leaves the defendant, Tilford Reppert the sole eligible claimant. The record shows that at the time of the arrest he was a deputy sheriff in Rockcastle County, but the arrest and recovery of the stolen money took place in Pulaski County. He was out of his jurisdiction, and was thus under no legal duty to make the arrest, and is thus eligible to claim and receive the reward. In [Citation] it was said:

'It is \* \* \* well established that a public officer with the authority of the law to make an arrest may accept an offer of reward or compensation for acts or services performed outside of his bailiwick or not within the scope of his official duties. \* \* \*.'...

It is manifest from the record that Tilford Reppert is the only claimant qualified and eligible to receive the reward. Therefore, it is the judgment of the circuit court that

he is entitled to receive payment of the \$1,500.00 reward now deposited with the Clerk of this Court.

The judgment is affirmed.

### CASE QUESTIONS

1. Why did the Bankers Association put the resolution of this matter into the court's hands?
2. Several claimants came forward for the reward; only one person got it. What was the difference between the person who got the reward and those who did not?

### Consequential Damages

EBWS, LLC v. Britly Corp.

928 A.2d 497 (Vt. 2007)

Reiber, C.J.

The Ransom family owns Rock Bottom Farm in Strafford, Vermont, where Earl Ransom owns a dairy herd and operates an organic dairy farm. In 2000, the Ransoms decided to build a creamery on-site to process their milk and formed EBWS, LLC to operate the dairy-processing plant and to market the plant's products. In July 2000, Earl Ransom, on behalf of EBWS, met with Britly's president to discuss building the creamery....In January 2001, EBWS and Britly entered into a contract requiring Britly to construct a creamery building for EBWS in exchange for \$160,318....The creamery was substantially completed by April 15, 2001, and EBWS moved in soon afterward. On June 5, 2001, EBWS notified Britly of alleged defects in construction. [EBWS continued to use the creamery pending the necessity to vacate it for three weeks when repairs were commenced].

On September 12, 2001, EBWS filed suit against Britly for damages resulting from defective design and construction....

Following a three-day trial, the jury found Britly had breached the contract and its express warranty, and awarded EBWS: (1) \$38,020 in direct damages, and (2) \$35,711 in consequential damages....

...The jury's award to EBWS included compensation for both direct and consequential damages that EBWS claimed it would incur while the facility closed for repairs. Direct damages [i.e., compensatory damages] are for "losses that naturally and usually flow from the breach itself," and it is not necessary that the parties actually considered these damages. [Citation]. In comparison, special or consequential damages "must pass the tests of causation, certainty and foreseeability, and, in addition, be reasonably supposed to have been in the contemplation of both parties at the time they made the contract."

...The court ruled that EBWS could not recover for lost profits because it was not a going concern at the time the contract was entered into, and profits were too speculative. The court concluded, however, that EBWS could submit evidence of other business losses, including future payment for unused milk and staff wages....

At trial, Huyffer, the CEO of EBWS, testified that during a repairs closure the creamery would be required to purchase milk from adjacent Rock Bottom Farm, even though it could not process this milk. She admitted that such a requirement was self-imposed as there was no written output contract between EBWS and the farm to buy milk. In addition, Huyffer testified that EBWS would pay its employees during the closure even though EBWS has no written contract to pay its employees when they are not working. The trial court allowed these elements of damages to be submitted to the jury, and the jury awarded EBWS consequential damages for unused milk and staff wages.

On appeal, Britly contends that because there is no contractual or legal obligation for EBWS to purchase milk or pay its employees, these are not foreseeable damages. EBWS counters that it is common knowledge that cows continue to produce milk, even if the processing plant is not working, and thus it is foreseeable that this loss would occur. We conclude that these damages are not the foreseeable result of Britly's breach of the construction contract and reverse the award....

[W]e conclude that...it is not reasonable to expect Britly to foresee that its failure to perform under the contract would result in this type of damages. While we are sympathetic to EBWS's contention that the cows continue to produce milk, even when the plant is closed down, this fact alone is not enough to demonstrate that buying and dumping milk is a foreseeable result of Britly's breach of the construction contract. Here, the milk was produced by a separate and distinct entity, Rock Bottom Farm, which sold the milk to EBWS....

Similarly, EBWS maintained no employment agreements with its employees obligating it to pay wages during periods of closure for repairs, dips in market demand, or for any other reason. Any losses EBWS might suffer in the future

because it chooses to pay its employees during a plant closure for repairs would be a voluntary expense and not in Britly's contemplation at the time it entered the construction contract. It is not reasonable to expect Britly to foresee losses incurred as a result of agreements that are informal in nature and carry no legal obligation on EBWS to perform. "[P]arties are not presumed to know the condition of each other's affairs nor to take into account contracts with a third party that is not communicated." [Citation] While it is true that EBWS may have business reasons to pay its employees even without a contractual obligation, for example, to ensure employee loyalty, no evidence was introduced at trial by EBWS to support a sound rationale for such considerations. Under these circumstances, this business decision is beyond the scope of what Britly could have reasonably foreseen as damages for its breach of contract....

In addition, the actual costs of the wages and milk are uncertain....[T]he the milk and wages here are future expenses, for which no legal obligation was assumed by EBWS, and which are separate from the terms of the parties' contract. We note that at the time of the construction contract EBWS had not yet begun to operate as a creamery and had no history of buying milk or paying employees. See [Citation] (explaining that profits for a new business are uncertain and speculative and not recoverable). Thus, both the cost of the milk and the number and amount of wages of future employees that EBWS might pay in the event of a plant closure for repairs are uncertain.

Award for consequential damages is reversed....

### CASE QUESTIONS

1. Why, according to EBWS's CEO, would EBWS be required to purchase milk from adjacent Rock Bottom Farm, even though it could not process this milk?
2. Surely it is well known in Vermont dairy country that dairy farmers can't simply stop milking cows when no processing plant is available to take the milk—the cows will soon stop producing. Why was EBWS then not entitled to those damages which it will certainly suffer when the creamery is down for repairs?
3. Britly (the contractor) must have known EBWS had employees that would be idled when the creamery shut down for repairs. Why was it not liable for their lost wages?
4. What could EBWS have done at the time of contracting to protect itself against the damages it would incur in the event the creamery suffered downtime due to faulty construction?

## 8.5 Summary and Exercises

### Summary

In this chapter we have seen that two fundamental sources of contract law are the common law as developed in the state courts and as summarized in the *Restatement (Second) of Contracts*, and the Uniform Commercial Code for the sale of goods.

Sales law is a special type of contract law, governed by Article 2 of the UCC. Article 2 governs the sale of goods only, defined as things movable at the time of identification to the contract for sale. When the goods are “sold” incidental to a service, the courts do not agree on whether Article 2 applies. For two categories of goods, legislation specifically answers the question: foodstuffs served by a restaurant are goods; blood supplied for transfusions is not.

Types of contracts can be distinguished along these axes: (1) express and implied, including quasi-contracts implied by law; (2) bilateral and unilateral; (3) enforceable and unenforceable; and (4) completed (executed) and uncompleted (executory). To understand contract law, it is necessary to master these distinctions and their nuances.

In order to determine whether a valid, enforceable contract exists, the following questions must be answered: (1) Did the parties reach an agreement? (2) Was consideration present? (3) Was the agreement legal? (4) Did the parties have capacity to make a contract? (5) Was the agreement in the proper form?

Remedies available against someone who breaches a contract include damages, specific performance, and restitution. Frequently the party who is not in breach must choose between tort and contract remedies.

## EXERCISES

1. On November 26, Joe wrote to Kate offering to purchase a farm that she owned. Upon receiving the letter on November 28, Kate immediately sent Joe a letter of acceptance. However, shortly after mailing the letter, Kate had second thoughts and called Joe to advise him that she was rejecting his offer. The call was made before Joe received the letter of acceptance. Has a contract been formed? Why?
2. On a busy day just before April 15, Albert Accountant received a call from a local car dealer. The dealer said, “Hi, Mr. Accountant. Now, while you have income from doing clients’ taxes, I have an excellent offer for you. You can buy a new Buick Century automobile completely loaded for \$36,000. Al, I know you’re busy. If I don’t hear from you by the end of the day, I’ll assume you want the car.” Albert, distracted, did not respond immediately, and the dealer hung up. Then followed an exhausting day of working with anxiety-ridden tax clients. Albert forgot about the conversation. Two days later a statement arrived from the dealer, with instructions on how Albert should pick up the car at the dealership. Is there a contract? Explain.
3. Bert purchased Ernie’s car. Before selling the car, Ernie had stated to Bert, “This car runs well and is reliable. Last week I drove the car all the way from Seattle to San Francisco to visit my mother and back again to Seattle.” In fact, Ernie was not telling the truth: he had driven the car to San Francisco to visit his paramour, not his mother. Upon discovery of the truth, may Bert avoid the contract? Why?
4. Langstraat was seventeen when he purchased a motorcycle. When applying for insurance, he signed a “Notice of Rejection,” declining to purchase uninsured motorist coverage. He was involved in an accident with an uninsured motorist and sought to disaffirm his rejection of the uninsured motorist coverage on the basis of infancy. May he do so?
5. Richard promised to have Darlene’s deck awning constructed by July 10. On June 20, Darlene called him and asked if he could get the job done by July 3, in time for Independence Day. Richard said he could, but he failed to do so, and Darlene had to rent two canopies at some expense. Darlene claims that because Richard breached his promise, he is liable for the cost of awning rental. Is she correct—was his promise binding? Why?
6. After taking a business law class at State U, Elke entered into a contract to sell her business law book to a classmate, Matthew, for \$45. As part of the same contract, she agreed to prepare a will for Matthew’s mother for an additional \$110. Elke prepared the will and sent the book to Matthew, but he refused to pay her. Is she entitled to any payment? Explain.
7. Sara Hohe, a fifteen-year-old junior at Mission Bay High School in San Diego, was injured during a campus hypnotism show sponsored by the

PTSA as a fund-raiser for the senior class. Hypnotism shows had been held annually since 1980, and Sara had seen the previous year's show. She was selected at random from a group of many volunteers. Her participation in the "Magic of the Mind Show" was conditioned on signing two release forms. Hohe's father signed a form entitled "Mission Bay High School PTSA Presents Dr. Karl Santo." Hohe and her father both signed a form titled "Karl Santo Hypnotist," releasing Santo and the school district from all liability. During the course of the show, while apparently hypnotized, Hohe slid from her chair and also fell to the floor about six times and was injured. She, through her father, then sued the school district. The Hohes claimed the release was contrary to public policy; the trial court dismissed the suit on summary judgment. Was the release contrary to public policy? Decide.

8. Plaintiff Irma Kozlowski cohabited with Defendant Thaddeus Kozlowski for fifteen years without marriage. She repeatedly asked him specifically about her financial situation should he predecease her, and he assured her—she said—that he would arrange to provide for her for the rest of her life. She had provided the necessary household services and emotional support to permit him to successfully pursue his business career; she had performed housekeeping, cleaning, and shopping services and had run the household and raised the children, her own as well as his. When they separated and she was "literally forced out of the house," she was sixty-three years old and had no means or wherewithal for survival. When she sued, he raised the Statute of Frauds' one-year rule as a defense. Is the defense good?
9. Owner of an auto repair shop hires Contractor to remodel his shop but does not mention that two days after the scheduled completion date, Owner is to receive five small US Army personnel carrier trucks for service, with a three-week deadline to finish the job and turn the trucks over to the army. The contract between Owner and the army has a liquidated damages clause calling for \$300 a day for every day trucks are not operable after the deadline. Contractor is five days late in finishing the remodel. Can Owner claim the \$1,500 as damages against Contractor as a consequence of the latter's tardy completion of the contract? Explain.
10. Calvin, a promising young basketball and baseball player, signed a multiyear contract with a professional basketball team after graduating from college. After playing basketball for one year, he decided he would rather play baseball and breached his contract with the basketball team. What remedy could the team seek?

## SELF-TEST QUESTIONS

1. An implied contract
  - a. must be in writing
  - b. is one in which the terms are spelled out
  - c. is one inferred from the actions of the parties
  - d. is imposed by law to avoid an unjust result
  - e. may be avoided by one party.
  
2. The Convention on Contracts for the International Sale of Goods is
  - a. an annual meeting of international commercial purchasing agents.
  - b. contract law used in overseas US federal territories
  - c. a customary format or template for drafting contracts
  - d. a kind of treaty setting out international contract law, to which the United States is a party
  - e. the organization that develops uniform international law.
  
3. Consideration
  - a. can consist of a written acknowledgment of some benefit received, even if in fact the benefit is not delivered
  - b. cannot be nominal in amount
  - c. is a bargained-for act, forbearance, or promise from the promisee
  - d. is all of the above
  
4. An example of valid consideration is a promise
  - a. by a seventeen-year-old to refrain from drinking alcohol
  - b. to refrain from going to court
  - c. to cook dinner if the promisor can get around to it
  - d. to repay a friend for the four years of free legal advice he had provided.
  
5. A contract to pay a lobbyist to influence a public official is generally illegal.

- a. true
- b. false

### SELF-TEST ANSWERS

1. c
2. d
3. c
4. b
5. false