Part VI

contracts

> *"The business of the law is to make sense of the confusion of what we call human life—to reduce it to order but at the same time to give it possibility, scope, even dignity."*
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> – **Archibald MacLeish**

Contracts seem to permeate our lives. If we rent an apartment or agree to buy a home, we enter into a contract. When we have electricity, gas and water furnished to that home or apartment, we have a contractual relationship with each utility provider for the service. When writing a check, we act under a contract with our bank to honor the check. We even enter into a contract when we marry.

The common law, developed by our courts (and England's) over the last several hundred years, generally governs contract law, although some significant topics, particularly those dealing the sale of goods and with business transactions, are governed by statute. (*See Part VII, "Business Transactions and Organizations."*) It is important to understand the details and obligations of various types of contracts because they affect so many areas of our lives.

What Is a Contract?

The law defines a contract as nothing more than "a promise the law will enforce." However, this simple definition is deceptive, because the law will enforce some promises but not others. As will be seen, the law of contracts imposes numerous limitations on the types of promises that are enforceable and on the circumstances in which they will be enforced.

Basic Requirements for a Contract

The basic requirements for a contract are *mutual agreement*, usually made through a process of *offer* and *acceptance*, and *consideration,* or one of its substitutes. In addition, the parties must be 18 years of age, and otherwise mentally competent, the terms of the agreement must be defined in enough detail that a court (and the parties) can determine their obligations, and the subject matter of the agreement must not be illegal.

To illustrate how a contract is formed, imagine your neighbor, Ms. Lodge, approaches you about raking the leaves around her house. You discuss the project, and Ms. Lodge agrees to pay you $50 to rake and bag the leaves. This meets the *mutual agreement* requirement for a valid contract: your neighbor offered to pay you $50 to rake and bag her leaves, and you accepted the terms of her proposal. Consideration is present because the transaction involves a simple exchange of promises: your promise to rake her leaves was made in exchange for her promise to pay the $50. You will receive a $50 benefit as a result of the deal and your neighbor will receive the benefit of a raked yard. Assuming you are both adults and not suffering from any mental incapacity, the terms are definite enough that it will be easy to determine if each of you performed your respective promises, and there is nothing illegal about an agreement to pay a neighbor to rake your leaves. This is a promise the law would enforce, although, if your neighbor failed to pay you for your work, it likely would not be worth bringing a lawsuit against your neighbor to collect the $50.

The Offer

An offer is the outward expression of a willingness to enter into an agreement. The agreement between you and your neighbor arises from an oral offer. Offers also can be written or even implied from conduct. Let us say you go to the doctor to be treated for the flu. The fact that you sought treatment from the doctor implies that you offered to pay the doctor for her medical services and that she agreed to treat you in exchange for

your implied promise to pay. In rare cases, an advertisement also can be an offer, although the usual advertisement is nothing more than an invitation to patronize the advertiser's business.

An offer might impose time limits on the acceptance. If so, the offer expires if it is not accepted within that time period. If there is no specific time limit, the offer must be accepted within a "reasonable" time. If you are the one making the offer, usually you may revoke or withdraw the offer before it is accepted, even if you have promised to keep it open for a specific amount of time. If the contract involves a sale of goods, however, and you promise to leave the offer open for some period of time (not to exceed three months), the offer cannot be withdrawn within that period.

Also, if the other person has paid you to keep the offer open, thus creating an *option contract,* then you do not have the right to revoke or withdraw the offer before it is accepted. For example, a company may find a parcel of land that looks promising for a new factory, but needs six months to decide whether it is feasible to build there. That company would then pay the property owner some money to keep the property off the market for a six-month period. The option agreement typically would provide that, at any time within the six months, the company could exercise its option and buy the land for a specified price and on terms that also are set forth in the option agreement.

The Acceptance

Like an offer, an acceptance consists of some outward expression of agreement. The acceptance can be express or implied, written or oral. It might consist of a signature on a written offer, a simple "okay" or even a nod of the head. If you call a repairperson, Mr. Simmons, to fix your washing machine, and he responds, your call is an implied offer to pay for the repair services, and by coming to your house, Mr. Simmons has implied his acceptance of your offer to pay a reasonable price for the repairs.

When an offer specifies terms of a particular method of acceptance, it may not be satisfactory to accept it any other way. For example, if an offer by Joe to sell a car to Hilda stipulates that it can only be accepted by a $250 deposit on the purchase price, an acceptance by Hilda without the deposit will not be effective.

Generally, accepting an offer requires an affirmative act by an individual. Silence does not usually imply acceptance. Let us say a telemarketer calls during dinner and offers to sell you steak knives. Irritated, you let the caller make his pitch, but then hang up without responding. Six weeks later, a set of steak knives arrives in the mail along with a bill. What happens? First, you have not entered into a contract to buy the knives by your silence. Second, you can keep the knives without paying because both Ohio and federal law clearly state there is no obligation to pay for unsolicited merchandise.

An individual does not have to accept an offer as proposed. The individual can reject it outright or make a counteroffer, which may include its own terms and conditions. If a counteroffer is made, all previous offers are void. If an offer is "accepted" with conditions, it is not actually an acceptance at all, but, rather, a counteroffer. The process of purchasing a house, for example, usually involves an initial offer and several counteroffers until the parties agree on the terms of the sale and actually create their contract. It should be noted that contracts involving real estate must be in writing.

Consideration and Reliance

Remember, for a contract to be valid, *each* party must make a promise or give or receive some benefit in return for the promise. A contract's consideration may be either an act or a promise. Without this element of exchange, a promise lacks consideration and usually cannot be enforced as a contract. As a result, a promise to make a gift to someone generally is not regarded as a contract, because usually only one party benefits and the necessary element of consideration is lacking.

Consideration can take many forms. It might be money, property, rights, services or simply a promise to do something in return or even a promise not to do something that you would otherwise have the right to do. Consideration can be present even though no money changes hands. Consideration exists when parties have done nothing more than exchange promises with one another. If you promise to sell your car to someone for $2,500 next Saturday, and the other person promises to pay that amount for your car at the same time, consideration exists even though neither of you has yet performed the contract, and no down-payment was made.

Even when there has been nothing given in exchange for a promise, the promise still might be enforceable if someone relied on the promise in some tangible way. Thus, even though a promise to make a gift is not usually enforceable, if the beneficiary of the gift takes some concrete action in reliance on the promise, the promise may be enforced. This is sometimes called *promissory estoppel*, because the person who made the promise is "stopped" from claiming that there was no consideration for the promise. A good example of this is seen when a person promises to make a charitable donation and the charity takes some action in anticipation of receiving the promised gift. Thus, if a person promises to make a donation to a college and the college, relying on the promised donation, constructs a building, the promise likely will be enforceable even though the college gave nothing in exchange for the pledge.

A promise to make a gift to a family member also might be enforceable if the family member takes some definite action in reliance on the promise. For example, if a rich uncle promises to give his niece $5,000 so she can take a trip to Europe, and the niece relies on the promise of the gift and actually goes on the trip, the niece will probably be able to sue her uncle for the money if he later tries to back out of his promise.

Fortunately, charities and family members usually are reluctant to sue people who have made such promises. They hope that the promised gift will eventually be made and that the donor will make even larger gifts in the future.

Other Requirements: Certainty, Legality, and Competence of the Parties

A contract cannot be enforced if its terms are so vague that no one can determine what to enforce. There is an offer and acceptance of sorts when, for example, you tell a friend you will do something for him or her in the future and the friend agrees. Because there is neither certainty about what to do or when to do it, nor certainty about the consideration for doing it, the contract (if there is one) would be unenforceable because of any one of these uncertainties.

In addition, the agreement must be for something that is legal for the parties to agree about. An agreement to do something illegal is not a contract, though it may be a conspiracy to commit a crime that could expose both parties to criminal prosecution. Likewise, an agreement to do something that the law will not permit, even if it is not a crime, cannot be enforced as a contract. Thus, an agreement to construct a building in violation of a zoning rule might not be enforceable.

Also, the parties to a contract must be competent to enter into it. In most cases, children under 18 years of age are not legally competent to enter into legally binding agreements. A person suffering from a mental disease or disability also might be found by a judge to be incompetent to enter into a legally binding agreement. On the other hand, a minor or incompetent person who receives something necessary for life, such as food, shelter, clothing or medical care, may be responsible to pay for the reasonable value of whatever was provided.

While a minor or a person suffering from legal disability cannot be bound to a contract, if such a

person performs his or her part of an agreement, the other party still will be bound by the contract.

Express and Implied Contracts

The terms "express contract" and "implied contract" refer to nothing more than the formality or informality of the method used to create the contract. Many express contracts are created by signing a detailed written agreement, containing all or most of the terms the parties have agreed upon, such as a contract for the purchase of a home or a new car. So-called "implied contracts" are created with little or no formality, such as the implied contract that is made when someone asks a mechanic to perform a necessary car repair. By asking the mechanic to do the work, the car owner implies that he or she agrees to pay the mechanic's usual hourly service fee together with the cost of any parts necessary to complete the repairs. By taking the car, the mechanic agrees to perform the work within a reasonable time and to do so in a professional manner for the usual hourly fee. If the charge is too high, or the work takes too long, a court might have to determine the precise meaning of these agreed terms. However, there would be little doubt that the parties entered into some type of agreement for the repair of the car even if they signed nothing and even if neither of them made a real "offer" or "acceptance."

Written and Oral Contracts

With some exceptions, an oral contract is as valid as a written contract, as long as the basic elements of a contract exist. However, in a dispute, the terms of an oral contract may be more difficult to prove than the terms of a written contract.

Some types of contracts must be in writing and will not be enforced unless the essential terms of the agreement are contained in a signed, written document. Contracts that must be written are:

- contracts for the sale of land or any interest in real property, including a home;
- contracts in which one person promises to pay another's debt (for example, when a parent guarantees a child's debt);
- prenuptial agreements or contracts between couples settling various questions of property and other rights in consideration of marriage;
- contracts that cannot be fully performed within a year of the time the contract is made, such as a contract to work for someone for 18 months;
- contracts for the sale of goods for a price of $500 or more.

The requirement that these contracts be written dates back to the English "Statute of Frauds." The legislatures of Ohio and other states have adopted their own versions of this 17th Century English law.

Written contracts do not have to be formal. The language can be plain or very complicated. Written contracts may be printed or typewritten. The writing may be of nothing more than a sales slip, which is no more than a memorandum of the contract of sale. It might even be a handwritten note on a stray scrap piece of paper.

Of course, it is almost always better to write out the terms of a contract, even when there is no legal requirement for the contract to be written. The more that is available in writing to all the parties to a contract, the less likelihood there is that there will be a misunderstanding between the parties about their obligations. However, if parties go to the trouble of writing out the terms of their agreement, they should make sure to include all of the agreed-upon terms. Otherwise, they may not be able to prove that a particular part of their agreement was ever made.

Performance of Contracts and the Consequences of Breach

Generally, parties to a contract must do everything required by their agreement. Differences of opinion and legal action may arise

when one party to a contract either fails to perform completely or chooses not to complete his or her end of the bargain. In these instances, questions of performance arise.

A person who substantially performs his or her side of bargain can enforce the contract against the other person if the other person fails to perform.

The situation becomes more complicated when a person "partially performs" a promise, but does not "substantially perform." If a person only partially performs a contract, he or she may not even be able to get paid for the value of his or her partial performance, and likely will be responsible for any harm caused to the other party. Let us say, for example, that a bricklayer only performs 20 percent of the patio he promised to install. If the homeowner must pay another bricklayer a higher price to get the job finished, then the cost of paying the new bricklayer might be higher than the value of the work done by the original bricklayer who started the job.

Generally, a party to a contract must fulfill the promises made as part of the contract. If one party does not perform, the other party usually is entitled to recover money damages for the losses suffered as a result of the breach. In addition, depending on the extent of the breach, the injured party may be justified in delaying or terminating performance of his or her own obligations under the contract.

Substantial Performance & Material Breach

At one time, the law required strict compliance with the terms of a contract. Even a minor deviation from the terms of one person's promise would excuse the other person from performing his or her own duties. Today, if one party has broken its promise in some minor way, but has still *substantially performed* its promise, then the other party still must perform his or her own part of the deal. The second party is excused from performing his or her own part of the deal *only* if the first party's failure to perform is serious enough to be a *material breach.*

An example will illustrate how this works. Mr. Smith has several dead trees on his property and enters into a contract with ABC Tree Company to cut down and remove the trees for a price of $700. ABC cuts the trees down, but simply leaves them lying on the lawn without removing them as promised. This is not only a breach; it is probably a material breach because it does not fulfill the essential purpose of the contract, which was to get rid of the trees. If, as a result of ABC's breach, Smith has to hire another company, which charges him $800 to cut up the trees and haul them off, Smith will not have to pay ABC anything. In fact, ABC would owe Smith the $100 difference between the $700 it agreed to charge for the job and the $800 Smith ended up having to pay to have the job finished.

On the other hand, if ABC cut down the trees, cut them up and hauled off everything except for two small pieces that had fallen into some bushes, Smith's contract with ABC will have been substantially performed. Although ABC did not do absolutely everything it contracted to do, it substantially performed the contract, and would be entitled to full payment, minus only whatever small expense Smith may incur to remove the two pieces that ABC failed to remove.

The result will be the same in a contract for the sale of goods. If, after a car is delivered, the buyer discovers that the brakes don't work, the buyer will be justified in returning the car and refusing to pay for it at all. Before returning the car without paying the agreed-upon price, however, the buyer may be required to give the seller a chance to "cure" the breach by repairing the defective brakes. (Likewise, in the agreement between ABC Tree Company and Mr. Smith, Smith likely will be required to give ABC an opportunity to finish the job before refusing to pay ABC and hiring someone else.) If the only problem the car buyer discovers is that the spare tire needs to be replaced, the buyer still must pay the price of the car, with a modest reduction based on the cost of a new spare tire.

Offer to Perform as a Precondition to the Right to Sue

As explained above, Ohio law does not require one party to honor an agreement if the other party breaks his or her end of the contract. But, to enforce a contract, a party may be required to demonstrate that he or she is still "ready, willing and able" to fulfill his or her part of the agreed exchange. For example, unless the buyer can demonstrate he or she can pay the agreed price for the promised product, the buyer will not be able to sue the seller if the seller refuses to deliver the goods to the buyer. Likewise, unless a seller can show he or she was ready, willing and able to deliver the product that was to have been sold, the seller will not be able to recover damages from the buyer. It works the same way with services that are to be performed.

In the case of ABC Tree Company, if ABC failed to cut up and remove the trees because Mr. Smith said he wouldn't pay for the work under any circumstances, then Mr. Smith has breached the requirement of good-faith tender of performance and would not be able to sue ABC for failing to finish the work.

Excuses for Nonperformance or Breach of Contract

Sometimes, a party to a contract may be excused from performing his or her part of an agreement. As explained above, a person is excused from performing due to the other party's failure to substantially perform his or her own obligations. Similarly, a party may be excused if it is clear that the other party is unlikely to perform, even if the other party has not yet breached the contract.

Consider, for example, a contract between a shopkeeper and one of the shop's suppliers for merchandise to be delivered immediately, but paid for some time later, such as at the end of the month. If the shopkeeper goes out of business, the supplier is likely to be excused from delivering the merchandise as promised, even though payment is not due until a month after the goods will be delivered. The likelihood that shopkeeper will be unable to pay will justify the supplier in making a written demand for adequate assurances of performance and in refusing to deliver the goods until the shopkeeper provides adequate assurance that the goods will be paid for if they are delivered.

When the contract specifies that its duties or obligations absolutely must be performed by a specific time (when "time is of the essence"), a delay by one party can excuse performance by the other and provide the other party with grounds for legal action. For example, contracts for constructing large buildings often require precise scheduling, and the general contractor or project manager will specify that various subcontracts must be completed by certain dates. Delay in performing a subcontract may justify the prime contractor in refusing to continue with the contract, and give the prime contractor the right to recover any losses caused by the delay.

A party to a contract also may voluntarily give up some rights under a contract through a voluntary "waiver." A waiver can be an excuse for nonperformance by the other party. For example, let us assume that you order a new car in "Treasure Island Green." Two weeks later, the dealer calls to tell you that the factory no longer makes that color. If you agree to allow the dealer to substitute "Sky Blue," you have waived the "color" portion of the original contract. Waivers are contract amendments and may be formal or informal, in writing or implied through the action or inaction of a party. If an original contract must be in writing, amendments must be written as well. Generally, a written amendment is the safest and most effective way to change a contract.

Prevention of Performance

Nonperformance of a contract is excused if one party prevents the other from complying with the contract. For example, the owner of a building

cannot contract to have the building renovated, and then deny the renovator access to the building to perform the work.

Impossibility of Performance

Impossibility of performance of a contract also might excuse its nonperformance. Let's assume that a carpenter, Ms. Harris, contracts with an owner to renovate the owner's building, but before the carpenter can start to work, a tornado destroys the building. Under these circumstances, it is impossible for her to perform the contract, and she is excused. If the owner has paid Ms. Harris a down payment, the owner probably will be able to recover the down payment. Otherwise, the carpenter would be unjustly enriched as a result of the tornado.

On the other hand, if the carpenter agrees to restore the building and then sells all of her tools and fires all of her workers before beginning work, she has only herself to blame. The fact that it is now impossible for her to complete the promised renovations is not an excuse and she will be liable to the owner for all the damages that the owner suffers as a result.

Remedies for Breach of Contract

The usual remedy for breach of contract is legal action to recover enough money to pay for the harm caused by the breach. In some cases, the injured party can force the breaching party to perform the contract, under threat of imprisonment for contempt of court, or have the contract modified or canceled, or get some other type of court order to prevent further loss.

The injured party should notify the other party right away if there is a defect in the other party's performance. In some situations, the injured party who fails to provide prompt notice will be prevented from obtaining any remedy. This is particularly true in contracts for the sale of goods. If the goods are defective, the buyer must advise the seller as soon as possible. If the goods are so defective that the buyer wants to "rescind" the contract and get his or her money back, the buyer must advise the seller promptly. Waiting, even for a little while, might prevent the buyer from getting the solution he or she wants or from obtaining any remedy.

Money Damages for Breach of Contract

The usual remedy for losses caused by a breach of contract is *monetary damages* (money paid to make up for the loss). The defendant isn't necessarily liable for the entire contract price, but rather for the value of the actual loss suffered by the injured party. For example, if a buyer breaches a promise buy a house for $100,000, and the seller is able to resell the property to someone else for only $90,000, the first buyer will be responsible for the $10,000 difference. The seller also may recover additional damages, such as insurance and maintenance expenses incurred while finding another buyer, and any other losses resulting from the delay or inconvenience.

Specific Performance

If the object of a contract cannot be obtained by any other means, or if the subject matter of the contract is unique, a court may force a party to comply with the contract rather than pay damages. For example, land is considered unique, and a rare museum piece or antique may be unique. A court may require he person who contracted to sell the land, museum piece or antique to transfer the land or item to the buyer as promised. Note that there is nothing unique about the money the seller would receive as the purchase price, so that if the buyer defaults, the seller's only remedy is monetary damages. Even if the subject of the contract is not unique, the court may award specific performance damages if obtaining a substitute will be difficult.

Cancellation

The technical term for cancellation of a contract is *rescission*, which refers to an action the injured party can take without going to court. In the earlier example involving the insolvent storeowner, the supplier probably would call the storeowner to say the contract is canceled, and probably should formalize and record the cancellation of delivery by writing a letter to the storeowner. In some cases, however, a party might remain bound to a contract despite a breach by the other party. In such instances, the first party may have to go to court to have the contract rescinded.

For example, suppose that a husband and wife contract to purchase a house subject to their ability to secure a loan, but the husband passes away before the sale is completed. If the wife is unable to secure financing alone, the contract may be canceled or rescinded.

Injunction

Injunctions are court orders that require people to act (or not to act) in certain ways. In contracting, an injunction would order a party not to violate a contract when there is a real threat that a breach of contract will continue. In these situations, monetary damages are inadequate remedies because the injured party would have to go to court repeatedly. If the injured party succeeds in getting an injunction against the other party, the other party risks being found in contempt of court for breaching the contract.

Let us say Mr. Smith contracts to sell a unique, antique dresser to Mr. Jones for $5,000, to be delivered six months in the future, but then threatens to sell it to someone else in the meantime. In order to prevent Mr. Smith from carrying out this threat, Mr. Jones might get an injunction, in which the court orders Mr. Smith not to sell the dresser to someone else. If Mr. Smith violates the injunction, he might not only be liable to Mr. Jones for the damages arising out of his breach of contract, but he also might be punished by the court for contempt—that is, for willingly violating the specific terms of the court's order.

Quasi-Contract or "Restitution"

Sometimes the law infers a contract-like relationship among parties to prevent someone from benefiting unjustly (legally called an *unjust enrichment*). Such a quasi-contract is used to protect one party from taking advantage of another, especially when the event in question arose innocently or accidentally.

The following scenario illustrates the concept of quasi-contract. Sue asked Fred to paint her house. She wanted it to be finished before her husband returned from a business trip. Fred gave Sue an oral quote that she accepted. When the work was completed, Fred gave Sue an invoice for his work, which she said would be paid when her husband returned. When Sue's husband came home, he refused to pay because he alone owned the house and had not contracted for the work. While Sue did not have the authority to enter into a binding contract with Fred to paint her husband's house, Fred may be able to recover payment for his work. Under the concept of quasi-contract, the law will not let Sue and her husband benefit from the misunderstanding. Sue's husband would have to pay the reasonable value of the work to prevent an unjust enrichment.

Chapter Summary

- Contract law, like other aspects of the law, is largely governed by the common law with some significant areas, such as contracts for the sale of goods, governed by statute.
- A *contract* is a legally binding agreement between or among two or more parties to perform the duties stated in the agreement.
- The basic elements of a contract are an offer, an acceptance of the offer, and either consideration or (sometimes) reliance on the promise.
- The terms of a contract must be sufficiently clear that the court can determine what the parties promised to do, the parties must be legally competent to enter into the agreement, and the subject matter of the agreement must be legal.
- If the basic elements of a contract exist, an oral contract is as valid and enforceable as a written contract, with certain exceptions.
- If a party performs the contract "substantially," or in large part, the other party cannot refuse to complete his or her part of the agreement. A *material breach* may justify the other party in refusing to perform its own promises.
- There are a number of situations in which a party to a contract is excused from performing his or her part of an agreement.
- The usual remedy for breach of contract is an action for damages.
- *Specific performance*, *rescission* and *injunction* are extraordinary remedies for breach of contract.

Web Links:

OSBA's "Law You Can Use" articles:
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"Digital Signatures: Might You Sign a Contract Without Realizing It?"

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From FindLaw's Web site:
http://library.findlaw.com/ (choose "Commercial Law and Contracts")

From Cornell Law School Legal Information Institute:
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