The Law of Contracts
and the Uniform Commercial Code

Second Edition

PAMELA R. TEPPER

The Law of Contracts and the Uniform Commercial Code

Second Edition

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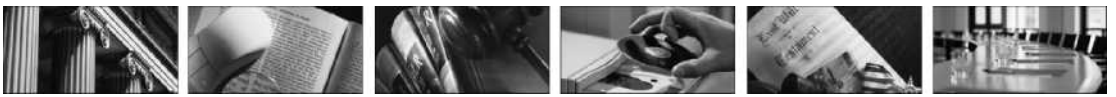

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DEDICATION

To my brother, Marc Tepper, who is always there for me—no matter what! Don't ever think it goes unnoticed. I don't know what I would do without you. Much love.

Brief Contents

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PART II: An Introduction to the Uniform Commercial Code

PART III: Drafting and New Developments in the Law

Preface

For whatever reasons, contracts is one of those subjects that students fear—and assume—will be boring. However, during my many years of teaching the subject, I have seen my students realize that contracts could be fun as well as intellectually challenging.

CHANGES TO THE SECOND EDITION

New Features

When first given the opportunity to write a contracts textbook, I was faced with the task of putting my teaching practices into a readable text. The second edition of this textbook follows the same philosophy, with many new and exciting features. In the second edition, an introductory fact pattern has been added entitled "*Just Suppose. . . .*" The introductions to each chapter are often from real cases and are intended to show the practical application of the concepts in the chapter. The fact pattern is used throughout the chapter to demonstrate how contracts and its concepts affect our daily lives, often with unusual results.

Since the original edition of this textbook was published, so much has changed from a technology perspective. Added sections that address technology issues in contracts are "TechCheck" and the "Cybercises." TechCheck focuses on some of the technology issues that have developed in contracts, such as using electronic signatures, clouding and outsourcing to name a few. The section called "Cybercises" has many applications and reasons for its inclusion. Cybercises not only will help students find practical applications to the legal concepts discussed in the chapter but also will assist the student in navigating through the Internet to find contract related Web sites that may help them in their professional life. For those who are not as computer savvy, the Cybercises are there to take some of the mystery out of the Internet and assist in gaining a comfort level in navigating through the different search engines and Web sites.

Often times, the technology issues have ethical considerations which may be addressed in either the TechCheck section or another new addition entitled "Strictly Speaking: Ethics and the Legal Professional." Regardless of your profession, ethics, and professionalism is important not only to you as a person, but you as a paralegal. Because your ethics is your profession, the "Strictly Speaking" section concentrates on many of the ethical issues you may encounter as a paralegal. It discusses your role as a paralegal and many of the legal limitations that you will be faced with in your career. This section is important for you professionally and is intended to offer some guidance on the distinction between the role of the attorney and the role of the paralegal in the legal profession.

No legal textbook would be complete without the case law, which is covered in the "Line of Reasoning" section. The second edition summarizes relevant cases within each chapter and poses thought provoking questions at the end of each case entitled "Questions for Analysis." The cases chosen have relevancy to the chapter concepts and (hopefully) present some fun examples of contract disputes between people with whom you have some familiarity. There are entertainment cases, sports cases, and current events cases sprinkled amidst the "contracts classics."

Following the cases is another new section, "State Your Case." This section is a fact pattern, which assists the student in critical thinking and analysis. The "State Your Case" feature appears in critical sections of the chapter to provoke thought and assist the student in understanding the legal concepts from a particular section as well as those within the chapter. Meant as a skill builder, this section often draws on concepts from previous chapters that will assist the student's understanding of the "big picture" concepts in the study of contracts.

Some of the new additions can be found at the end of each chapter. The new legal terminology that is identified in bold with margin definitions is now listed in a new section "Key Terms." This new addition will help the student identify the new legal vocabulary introduced within the chapter. Of course, the new edition retains the summary section, review questions, and exercises, but the exercise section has been expanded to provide additional opportunities for the student to test their understanding of the concepts in the chapter. The exercises are often drawn from real cases or current events to engage the student and to show that the concepts discussed within the chapter have both practical and current application.

Students are always concerned about their future, especially jobs. For the new paralegal, it is difficult to show an employer your capabilities when you are just starting in the profession. To ameliorate that problem, "Case Assignments" has been added to the concluding sections of each chapter. In this section, the student will draft, create and exhibit their skills and talents. Case Assignments can be used to create a portfolio for the new professional as well as a mechanism to sharpen the skills of the more seasoned paralegal. Additionally, this section shows students what they will be doing in the "real world," as the assignments are intended to be an example of what their attorney or boss could assign them to do—essentially practice in action.

New Chapters

In the second addition, three new chapters have been added. Chapter 1—Contract Law: A General Introduction—provides an introduction to contracts and identifies many of the legal resources for contract law. Students are faced with being introduced to a new topic and have no idea what legal resources will help them perform various tasks and do their jobs. This chapter will take some of the guess work out of where to find resources—print text and electronic—when legal research and drafting is required for an assignment. In part, this chapter was developed because of the frustration of students not knowing where to look when researching assignments, both at school and at work. This chapter provides a basic framework for students to not only have a general understanding of the concepts they will learn, but also where to find information on those concepts.

The Internet has posed many new laws and issues relating to the area of contracts. Contracting online is now commonplace and the "old" either had to be adapted, reinvented or simply created to address the many issues that the Internet and technology has generated. What effect does an electronic signature have on a transaction? Can an e-mail create a contract? Are consumers bound to a contract when they click "accept" on a Web site? These are some of the global issues that the Internet and e-commerce have created requiring an entire chapter devoted to the topic. Chapter 16—Contracts and the Internet: Something Borrowed, Something New—addresses many of the issues that have developed in our age of technology and electronic transactions. New laws will be discussed, such as UETA, E-SIGN, and UCITA. How the courts have treated these emerging issues and the leading cases on the subject are included in the chapter. Included in the chapter is a discussion of clickwrap, shrinkwrap, and browsewrap contracts, which developed because of the Internet and technology. But most importantly, the chapter tackles many of the issues courts, lawmakers and lawyers face every day in determining how to interpret transactions created either on the Internet or through some electronic medium. This area of contracts law is constantly changing and evolving along with the technology it attempts to interpret.

The third new chapter, Chapter 19—Analyzing a Contracts Problem: Putting Theory into Practice—is a

roadmap to help you analyze a contracts problem. This chapter guides the student though a contracts problem showing the student where to begin, what questions to ask, and how to create a final product. The chapter creates a step-by-step approach using a fact situation from a real case to guide the student through the process. They will be able to refer back to this chapter to help them in their jobs when they are presented with a legal assignment. For ease, checklists have been created. This final chapter encapsulates the concepts that have been presented in the textbook and classroom work and is intended to draw together the entire course.

Graphics

And lastly, the second edition has many more graphics. There are graphs and charts that reinforce the concepts in the chapter and of course, add a little more interest to the subject!

CHAPTER FEATURES

Some things have not changed. Each chapter still has chapter objectives, definitions, (with new bolded terms), a summary at the end of each chapter, questions for review, and expanded exercises. The last section of each chapter still has the "Practical Application," which takes the concepts discussed in the chapter and shows how you will use them in practice. Many of the examples have been updated with some new ones added. One feature that remains as well is the comics. Each chapter has a comic strip from some of your favorites, illustrating legal concepts and points within the chapter. I hope they are a bit of levity while teaching you legal concepts. (I always enjoy collecting them and do get a bit obsessive about finding the right ones!)

In all, the textbook is now 19 chapters. Both the common law of contracts and Article 2—Sales—of the Uniform Commercial Code are discussed in detail. In order to minimize the additional purchase of the U.C.C. and the Restatements, the relevant sections are reprinted within the text when cited. The first half of the book focuses on the common law of contracts from making an offer to assessing the remedy for a breach. The second half of the textbook focuses on the Uniform Commercial Code, specifically Article 2, which deals with sales and legal writing with a focus toward drafting. Chapters 12 through 15 introduce the U.C.C. and cite the differences between it and the common law of contracts. As previously mentioned, Chapter 16 deals with the Internet and Contracts with the remaining chapters illustrating and emphasizing drafting skills and critical thinking—the "how to" of contracts. Although not a writing course, the final chapters offer drafting advice and suggestions when students are presented with drafting and writing tasks.

The second edition of *The Law of Contracts and the Uniform Commercial Code* remains true to the original concept of a practical, understandable and realistic approach to the law of contracts. The new additions are meant to enhance the original textbook and still have some enjoyment while learning about contracts.

INSTRUCTOR'S MANUAL

An Instructor's Manual and Test Bank by the author of the text accompanies this edition and has been greatly expanded to incorporate all changes in the text and to provide comprehensive teaching support. It includes the following:

- Suggested answers to the end-of-chapter questions
- Teaching suggestions
- A test bank and answer key

The Instructor's Manual also includes a section entitled "Check It Out." This section identifies movies that illustrate many of the concepts in the chapter. It will help students view these movies differently; hopefully with an eye toward contracts.

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- Customizable **PowerPoint® Presentations** focus on key points for each chapter.

(PowerPoint® is a registered trademark of the Microsoft Corporation.)

All of these Instructor materials are also posted on our Web site, in the Online Resources section.

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  - Flashcards
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Please note that the Internet resources are of a time-sensitive nature and URL addresses may often change or be deleted.

SUPPLEMENTS AT-A-GLANCE

SUPPLEMENT:	WHAT IT IS:	WHAT'S IN IT
Paralegal CourseMate 	Online interactive teaching and learning tools and an interactive eBook. Go to login.cengage.com to access.	Interactive teaching and learning tools, including: • Quizzing • Case Studies • Chapter Objectives • Flashcards • Weblinks • PowerPoint® Presentations • Interactive eBook • Engagement Tracker
Online Instructor's Manual 	Resources for the Instructor, posted online at www.paralegal.delmar.cengage.com in the Online Resources section	• Instructor Manual with lecture ideas, suggested answers, and test bank with answer key • PowerPoint® Presentations
Instructor Resources CD-ROM 	Resources for the Instructor, available on CD-ROM	• Instructor Manual with lecture ideas, suggested answers, and test bank with answers Computerized Test Bank in ExamView with many questions and styles to choose from to create customized assessments for your students • PowerPoint® Presentations
Contracts Online Course	Robust Online Course available on both Blackboard and WebCT. (Availability upon request for eCollege, Angel, Desire2Learn, and more.) The course can be used along with this textbook or any book for the Introductory course. See a demo at: http://cengagesites.com/academic/?site=4074	Includes 16 lessons with an Introduction; Objectives; Lecture Outline; Video Activities; Journal Activities; Group Activities; Internet Activities; Discussion Questions; Ethics Question; Glossary Terms; Weblinks; Study Notes; and Quizzing for the student. Instructor materials include PowerPoints and Testbanks.

Acknowledgments

The second edition of this textbook, like the first, had so much support from friends, family and the Cengage staff. This book would not have been possible without the perseverance and assistance of my Acquisitions Editor, Shelley Esposito. I really appreciate that she remained true to my vision and allowed me to create the book that I wanted to write. And, thank you Shelley for assigning me Melissa Riveglia as my Product Manager. Melissa, like yourself, is dedicated and has been immensely helpful throughout this process. She always was there when I needed some guidance with the text. Her suggestions made this book better, and I thank her for that. So, thank you "Cengage family" for giving me the opportunity to update my contracts textbook—a textbook that is very personal to me.

And speaking of personal, I want to publically thank Dora Lettsome and Cecilia Emanuel. Mrs. Lettsome brought me her newspapers every day, so I could scan the comics section for new additions to the second edition. Had it not been for her, there may not have been comics in the second edition at all. Thank you. And, Cecilia Emanuel was my savior. She gained all the permissions from the comic strip syndicates so we could have the rights to use the comics in each chapter. There is no telling what would have happened had Cecilia not said "yes" when I asked for assistance. Your contribution to this book was critical to my vision and what I wanted to convey in the text. Words cannot express how grateful I am to you. Thank you is not enough. And, to my very good friend Mac Davis who was there when I needed support and a shoulder to lean on, thank you.

My family is always supportive of my writing, especially my mom, Irene Tepper, and my brother Marc Tepper to whom this book is dedicated. They know how they helped me and it is appreciated.

I am an author who understands the importance of the academic reviewers. I read each comment and incorporate almost all of the suggestions and additions. There is no doubt in my mind that all of you made the second edition of this textbook better and more complete. Thank you for all the time you spent to review my chapters. It made me think, and often rethink, my approach to a particular area. So, a big and appreciative thank you to:

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Alexandria, VA

Clark Wheeler
Santa Fe College
Gainesville, FL

And to my students, past, present and future, thank you for being enthusiastic, honest, and open to explore a subject that is very special to me.

Biography of Author

Pamela R. Tepper is presently an Assistant Attorney General with the Virgin Islands Department of Justice, St. Thomas, Virgin Islands. She formerly was the Deputy Solicitor General of that Department managing the sections contracts, appeals and special projects. From 2000 to 2008, Ms. Tepper was the Vice President of Legal Affairs and General Counsel at the Governor Juan F. Luis Hospital and Medical Center, St.Croix, Virgin Islands. For over 20 years, Ms. Tepper has taught in a number of paralegal programs including the Southeastern Paralegal Institute and Southern Methodist University programs in Dallas Texas, The University of Texas, Arlington campus ,and the University of the Virgin Islands. Along with this textbook, *The Law of Contracts and the Uniform Commercial Code, second edition*, Ms. Tepper is the author of *Basic Legal Writing for Paralegals, second edition, Legal Research and Writing,* and *Texas Legal Research.* Ms. Tepper graduated from Hamilton College with a B.A and earned her J.D. at New England School of Law in Boston, Massachusetts. She licensed to practice law in Texas and the Virgin Islands.

Part I

An Introduction to Contracts

CHAPTER 8
Proper Form of the Contract: The Writing

CHAPTER 9
Performance and Discharge of the Contract

CHAPTER 10
Remedies in Contract Law

CHAPTER 11
Third-Party Contracts

Chapter 1

Contract Law: A General Introduction

Just Suppose . . .

You receive a letter from a sweepstakes sponsor saying that you have just won $3.5 million. Excitement! Happiness! Retirement! You have been receiving these letters for years, and finally it's your day. All those magazine subscriptions paid off. You receive telephone calls from the sponsor encouraging you to respond to the letter. But, when you attempt to claim the prize, the company informs you that you are not the grand prize winner. The fine print actually said "here's a draft of the letter I'll write should you win our Superprize." In fact, the company informs you that you were never officially entered into the contest after all. You believe you have won the "Superprize" despite what the company maintains. The question is whether the actions of the company created an enforceable contract. This is what the world of contracts is all about—everyday situations experienced by everyday people.

Outline

INTRODUCTION: WELCOME TO MY WORLD!

For many, mention of the word "contracts" sends chills and fear through their bodies. Most think of contracts as elusive, unapproachable, and even boring. Not so! When approached with an open mind, contracts can be eye-opening and, yes, entertaining just like our situation at the beginning of the chapter.

Because the law of contracts affects virtually all aspects of daily life, it is important to understand its importance as well as its significance. The simplest task involves contract law. For example, when you purchase groceries at the food market, contract law applies; when you purchase an item with your credit card, contract law applies; when you hire someone to cut your lawn, contract law applies; and even when you sell your old texts books on eBay, contract law applies. As you will learn, the question is what type of contract law applies, which is why it is important to have a working knowledge of contract law. Once you have finished this textbook, you will be amazed at how empowered and more informed you will be. We will build logically on the basic concepts of contract law until you have a working knowledge of the subject. In this chapter, you will be introduced to some of the sources of contract law and related concepts; you also will learn where to find information to assist you in understanding contract issues and problems. Later chapters delve into more details with cases and everyday examples. So, forget all those preconceived notions as to what you thought contracts were all about, and let's take a practical approach so that you can actually use what you will learn.

1.1 THE LAW OF CONTRACTS: THE PAST, THE PRESENT AND THE FUTURE

Before we delve into the details, an understanding of the laws that govern contract transactions is important. Contract law can be divided into two broad categories: common law contracts and statutory contract law, specifically the Uniform Commercial Code (U.C.C.). Each area is equally significant in contract law. Similarly, with the Internet and new technologies bursting onto the scene (and changing every day), the law still is developing with the courts and legislatures setting standards and passing statutes in an attempt to regulate how we do "our business" in that environment. That is why understanding the basics of contract law and the U.C.C. become increasingly more significant.

precedent
Prior decisions of the same court or a higher court that a judge must follow

stare decisis
"Stand by the thing decided" Related to the concept of precedent; Rule that a court should apply the same legal principle to the same set of facts and apply it to later cases that are similar

The Common Law of Contracts: Developing the Case Law

Prior to the creation of statutes, the law developed primarily from behavior and later through judge-made law. Our American system borrows its origins from English law, in which disputes were brought before a tribunal of judges who analyzed traditions, behavior, and the rules of a community to render a decision. Eventually, through the development of a formal American court system, judges handed down decisions creating standards for future judges (and citizens) to follow, called **precedents.** These precedents create the legal concept of **stare decisis**—stand by the thing decided. Through stare decisis, judges review past decisions and apply similar rules to similar situations. In doing so, stare decisis allows for fairness and some level of predictability in the

common law
Law found in the decisions of the courts rather than statutes; judge-made law

constitutions
Documents that set out the basic principles and general laws of a country, state, or organization

administrative law
Body of laws that are imposed on administrative agencies by the courts or legislatures

procedural rules
Rules established by courts and legislatures that parties must follow

mandatory authority
Legal authority that must be followed by a court

persuasive authority
Legal authority that may be followed by a court; usually from another jurisdiction or secondary source

complaint
Beginning document that commences a lawsuit

reasoning
A court's legal basis for deciding a case

dicta (dictum)
Part of a case decision that is not directly related to the reasoning of the court in reaching the result of the case

holding
The legal principle that a case stands for; the result

decisions that are made by judges. But this principle is not static. As the world changes, precedents often adjust to the changing needs of society. Think about how the Internet has affected how we do business and how the law has had to adapt to the new technologies. However, we do use the past to guide us into our future.

Setting and following precedents became the foundation of what now is known as the **common law.** The common law of contracts is, therefore, the law based upon English traditions and created by judges to settle disputes arising out of contractual relationships.

Case Law

Case law is derived from the judge-made decisions interpreting the various types of law that includes the common law (case law), **constitutions**, statutes, **administrative law** and **procedural rules**, such as the Federal and state rules of civil and criminal procedure and evidence. The case law builds its decisions based upon past precedents upon which judges rely. Precedents are either **mandatory authority**, which must be followed by a court, or **persuasive authority**, which may be considered by a court, but do not have to be followed. Throughout this text, cases will be used to illustrate legal principles relating to the topics discussed in a chapter. Cases are generally structured as follows:

The Parties: The beginning of a case identifies the persons or entities involved in the case. As mentioned earlier, the Plaintiff files the **complaint** or lawsuit against the Defendant. Typically, the plaintiff is the wronged or injured party and the defendant is the one who is responding to the complaint.

The Court: Included in the beginning of the case also is the identification of the court in which the case is filed. Some of the cases you will read originate in a trial court, which is where a lawsuit commences. When a losing party challenges a decision at the trial level, they can appeal to a court of appeals. Depending on the jurisdiction, some states have a three-tiered court system others a two-tiered system. This is important because you need to understand from which court a decision originates. The highest appeals court has more precedential value than an intermediate court. Of course, in the United States the highest court is the U.S. Supreme Court, whose decisions have precedence in all states. U.S. Supreme Court cases are the "law of the land." This text is beyond a detailed discussion of the U.S. court system, but suffice it to say that understanding the U.S. federal court system and state court systems is important in knowing which case law you will be searching for when presented with assignments from an attorney.

The Decision: Following the identity of the parties and the court is the decision. The decision encompasses the court's **reasoning** based upon the facts and law of the situation. In the reasoning, the court identifies the issues between the parties and applies the applicable legal principles. Most cases have **dicta or dictum**, which is the part of the court opinion that is not used as the basis for the court's result. Dictum is not part of the reasoning. However, through the reasoning, the court will reach a result known as the **holding**.

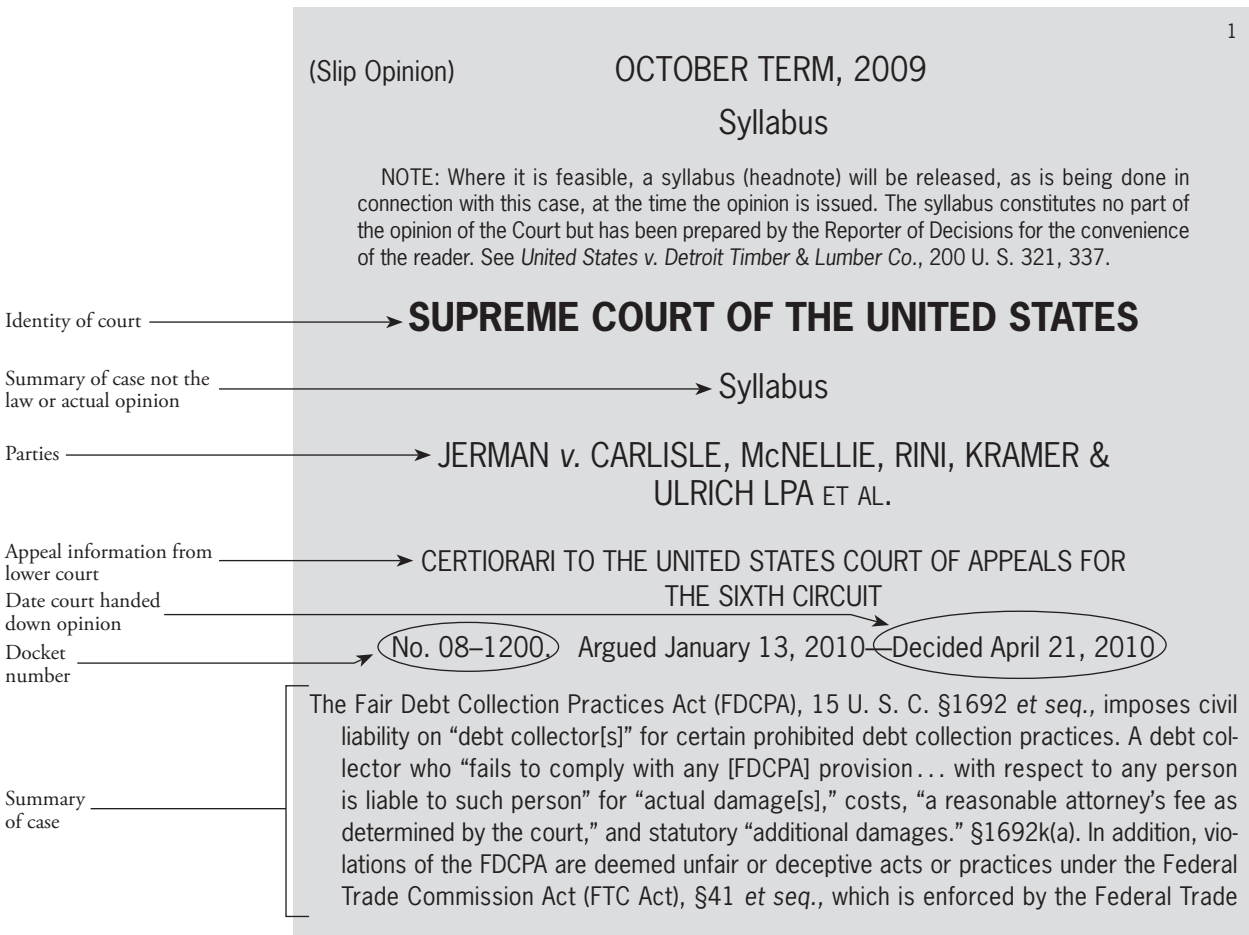
case summary
Section at the beginning of a case that summarizes general information about the case; it is usually prepared by the publisher of the case and the court

case headnotes
Short case summary at the beginning of a case that identifies a point of law within a case; prepared by the publisher and is not part of the formal court opinion

The holding is the legal principle for which the case stands. The holding sets the precedents for which other courts can and will follow. All these components create the basis of our case law. Exhibit 1-1 is an example of the beginning of a case from the U.S. Supreme Court Web site. It should be noted that a court Web site reports the case unannotated as compared to a commercially published annotated case. The annotated case includes such items as a **case summary,** which summarizes the holding and history of the case; **case headnotes,** which summarizes points of law contained within a case; and other aids, which assist in legal research. These aids are not part of the official version of the case and are not part of the court's reasoning or holding.

EXHIBIT 1-1

Example of the introductory information from a U.S. Supreme Court case



Name of case → JERMAN *v.* CARLISLE, McNELLIE, RINI, KRAMER & ULRICH LPAs 2

Syllabus

Commission (FTC). See §1692*l*. A debt collector who acts with "actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is [prohibited under the FDCPA]" is subject to civil penalties enforced by the FTC. §§45(m)(l)(A), (C). A debt collector is not liable in any action brought under the FDCPA, however, if it "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." §1692k(c).

Summary continued

Respondents, a law firm and one of its attorneys (collectively Carlisle), filed a lawsuit in Ohio state court on behalf of a mortgage company to foreclose a mortgage on real property owned by petitioner Jerman. The complaint included a notice that the mortgage debt would be assumed valid unless Jerman disputed it in writing. Jerman's lawyer sent a letter disputing the debt, and, when the mortgage company acknowledged that the debt had in fact been paid, Carlisle withdrew the suit. Jerman then filed this action, contending that by sending the notice requiring her to dispute the debt in writing, Carlisle had violated §1692g(a) of the FDCPA, which governs the contents of notices to debtors. The District Court, acknowledging a division of authority on the question, held that Carlisle had violated §1692g(a) but ultimately granted Carlisle summary judgment under §1692k(c)'s "bona fide error" defense. The Sixth Circuit affirmed, holding that the defense in §1692k(c) is not limited to clerical or factual errors, but extends to mistakes of law.

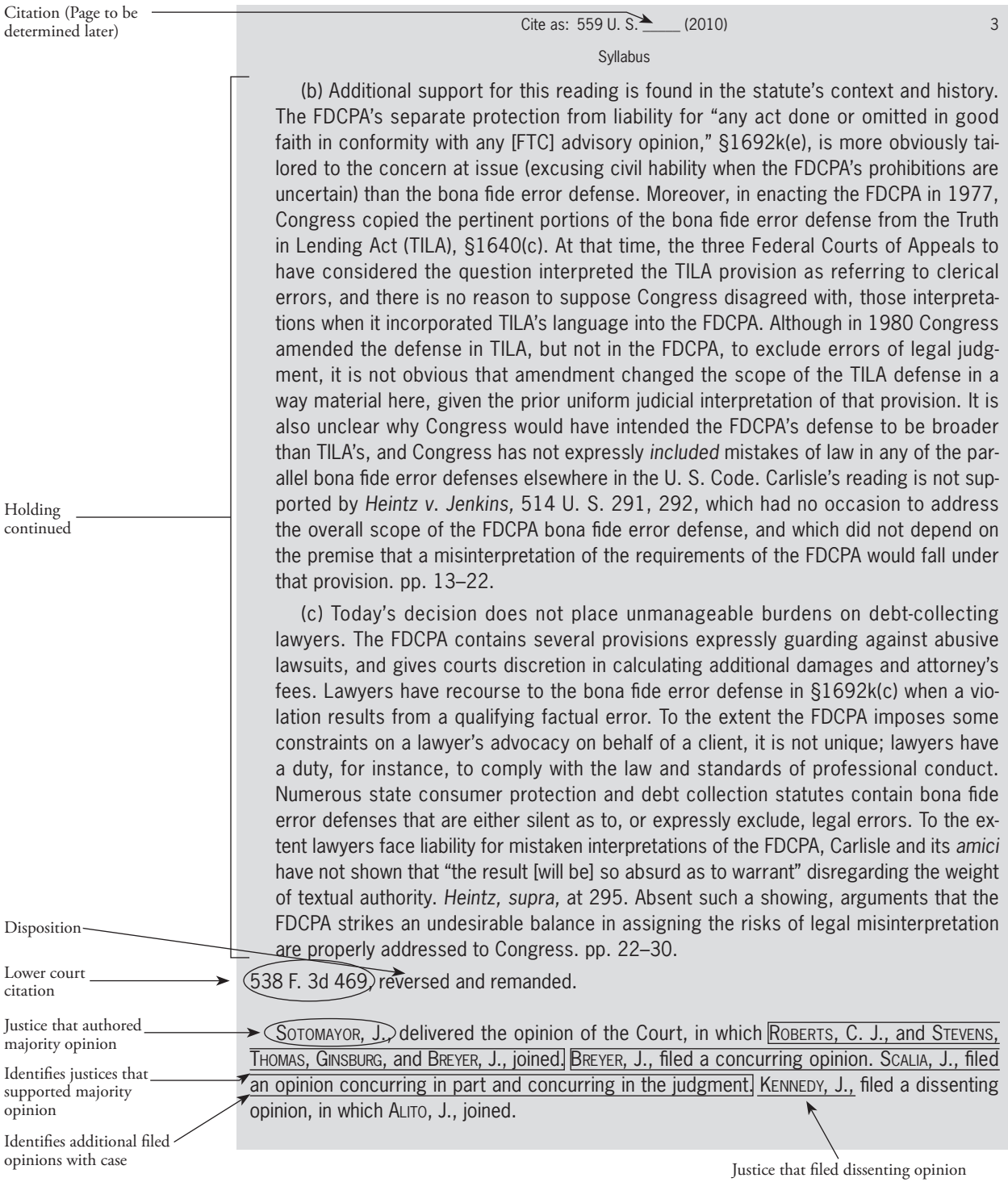
Procedural history

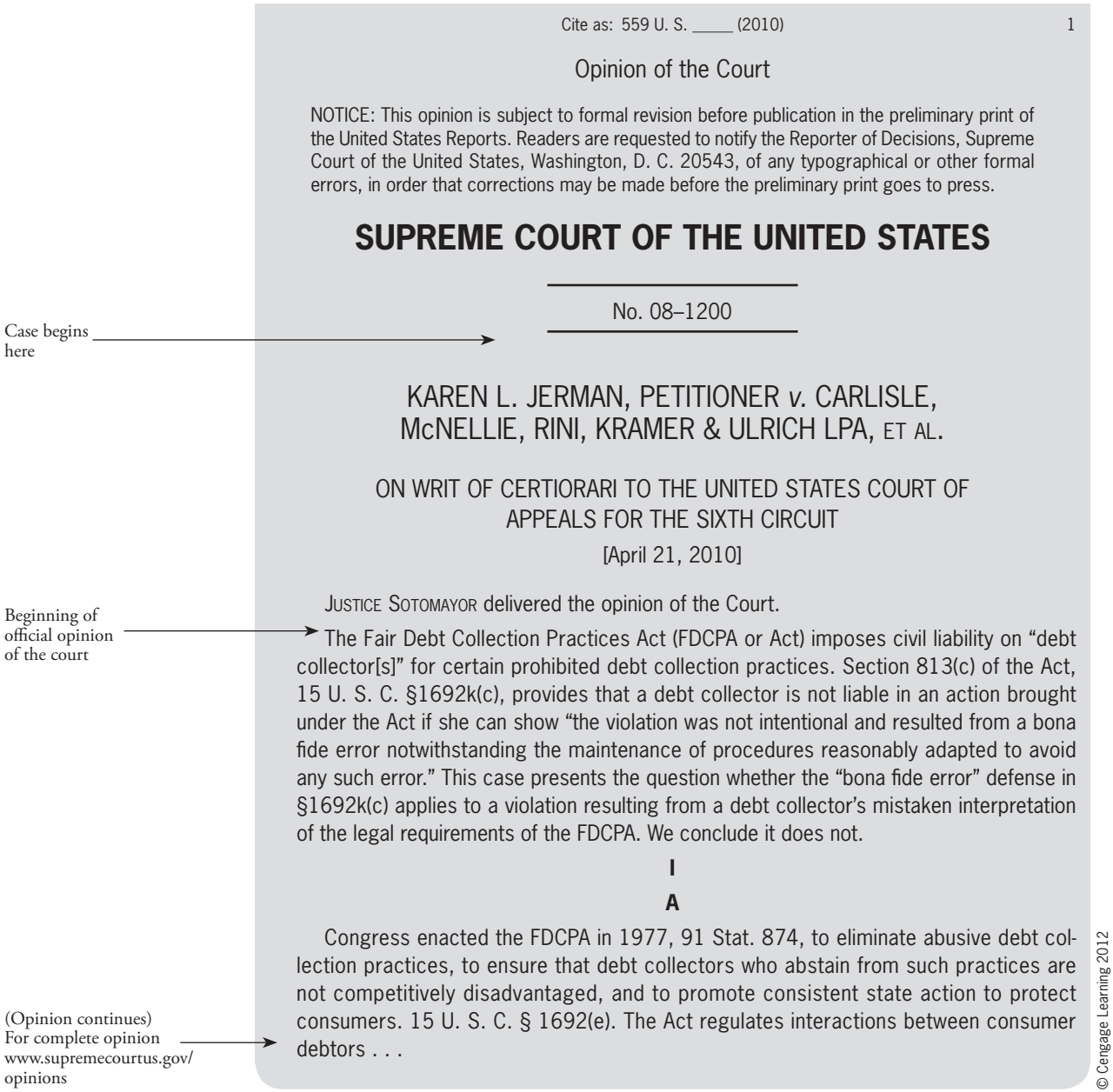
Held: The bona fide error defense in §1692k(c) does not apply to a violation resulting from a debt collector's mistaken interpretation of the legal requirements of the FDCPA. Pp. 6–30.

Holding

(a) A violation resulting from a debt collector's misinterpretation of the legal requirements of the FDCPA cannot be "not intentional" under §1692k(c). It is a common maxim that "ignorance of the law will not excuse any person, either civilly or criminally." *Barlow v. United States,* 7 Pet. 404, 411. When Congress has intended to provide a mistake-of-law defense to civil liability, it has often done so more explicitly than here. In particular, the administrative-penalty provisions of the FTC Act, which are expressly incorporated into the FDCPA, apply only when a debt collector acts with "actual knowledge or knowledge fairly implied on the basis of objective circumstances" that the FDCPA prohibited its action. §§45(m)(l)(A), (C). Given the absence of similar language in §1692k(c), it is fair to infer that Congress permitted injured consumers to recover damages for "intentional" conduct, including violations resulting from a mistaken interpretation of the FDCPA, while reserving the more onerous administrative penalties for debt collectors whose intentional actions reflected knowledge that the conduct was prohibited. Congress also did not confine FDCPA liability to "willful" violations, a term more often understood in the civil context to exclude mistakes of law. See, e.g., *Trans World Airlines, Inc. v. Thurston,* 469 U. S. 111, 125–126. Section 1692k(c)'s requirement that a debt collector maintain "procedures reasonably adapted to avoid any such error" also more naturally evokes procedures to avoid mistakes like clerical or factual errors. pp. 6–12.

Identifies where discussion of this information is located in the official opinion


Citation (Page to be determined later)
Cite as: 559 U. S. ____ (2010) 3
Syllabus
(b) Additional support for this reading is found in the statute's context and history. The FDCPA's separate protection from liability for "any act done or omitted in good faith in conformity with any [FTC] advisory opinion," §1692k(e), is more obviously tailored to the concern at issue (excusing civil hability when the FDCPA's prohibitions are uncertain) than the bona fide error defense. Moreover, in enacting the FDCPA in 1977, Congress copied the pertinent portions of the bona fide error defense from the Truth in Lending Act (TILA), §1640(c). At that time, the three Federal Courts of Appeals to have considered the question interpreted the TILA provision as referring to clerical errors, and there is no reason to suppose Congress disagreed with, those interpretations when it incorporated TILA's language into the FDCPA. Although in 1980 Congress amended the defense in TILA, but not in the FDCPA, to exclude errors of legal judgment, it is not obvious that amendment changed the scope of the TILA defense in a way material here, given the prior uniform judicial interpretation of that provision. It is also unclear why Congress would have intended the FDCPA's defense to be broader than TILA's, and Congress has not expressly *included* mistakes of law in any of the parallel bona fide error defenses elsewhere in the U. S. Code. Carlisle's reading is not supported by *Heintz v. Jenkins,* 514 U. S. 291, 292, which had no occasion to address the overall scope of the FDCPA bona fide error defense, and which did not depend on the premise that a misinterpretation of the requirements of the FDCPA would fall under that provision. pp. 13–22.
Holding continued
(c) Today's decision does not place unmanageable burdens on debt-collecting lawyers. The FDCPA contains several provisions expressly guarding against abusive lawsuits, and gives courts discretion in calculating additional damages and attorney's fees. Lawyers have recourse to the bona fide error defense in §1692k(c) when a violation results from a qualifying factual error. To the extent the FDCPA imposes some constraints on a lawyer's advocacy on behalf of a client, it is not unique; lawyers have a duty, for instance, to comply with the law and standards of professional conduct. Numerous state consumer protection and debt collection statutes contain bona fide error defenses that are either silent as to, or expressly exclude, legal errors. To the extent lawyers face liability for mistaken interpretations of the FDCPA, Carlisle and its *amici* have not shown that "the result [will be] so absurd as to warrant" disregarding the weight of textual authority. *Heintz, supra,* at 295. Absent such a showing, arguments that the FDCPA strikes an undesirable balance in assigning the risks of legal misinterpretation are properly addressed to Congress. pp. 22–30.
Disposition
Lower court citation
538 F. 3d 469, reversed and remanded.
Justice that authored majority opinion
Identifies justices that supported majority opinion
Identifies additional filed opinions with case
SOTOMAYOR, J., delivered the opinion of the Court, in which ROBERTS, C. J., and STEVENS, THOMAS, GINSBURG, and BREYER, J., joined. BREYER, J., filed a concurring opinion. SCALIA, J., filed an opinion concurring in part and concurring in the judgment. KENNEDY, J., filed a dissenting opinion, in which ALITO, J., joined.
Justice that filed dissenting opinion



Cite as: 559 U. S. ____ (2010) 1

Opinion of the Court

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 08–1200

KAREN L. JERMAN, PETITIONER *v.* CARLISLE, McNELLIE, RINI, KRAMER & ULRICH LPA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

[April 21, 2010]

JUSTICE SOTOMAYOR delivered the opinion of the Court.

The Fair Debt Collection Practices Act (FDCPA or Act) imposes civil liability on "debt collector[s]" for certain prohibited debt collection practices. Section 813(c) of the Act, 15 U. S. C. §1692k(c), provides that a debt collector is not liable in an action brought under the Act if she can show "the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." This case presents the question whether the "bona fide error" defense in §1692k(c) applies to a violation resulting from a debt collector's mistaken interpretation of the legal requirements of the FDCPA. We conclude it does not.

I

A

Congress enacted the FDCPA in 1977, 91 Stat. 874, to eliminate abusive debt collection practices, to ensure that debt collectors who abstain from such practices are not competitively disadvantaged, and to promote consistent state action to protect consumers. 15 U. S. C. § 1692(e). The Act regulates interactions between consumer debtors . . .

Case begins here

Beginning of official opinion of the court

(Opinion continues) For complete opinion www.supremecourtus.gov/opinions

The first half of this book focuses primarily on the common law of contracts and the *Restatement of Contracts*; while the second half of this book focuses on statutory law, such as the U.C.C. and some of its newer cousins developed essentially as a response to e-commerce and the Internet.

The Restatements of Contracts

As a response to the volume of case law being decided in this country, a group of lawyers, judges, and law professors formed the American Law Institute (ALI) in 1923. The purpose of the ALI was to gather the law to create a guide for legal professionals. One of their publications is called the ***Restatements.*** The ALI initially produced *Restatements* in nine areas, including torts, property, and contracts. It has grown to include over 14 subjects including such topics as unfair competition and conflicts of laws.

Restatements
A compilation of general areas of the law by the American Law Institute

Unlike cases, the *Restatements* consist of chapters and subsections which state generally accepted legal rules and principles known as **black letter law.** Each section is followed by comments by the ALI and illustrations. Although the *Restatements* are acknowledged and used by courts, they have never received formal judicial recognition and do not carry the weight of case law or statutes. They are not mandatory authority and are more often used as persuasive authority by a court. Consequently, among legal professionals their value is debated and many have mixed views on their importance. However, when a court needs to set forth a generally accepted legal principle, the *Restatements* often are the chosen source of law. Nevertheless, regardless of the debate, the *Restatements* have played an integral part in the development of contract law.

black letter law
The fundamental and well-established rules of law

Cybercises

Using the Internet, determine whether your state has adopted, in whole or in part, the *Restatement (Second) of Contracts*. Locate three recent contracts cases from your jurisdiction where the Court has cited the *Restatements* as authority in making their decision.

Presently, the ALI has published a *Restatement (First) of Contracts* and a *Restatement (Second) of Contracts,* which are divided into16 general chapters. Within each chapter a general rule of law is stated followed by a commentary and examples of how the rule is applied. Usually these examples have developed from previous cases decided by judges. The *Restatements of Contracts* provide a detailed account of the law of contracts. The *Restatements* are sometimes adopted by state legislatures, making them part of the statutory law, but this is the exception and not the rule. As the Supreme Court of Oregon observed:

> Although this court frequently quotes sections of the Restatements of the American Law Institute, it does not literally adopt them in the matter of legislative enacting …. The restatements themselves purport to be just that, "restatements" of law found in other sources, although at times they candidly report that the law is in flux and offer a formula preferred on policy grounds.

Brewer v. Erwin, 600 P.2d 398, 410 (Or. 1979). Despite the discussion of their place as legal authority, the *Restatements* are a good guide to understanding general principles of law and are an attempt to incorporate the common law principles coming from cases into one place.

The Uniform Commercial Code: The Law of Commercial Transactions

Uniform Commercial Code
Statutory contract law that has been adopted in a whole or part by all the states

As our society became more mobile, difficulties arose in doing business from state to state; there was a need for uniformity in the commercial laws among the states. Often the practices of one area or state differed from another creating an impediment to resolving contractual problems that arose between merchants, consumers, or both. To deal with this problem, the National Conference of Commissioners on Uniform State

Laws was created. The Conference's task was to develop uniform standards of practice in commercial law.

The earliest Acts passed by the Conference were the Negotiable Instruments Act, the Sales Act, and the Bill of Lading Act. Unfortunately, these acts did not fulfill the needs of the commercial marketplace. The older acts were the prelude to the Conference's most notable achievement, the Uniform Commercial Code (U.C.C.).

Originally, the U.C.C. consisted of nine articles, but two new ones have been added—Article 2A Leases and Article 4A Fund Transfers—making the total now eleven articles. The articles are outlined in Exhibit 1-2. Because it has been adopted in whole or in part by all fifty states, including the District of Columbia, Puerto Rico and the U.S. Virgin Islands, the U.C.C. is considered statutory law. With the adoption of the U.C.C. in the United States, merchants and business people can conduct their contractual arrangements with higher degrees of certainty and reliability. The U.C.C. is an important source of contract law and governs commercial contract law. It is fair to say that the U.C.C modifies the common law to suit the needs of modern business. Thus, the second half of this book is devoted to the U.C.C.'s Article 2, Sales—the statutory counterpart to the common law of contracts.

Most legal professionals refer to the Uniform Commercial Code as the U.C.C. It is common to use this abbreviated reference. However, be sure if you are preparing a formal document always write the complete proper name, indicate the shorthand reference in a parenthetical and then use the shorthand terminology. In conversation, any legal professional will understand when you reference the U.C.C.

EXHIBIT 1-2 Articles of the Uniform Commercial Code

Article	Purpose
Article 1 General Provisions	Sets out the general purposes of the U.C.C. and the definitions used in the Code.
Article 2 Sales	Applies to all transactions involving the sale of goods.
Article 2A Leases	Provides framework for the negotiation and enforcement of leases.
Article 3 Negotiable Instruments (formerly known as Commercial Paper)	Governs presentment of checks and transactions relating to banks.
Article 4 Bank Deposits and Collections	Read in conjunction with Article 3, focuses on the rules and regulations of bank deposits and collections of commercial paper.
Article 4A Fund Transfers	Governs electronic methods of payment and rights and obligations associated with those transfers.

Article 5 Letters of Credit	Sets out requirements for commercial transactions involving credit arrangements between banks and their customers.
Article 6 Bulk Sales (formerly known as Bulk Transfers)	Governs the sale and transfer of business assets and notice requirements to creditors. Most states have repealed this section; some have adopted the revision proposed by the Uniform State Law Conference.
Article 7 Warehouse Receipts, Bills of Lading, and Other Documents of Title	Governs transactions regarding documents of title and when title passes to a party.
Article 8 Investment Securities	Sets out requirements for security transactions and investments in registered form.
Article 9 Secured Transactions; Sales of Account and Chattel Paper	Governs any transaction that creates a security interest in personal property or fixtures, chattel paper, or accounts.

Cybercises

Find out when your state adopted the Uniform Commercial Code and whether it has adopted all articles or just some of them. Also, ascertain whether your state has adopted some form of Article 6, Bulk Sales or has adopted another approach to bulk sales transactions.

The Law of Sales: Article 2

The law of domestic sales in the United States is usually governed by Article 2 of the U.C.C. When a seller sells goods to a buyer, normally some form of the U.C.C will apply to the transaction. A notable exception is the state of Louisiana, which has not adopted Article 2 (nor a recent addition Article 2A, Leases, as well). As you will learn later in the text, Article 2 is divided into seven parts, consisting of sections usually followed by a commentary about the section. If your jurisdiction has adopted Article 2, the section is generally followed by the respective case law in your state.

Which Law Applies: Common law or the U.C.C.?

In most circumstances, determining whether a transaction is governed by the common law of contracts—case law—or the U.C.C. is pretty straightforward. And, then there are those times, when determining the answer to the question is not so simple. As a general rule, transactions that do not involve a sale of goods use the common law of contracts. These transactions ordinarily involve services or sales between nonmerchants, such as if a paralegal student sells her used textbook to another paralegal student, neither is considered a merchant and the common law of contracts would apply; or if your spouse hires a company to paint your garage, the common law of contracts applies because no sale of goods is involved.

The U.C.C., Article 2, applies to transactions involving the sale of goods and merchants. When you purchase a car from a local car dealer, the U.C.C. applies; similarly, the purchase of your new computer from a retailer involves the U.C.C. It seems simple,

right? Not so fast. As you might have guessed, the law gets a bit more complicated when a transaction is not as easily identifiable or involves a mix of sales and services. Examine *TK Power, Inc. v. Textron, Inc.* Here the Court had to decide whether to apply the common law of contracts or the U.C.C. to the transaction.

Line of Reasoning

Knowing which law applies is never easy. Courts must make such distinctions every day—often with differing results. In *TK Power, Inc. v. Textron, Inc.*, 433 F. Supp. 2d 1058 (N.D. Cal. 2006), the court had to determine whether the U.C.C. or the common law of contracts applied to a failed transaction for the creation of prototype battery chargers to be used on battery operated golf carts. TK Power was supposed to develop a battery prototype for Textron in three phases, with the last phase being the purchase and sale of the custom-made battery. The main issues for the court to decide were (1) whether TK breached its obligations in timely developing the prototype battery; (2) whether a contract existed for the final phase which was the purchase of the prototype battery; and (3) whether the common law of contracts or the U.C.C. applied to the transaction. The Court extensively discussed the attributes of the transaction carefully distinguishing the characteristics of common law contract transactions for services versus a U.C.C. based transaction in sales. In the end, the Court found that this was a service oriented contract and the U.C.C. did not govern. Locate a copy of the case and prepare a case brief focusing specifically on the court's reasoning for its decision.[1]

Questions for Analysis

Review *TK Power, Inc. v. Textron, Inc.* What facts did the court rely upon in reaching its result? What issues were distinguishing for the court in finding that the transaction was governed by the common law rather than the U.C.C.? Would the court's decision have been different had TK Power completed the development of the prototype battery and sold it to Textron? Why or why not?

[1] An example of a case brief is located in the Appendix. You can use this example as a guide for briefing cases in this text or in your professional endeavors.

State Your Case

Abby was in the infancy stages of starting her new business. She was opening a catering service that would focus on healthy eating. And best of all, she would purchase all her ingredients from local farmers. Abby researched the different farms and the products they produced. She decided to visit four farms to learn more about their products. After her visits, she decided to hire Vince Barton from Barton Farms and Toby Lindley from Springfield Gardens. Initially, she hired both farms to provide her consulting services to help her plan menus and determine how to incorporate seasonal vegetables into her menus. When the business started, Abby would begin buying the produce from

Vince and Toby. Before she had her first customer, Vince moved away. His replacement, Amanda Coates, insisted that Abby only use Barton Farms for consultation. Abby refused. She did not like Amanda's style of doing business and decided to cease using Barton Farms as a consultant and refused to purchase any produce from Barton Farms—ever. Although Vince had never signed a formal document with Abby, Amanda sued Abby for terminating her relationship with Barton Farms. As the paralegal for the firm assisting Abby, you are faced with determining which law applies the common law or the U.C.C. Present your best arguments as to which law may apply to these facts.

Consumer-Based Laws: Protecting the Public

The U.C.C. is not the only statutory law that monitors and enforces commercial and sales transactions. Since Article 2 of the U.C.C. primarily applies to merchants, Congress and the states have passed numerous legislative protections to level the playing field for consumers. The most notable is the federal **Magnuson-Moss Warranty Act** passed by Congress. This Act applies to warranties for transactions for products used by "households, families, or individuals". Notice that when you purchase a hair dryer, vacuum cleaner, or ear phones, there is a warranty prominently attached or displayed on the item. The warranty is either a "full warranty" or a "limited warranty" setting forth your rights as a consumer if the product is defective. Of course, a full warranty is better than a limited one, but with a full warranty, the Magnuson-Moss Act adds more requirements. Because each type of warranty has certain legal requirements, most products we purchase have limited warranties, (which is shocking, no doubt!).

Magnuson-Moss Warranty Act
Federal law that applies to warranties for transactions for products used by a household, family or individuals

States have a myriad of consumer-based laws. These laws are specific to the state that passed the law and consequently are not uniform around the country. Consumer laws in Illinois are different than those found in Iowa which differ from those in South Carolina. The common thread with any consumer protection law is its intent to protect us—the consumer—from merchants or manufacturers who may act unscrupulously or place in the stream of commerce defective products that can harm. Probably the most notable and familiar consumer protection laws are state "lemon laws." You know about them. They are the laws that protect consumers from cars that do not meet quality and performance standards. Most states have some form of a lemon law that basically provides recourse to consumers for the purchase of a faulty car, but many states are expanding lemon laws to include such items as motorcycles, RVs, and even computers. Some of these issues will be addressed in more detail in Chapter 5.

Cybercises

Locate your state's "lemon law" and compare it with that of another state. Identify the differences and similarities in the laws. What requirements are placed on the merchant that sold the products? Are there time limits associated with each state you chose, and if so, what are those limits?

One question you may be asking yourself is "why should I care about consumer protection laws in a contracts course?" The reason is that most consumer transactions involve contracts of some kind. Often these transactions involve our everyday activities, such as purchasing an item at Walmart or K-Mart. Think about it, most of our daily activities involve contracts, which is why mention of consumer protection laws is important. Our ever expanding electronic world presents consumer-based issues that many have not even considered. Laws are being deliberated that address those emergent issues as well.

That brings us to our next, and relatively new, area of the law and contracts—e-contracts and e-commerce.

A New World: E-commerce and the law

Think back when the Internet was in its infancy and no one had ever heard of an iPhone or iPods; it is almost impossible. Times change and often more quickly than the law can keep up. Since the law was lagging behind the technology, Congress and some legal scholars were faced with the task of setting some parameters for e-commerce and transactions arising in this new world. The result were some new statutory laws: Uniform Electronic Transactions Act (UETA), Electronic Signatures in Global and National Commerce Act (E-Sign), and Uniform Computer Information Transactions Act (UCITA).

UETA
A uniform act passed by most states addressing electronic signatures and records

The Uniform Electronic Transactions Act (UETA)

In 1999, the National Conference of Commissioners on Uniform State Laws (NCCUSL) recognized the need to develop laws addressing electronic transactions, specifically electronic signatures and the retention of paper documents. Responding to the need, the NCCUSL prepared a draft uniform law—the Uniform Electronic Transaction Act (UETA). This uniform law was designed to address two specific areas: (1) the retention of paper documents, which could be changed into electronic ones; and (2) the effect of electronic signatures on documents, whether from an original document or an electronic one. What that means is that an electronic document is equivalent to the original paper counterpart. Many states, including Puerto Rico and the Virgin Islands, have adopted UETA. By adopting UETA, many merchants and banks only need retain an electronic version of a document rather than the paper version. The law also validated the use of electronic signatures as an equivalent to an original signature on a paper version of a document. Recall when your bank statements contained all your cancelled checks. Now, you receive a copy of the original checks which are now stored electronically. Because of UETA, an electronic version of a check has the same effect as the original paper one. For example, if you need to produce a check that you wrote for a transaction, the bank will not produce the original paper version but an exact replica of the original check, routing stamps included. Had laws like UETA not been drafted and adopted, your bank would be required to maintain the paper version of the check. Chapter 16 will address UETA in more detail.

Cybercises

Determine the following: a) when your jurisdiction passed UETA or some form of e-signature legislation, and b) when the law became effective.

E-SIGN
Federal law that addresses electronic signatures and records

Electronic Signatures in Global and National Commerce Act (E-Sign)

Congress answered the emerging needs of e-commerce by enacting the Electronic Signatures in Global and National Commerce Act–E-Sign—on June 30, 2000. This federal law lessened the barriers between the paperless and paper driven worlds of the past. E-Sign specifically allowed the use of electronic technologies to form and sign e-contracts and e-transactions. The law also provided a mechanism of collecting and storing e-documents. Companies now can validly contract online in a paperless (electronic) world without the impediments previously associated with e-transactions.

There are some caveats to use and implementation of E-Sign. A consumer must consent to using and contracting through the use of electronic signatures and electronic

records. This consent is a protection for consumers that must be received before many e-transactions can be valid. Along with UETA, E-SIGN is discussed in Chapter 16.

UCITA
Uniform law drafted by the NCCUSL to address electronic and Internet transactions; not widely used or accepted in commercial world

Uniform Computer Information Transactions Act (UCITA)

Of the recently drafted and developed e-commerce laws, the Uniform Computer Information Transactions Act—UCITA—is perhaps the most controversial. UCITA attempts to address, in the broadest of terms, all related e-transactions under one uniform law. Highly criticized for its failure to address many consumer-based issues, the law originally was intended to be as sweeping as the U.C.C., but as of the publication of this text, it only has been adopted by two states—Maryland and Virginia. Whether UCITA or a less controversial version will be adopted remains to be seen. Clearly, as the law of information technology expands, laws will be proposed that address the issues that arise as the informational age continues to expand. Exhibit 1-3 is a summary of the laws that apply to contract transactions.

EXHIBIT 1-3

Applicable laws to contract transactions

Common Law	Judge-Made Law (case law): Applies mainly to non-U.C.C. transactions. Usually for services and not sales.
Uniform Commercial Code	Statutory Law: Applies to Commercial Transactions. Article 2 applies to sales. Often modifies the common law of contracts.
Consumer Protection Laws	Statutory Laws: Protects consumer-based transactions at both the federal and state levels.
Uniform Electronic Transactions Act (UETA) Electronic Signatures in Global and National Commerce Act (E-Sign) Uniform Computer Information Transactions Act (UCITA)	Statutory Laws: Provide legal certainty in many e-transactions, such as e-signatures. Most states have adopted UETA in some form. E-Sign the federal equivalent. UCITA was designed to be the electronic commerce equivalent of the U.C.C. but has only been adopted by two states. Laws policing e-commerce arena in formative stages.

TECH CHECK

The Internet has transformed the way business is conducted both domestically and internationally. Words such as e-commerce, e-business, and e-transactions are common terms used every day. E-commerce has quickly become the norm because of the global reach of technology. But the reach and transformation of the global technologies, including the Internet, have not always kept pace with the law. Although legislatures have not overlooked the world's increasing reliance on e-commerce and the emerging e-business, which is a natural outgrowth of the new technologies, the legal impact has not always kept pace. As a result, any legal professional must be cognizant that the law of e-commerce, which encompasses the development of the

law of e-contracts, is fluid. Courts will be faced with new challenges as cases are argued and precedents are set. This coupled with legislatures enacting new laws to address how business is conducted in the e-world presents new challenges for us all. It is incumbent upon legal professionals to monitor the legal developments as new laws are passed and cases are handed down by courts. What is important to keep in mind is that with the changing technology and changing business atmosphere, behavior that is acceptable today may be prohibited tomorrow. Your role, as a paralegal, is to know where to find answers to the inevitable questions that will arise in an atmosphere which changes daily in a virtual world.

This section of the chapter focused on the different laws that apply in contractual transaction from the common law to statutory laws. The next section will help you learn where to find the information you will need to assist you in performing your job.

1.2 LOCATING THE LAW: A STARTING POINT

Beginning a new journey can be a challenge, especially when starting a course of legal study. Figuring out where to find helpful information either online or in a library can be daunting. Before we settle into learning some of the basic concepts in a contracts course, knowing about resources that will make the journey easier is important. We already have discussed the common law (case law), statutes, and the *Restatements* as areas devoted to understanding contract law. There are other resources to explore, which will assist you in finding the law and drafting documents for commercial transactions. The next section discusses the main resources in the contracts area and is by no means an exhaustive discussion on the subject.

Legal Treatises

legal treatise
Scholarly book on a specific legal subject; usually multivolume

A **legal treatise** is a single volume or multivolume set of books that are devoted to the study and interpretation of an area of law. In contracts, the two most famous legal scholars are Professor Arthur L. Corbin, who taught at Yale University, and Professor Samuel Williston, who taught at Harvard University. Both men established themselves as leading authorities on contracts, creating treatises that are the benchmark in the area. These two treatises are often cited by judges in cases and are quoted extensively. Knowing these names is important in the study of contract law. Their treatises are:

Arthur L. Corbin, *Corbin on Contracts* (Rev. ed. 1993)

Samuel Williston, *A Treatise on the Law of Contracts* (4th ed. 1990)

These treatises also can be found online on LexisNexis (Corbin) and Westlaw (Williston) respectively.

Many other treatises have followed but they are the most notable.

Hornbook Treatises

hornbook
Legal book that summarizes a legal subject; usually used by law students

A **hornbook** is a single volume treatise. Hornbooks often are used in the law school setting and offer detailed, albeit a more condensed, view of an area of the law. The leading

hornbook for contracts is Joseph M. Perillo's *Calamari and Perillo on Contracts, 5th Edition* (St. Paul, MN: Thomson West, 2003). This book provides a scholarly commentary of the law of contracts with cases cited in the text and its extensive footnotes.

The most notable hornbooks on the Uniform Commercial Code and Sales are written by James J. White and Robert S. Summers. They are *White and Summers' Hornbook on the Uniform Commercial Code*, *5th Edition* (St. Paul, MN: Thomson West, 2000) and *White and Summers' Hornbook on the Uniform Commercial Code: Sales, 4th Edition* (St. Paul, MN: Thomson West, 1998). The volume on the U.C.C. is more comprehensive as it covers all eleven articles of the Code. These hornbooks are a staple among students desiring more detail in the area of the U.C.C.

A more user friendly introduction to the law is found in a paperback series known as the "nutshell series" published by Thomson West Publishing. They are what the name suggests, a straightforward quick review of virtually any area of the law in a "nutshell" including contracts and the U.C.C. This series is not to be used in your research of a contract case for a work assignment but simply as a supplement to understanding general legal concepts. Unlike the hornbooks mentioned, a "nutshell" should never be cited to support your legal proposition. A case where the court took an attorney to task for "plagiarizing" a legal treatise is *Kingvision Pay Per View v. Wilson,* 83 F.Supp. 2d 914 (W.D. Tenn. 2000).

Line of Reasoning

Kingvision Pay Per View v. Wilson involved a number of issues, including theft of intellectual property and statute of limitations issues. For our purposes, the notable portion of the case involves the Court's displeasure with the way that one of the attorneys representing the Plaintiff, Kingvision, used a legal treatise. Apparently, the attorney copied a legal treatise "verbatim" in his response to a pleading. The attorney used the treatise to discuss certain aspects of federal procedure and failed to credit the authors of the treatise. In the response, plaintiff's attorney copied approximately seven paragraphs directly from the legal treatise—Charles Alan Wright, Arthur R. Miller, and Edward H. Cooper, *Federal Practice and Procedure*—without providing a legal citation. In effect, the attorney represented the treatise as his own work. The attorney also used the treatise in his footnotes in the document, again without giving credit to the legal source. The court in a footnote warned: "Nowhere in the responsive pleading was any credit given to Wright and Miller, which is copyrighted by West Publishing Company. The court does not condone this practice and finds this practice even more distasteful in a case, such as the present, that is predicated on alleged theft of intellectual property." The court concluded that the attorney's practice may have violated ethical rules involving dishonesty and deceit to the court. No other action appears to have been taken, other than the scathing footnote in the case. The court made its point.

Questions for Analysis

Review *Kingvision Pay Per View v. Wilson*. What are the issues in the case? What was the basis of the challenge to the statute of limitations question? What is the central theme in the footnote 4 of the court's opinion? How does the footnote have bearing on the practice of paralegals in researching projects for their attorneys?

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Law Review Journals and State Bar Journals

Law schools publish scholarly journals known as law review journals. These journals can be a good source of the law, especially for citing trends in the law. Law reviews contain articles from noted scholars and professors on a myriad of topics and are extremely well researched. The case note sections are authored by students and also are well researched. The articles offer extensive source material in their footnote sections, which can be an invaluable tool when researching a client's case.

State bar journals provide articles on state specific issues written by attorneys and professors. They are not as detailed as a law review journal article but do discuss trends and hot topics in the law both nationally and statewide. They can be helpful in current topical issues in your jurisdiction, especially in the technology areas.

Encyclopedias

Legal encyclopedias are a great resource. They are found online and in most law libraries. The leading legal encyclopedias are *American Jurisprudence*, (*Am. Jur.*) and *Corpus Juris Secundum,* (*C.J.S.*). Both encyclopedias now are published by Thomson West Publishers and can be found on Westlaw. They provide excellent detailed overviews of every area of the law and are a great starting point for any assignment in a law office or legal related job. The encyclopedias provide the black letter law on a subject, West Key Numbers, and cases from both state and federal jurisdictions related to the topics in the respective sections. Many states have state specific encyclopedias, such as California, Texas, and Illinois. For state-specific contract and sales issues, a state-specific encyclopedia is a good starting point for any assignment.

There also are subject-specific encyclopedias which can be helpful. Remember that information in an encyclopedia is general and can help you locate specific cases on the topic you are researching.

State Practice Series: Formbooks

formbook
Multivolume set of books that contains examples or templates of legal documents to assist in drafting

Virtually all states have state-specific practice series that focus on drafting documents that apply the legal requirements of that state's laws. These books contain forms to assist in drafting a document and are known as **formbooks**. When asked to draft an employment contract or purchase and sale agreement, you want to draft the document according to the laws of your jurisdiction. The state practice series formbooks provide guidance not only on the law of that state but also on how to prepare documents relating to the transaction you need. These books are an invaluable tool for both the paralegal and the legal practitioner. Most states have practice series which will assist you in understanding your state's contract law and U.C.C. as well as drafting documents associated with commercial transactions.

A good starting point when beginning a drafting assignment is the formbook of that state's practice series. But be warned that these are forms that can, will, and should be modified for the specifics of a client's needs. Do not use them in a vacuum. Think of them as a guide only. This is a warning that should have been heeded by an attorney in *Eschwig v. State Bar of California,* 1 Cal. 3d 8, 459 P.2d 904, 81 Cal. Rptr. 352 (1969). The Court disbarred him from the practice of law.

Line of Reasoning

Eschwig v. State Bar of California involves an elderly woman who placed her trust in her attorney who in turn took advantage of his client. It turns out the attorney did not look out for his client's best interest, only his own. Mr. and Mrs. Handel hired Constantine Eschwig to prepare Mr. Handel's will because he was ill and his death imminent. Within a month of executing the will, Mr. Handel died. Mrs. Handel, 80 years old, asked for advice from Eschwig on how best to handle the probate of her husband's estate. The main asset of the estate was a house on an acre of land. The attorney and his wife offered to purchase the house in exchange for providing for Mrs. Handel's care for the remainder of her life, and to pay for the expenses related to both the probate of her husband's estate and his funeral. Eschwig prepared a three-page agreement, which was dated May 7, 1960. All parties signed the agreement. Mrs. Handel then executed a deed in favor of Eschwig's wife, but Eschwig did not inform the Court of the transaction. In California, there was a statute that governed life-care contracts as well as procedures, which must be followed when property is sold from a probate proceeding. Eschwig did not follow the law or the required procedures. The problem, claims Eschwig, is that he used a formbook to draft the three-page contract and failed to read the law on "life care estates" or the procedures in probate proceedings. As a result, the agreement he prepared did not comply with the law in any respect. To make matters worse, Eschwig moved away from the area where he and Mrs. Handel had lived. Eschwig's wife was ill and they moved to Placerville, California. (No more details are provided in the case.) Mrs. Handel had difficulties living by herself and ultimately Eschwig moved her to the Placerville area. (Now, remember, Eschwig is supposed to provide care for Mrs. Handel for life.) Eschwig kept moving Mrs. Handel from home to home trying to find "cheap" care for her. Eschwig claimed that he could not find a home that would care for Mrs. Handel because she was incontinent. The reality was that Eschwig simply would not pay for the added care for Mrs. Handel. Somehow word of Mrs. Handel's situation got back to her Pastor who applied for conservatorship—a form of guardianship to act on behalf of a person who cannot care for him- or herself. When Eschwig

heard of the conservatorship, he requested his wife be considered. The court would not have any of it, appointing a public guardian. The public guardian investigated the situation and realized what Eschwig had done; the guardian notified the court, which nullified the initial contract of May 7, 1960, and the sale of her real property. The court also found that Eschwig acted improperly by unduly influencing his elderly client, prompting a disciplinary action. In the present case, the court reviewed all Eschwig's actions and found him to have violated a number of ethical canons, among which were: he failed to act in good faith; he failed to pledge fidelity to his client; he misrepresented and concealed facts to the court; he violated his ethical obligation to seek the highest possible price on the sale of an estate asset; he acted in his own self-interest and committed acts of moral turpitude. The court disbarred Eschwig for his actions against Mrs. Handel.

Questions for Analysis

Review and carefully analyze the court's actions in *Eschwig v. State Bar of California.* Would the Court's result have been different had Eschwig reviewed the law and disclosed his interests? Why or why not? If Eschwig had reported the sale to the Court initially, would the resulting disbarment still have occurred? From the facts, what importance does the court place on researching the law prior to preparing a contract document? Explain your responses.

Strictly Speaking: Ethics and the Legal Professional

A well-researched case or properly drafted legal document is important in the practice of law. Part of the practice of law for both attorneys and paralegals are professionalism and ethics. You are nothing without your integrity and your professionalism. From the beginning of your career, pay close attention to "doing the right thing" and "doing things right." In the practice of law, whether in contract law or some other discipline, you will be assisting your attorney in preparing court documents, briefs, and legal documents. Many documents are drafted from forms and are adapted to the client's needs. This is a readily acceptable practice, but it should be distinguished from writing a legal brief where cases are cited and arguments made from researching and analyzing the law. This distinction is important. Plagiarism is not an accepted practice when preparing a legal brief or memorandum of law. Legal authority must be cited for the propositions of law presented. If you are preparing a brief in a client's case, copying another's work violates the canons of ethics for both attorneys and paralegals. Throughout this text, reference will be made to the ethical standards required of both attorneys and paralegals in the legal profession. Although the standards are different for attorneys, as a paralegal you must be acutely aware that whatever you do is a not only a reflection on you, but the firm or company with whom you work. For a guide to the acceptable ethical and professional practices for paralegals, visit www.nala.org, which is the Web site for the National Association of Legal Assistants, or www.paralegals.org, which is the Web site for the National Federation of Paralegals Associations. Both assist in setting the parameters for the practice of paralegals. The American Bar Association also sets forth guidelines for paralegals; these can be accessed at www.abanet.org. Also, most states have specific rules and guidelines governing paralegals. Always check with the state in which you are practicing to determine what rules of ethics and professionalism apply to you.

Internet Web Sites

Internet Web sites are in constant flux. Often they disappear as quickly as they appear. There are, of course, the fee-based legal research Web sites: Westlaw and LexisNexis. Both sites contain extraordinary databases and one or the other is usually available in law firms and legal related jobs. There are some smaller less expensive and comprehensive fee-based Web sites: Loislaw and Versuslaw. These are alternatives to Westlaw and Lexis.

For free Web sites, www.findlaw.com is one of the most comprehensive. It provides access to cases, legal articles, and forms, especially in the contracts area. Other helpful Web sites are www.ilrg.com, which provides forms with state-specific provisions. Other Web sites with general forms are www.alllaw.com and www.lectlaw.com. Many law schools provide access to general legal information as well as contract information. One of the most respected sites is www.law.cornell.edu. Most law schools have comprehensive law libraries online; it is simply a matter of preference. General search engines, such as Google, Yahoo!, www.answer.com, and others provide access to information without a fee. These search engines will lead you to an online legal library.

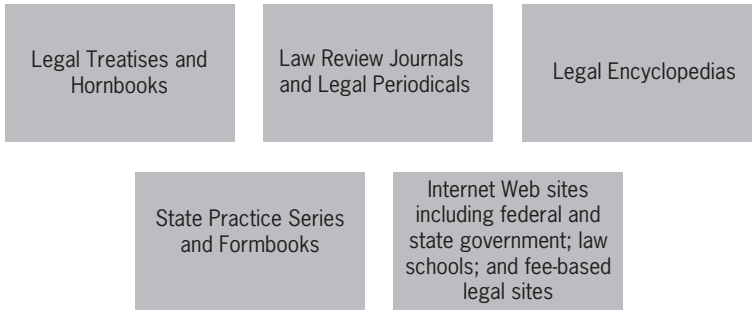
Do not forget government and state Web sites that provide a wealth of free information from cases to statutes. Federal cases can be accessed from the federal district courts and the federal circuit courts of appeals up to the U.S. Supreme Court. For the general Web site of the federal courts, use www.uscourts.gov; this site will lead you to any federal court including the district courts, bankruptcy courts, and circuit courts of appeals. Cases are posted as soon as they are released and are free. For the U.S. Supreme Court, use www.supremecourtus.gov which also posts its cases almost immediately after it is released. State courts can be accessed by using www.court.state (abbreviation of your state).us. For example, to find cases in Minnesota, use www.court.state.mn.us.

Federal statutes can be accessed on www.thomas.gov, www.house.gov, and www.gpoaccess.gov. A wealth of federal statutes and regulations can be found on these sites, including links to related Web sites. Thomas.gov and gpoaccess.gov are especially helpful. These sites augment your access to information, are reliable and better yet, are free.

State governments have Web sites for their courts, legislatures, and state agencies. The content of state Web sites varies but usually includes recent postings of cases from the various state courts—especially its highest courts—and statutes, including proposed bills, on the legislative Web sites. Consequently, if you need an amendment to your state's consumer protection law, for example, and you do not have access to Westlaw or LexisNexis, try your state's legislative Web site for the information. If you need a copy of a state's regulation on a subject, such as an environmental regulation, go to the state agency's Web site. Exhibit 1-4 is a summary of contract related legal resources.

Although this section dealt with Internet sites for contract law sources, do not forget that most sources also can be found in hard copy or book form. This includes cases, statutes, legal treatises, and formbooks. Be mindful that if you do not have access to the Internet, local libraries should have computer access or provide the information in book form.

EXHIBIT 1-4 Summary of legal resources for contracts



1.3 PRACTICAL APPLICATION

So far we have reviewed what laws apply to contracts and where to find source material in the contracts area. The question then is "how does all this information apply in real life?" That is what this section will always be addressing throughout this text—the practical application of the chapter's legal theory. Why do I care what law applies and where to find it? Let's use an example to illustrate the importance of the concepts discussed in this chapter. A client communicates the following during an initial interview where your supervising attorney is determining whether this client has a viable case to pursue.

Ms. Hartley: This is very difficult for me. I purchased a brand new sail boat three months ago, in March, to use at our shore house in Maine. It was a surprise birthday present for my husband. My husband and I were really excited about the boat and couldn't wait to use it. We decided to go up to the house for Memorial Day weekend where it was our intention to take it out to sea. We had a company assist us in sliding it into the water. We were about 15 minutes into our sail when I noticed that the hull was damp. That was quite unusual, especially since it was a brand new boat. I just figured it was water spray as the ocean was a bit rough. I didn't think much about it until about an hour later when I saw puddles of water. I was concerned, so I got my husband. We didn't know what was happening, but decided to immediately go ashore. When we got back to the dock, we had someone examine the boat. Apparently, the bottom surface of the hull cracked and had we stayed out any longer, the boat would have sunk with us in it. I have contacted the company in Massachusetts, Luxury Boats, Inc., where we purchased the boat, but they won't answer my calls or e-mails. The boat cost $50,000.00. Because of the cracks in the hull bottom, we decided to have the boat thoroughly inspected. We now have learned that the material used to construct the boat was inferior. I want to return the boat and get my money back. What can I do? Am I stuck with this "lemon" of a sail boat?

Mr. Styler, Esq.: Sounds like you have a good case. We have to check out the law on this and get back to you. Let's set up another appointment for next week where we can discuss our next steps in this matter.

The meeting ends.

Mr. Styler, your supervising attorney, wants clarification on some of the points of the law. He wants you to get copies of all the documents in the case from Mrs. Hartley and research the law in Massachusetts and Maine. Does contract law or the U.C.C. apply? Have Mrs. Hartley's rights been affected? If so, how and what laws may apply? Where would you begin this project?

In the above fact situation, you can see that it is important to begin to understand what laws may apply and where to find them. As we progress through this text, you will be able to analyze the concepts presented in the Hartley case. What you should take from this exercise is that each chapter's concepts build on the other until you have a complete picture and understanding of the law of contracts.

State Your Case

Using the facts from the Hartley matter in the Practical Application section, determine whether the Hartleys have a case against the boat company? As part of you assignment, identify the legal resources you used to research the case.

SUMMARY

1.1 The law of contracts is founded in both the common law and statutory law. The common law is the law created by judges and statutory law is that which is passed by a legislature. In contracts, the common law has been codified in the *Restatement* Second Contracts. The *Restatements* are the black letter law formulated by legal scholars and often adopted by courts as a basis for their decisions. The Uniform Commercial Code is the most important form of statutory law in the field of contracts consisting of eleven articles with Article 2 focusing on the topic of sales. As the Internet emerges as a means for contracting, laws are being passed by both Congress and state legislatures to address the emerging issues in e-commerce. The two most notable statutory laws relating to e-commerce and transactions are E-Sign and UETA. UCITA, drafted as the equivalent to the U.C.C., has not had the widespread recognition and adoption as anticipated. It is considered controversial and thus, only two states have adopted it.

1.2 Knowing where to find information relating to contract law is important. Legal treatises provide scholarly interpretation of contract law with the two most notable written by Professors Corbin and Williston. A more user-friendly version of a legal treatise is a hornbook. The most recognized hornbooks in the contract arena are *Calamari and Perillo on Contracts* and *White and Summers' Uniform Commercial Code*. Law review journals provide excellent sources of analysis of contract and legal topics with extensive information located in footnotes of the articles. Some general sources which provide guidance in understanding the law of contracts and the U.C.C. are legal encyclopedias, specifically *American Jurisprudence* and *Corpus Juris Secundum*. Many states have state-specific encyclopedias as well. States also have practice series which are helpful in drafting

documents. Internet Web sites are an invaluable source of information. Westlaw and LexisNexis are the most comprehensive. Government Web sites offer extensive amounts of information such as cases, statutes, and regulations for free.

KEY TERMS

precedents
stare decisis
common law
constitutions
administrative law
procedural rules
mandatory authority
persuasive authority
complaint
reasoning
dicta (dictum)
holding
case summary
case headnotes
restatements
black letter law
Uniform Commercial Code (U.C.C.)
Magnuson-Moss Warranty Act
Uniform Electronic Transaction Act (UETA)
Electronic Signatures in Global and National Commerce Act (E-Sign)
Uniform Computer Information Transactions Act (UCITA)
legal treatise
hornbook
formbook

REVIEW QUESTIONS

1. Define the concepts of precedent and stare decisis.
2. What is the common law?
3. Who developed the *Restatements of Contracts* and why?
4. What is the Uniform Commercial Code and what distinguishes it from the common law?
5. How many articles are presently included in the Uniform Commercial Code and which article is devoted to the law of sales?
6. What is one of the federal consumer-based statutes, and why are consumer protection statutes important in to the law of contracts?
7. List the technology based laws that govern e-commerce and what types of changes these statutes brought about that were significant to contracts?
8. What is a legal treatise and which two are the most noteworthy in contract law?
9. Identity resources that will assist in finding the law in both in your jurisdiction or another state. Explain how each resource will assist you in preparing an assignment or project for your supervising attorney.
10. Name three online sources that will assist you in finding federal cases in your jurisdiction and federal statutes.

EXERCISES

1. Determine which law applies to the transaction. Support your response with a detailed explanation.
   a. Arlene wants to remodel her kitchen and hires Kitchen Make-Over, Inc.
   b. Marty buys a new flat screen television from Electronics World.
   c. Marty buys a flat screen television from his friend John.

   d. Hotels Corporation buys 500 sets of sheets from Linens of the World, Inc.
   e. Hotels Corporation hires Linens of the World to decorate its rooms in its Chicago and Philadelphia locations.

2. Determine whether the following questions are true or false statements.
   a. The common law is the law created by a legislature.
   b. The common law is the law created by judges.
   c. The Uniform Commercial Code governs the law of sales and other commercial transactions.
   d. UCITA has been adopted by every jurisdiction in the United States.
   e. The most significant legal treatises on contracts law are Calamari and Perillo on Contracts and Williston on Contracts.
   f. Legal encyclopedias present a general overview of the law.

3. Lori wants to start a business selling cookies. She does not have a lot of financial resources so she begins by baking cookies in her home and selling them to neighbors and friends. She hires Margie to assist her for $10.00 an hour. Margie works for two weeks and quits. Lori never paid her. What law would apply to this transaction and why?

4. Lori's cookie business is really taking off. She finally gets that big account, Delectable Cookie Delights. They place an order for 50 dozen cookie due in two weeks. Lori panics because she realizes she does not have any help to bake the cookies. She misses her deadline and only supplies thirty dozen cookies. Delectable Cookie Delights are not happy and want to enforce their agreement. What law would apply to the transaction and why? What if Lori's neighbor Melissa ordered the 50 dozen cookies, would that change your response? Explain your responses.

5. A new client, Delia Johnson, has hired your law firm to represent her in a lawsuit she intends to file against her employer. Answer the following questions.
   a. What type of law would apply to the relationship between the law firm and Delia Johnson? Support your response.
   b. What type of law would apply to the relationship between Delia Johnson and her former employer? Support your response.

6. Define the following terms.
   a. Precedent
   b. Common law
   c. Uniform Commercial Code
   d. *Restatements*
   e. Legal treatise

7. Locate the following law review articles.
   a. Michael H. Dessent, "Digital Handshakes in Cyberspace Under E-SIGN: There's a New Sheriff in Town!" 35 U. RICH. L.REV. 943 (2002)
   b. Richard W. Painter, "Professional Responsibility Rules as Implied Contract Terms," 34 GA. L.REV. 953 (1999)
   c. Gregory E. Maggs, IPSE DIXIT: THE RESTATEMENT (SECOND) OF CONTRACTS AND THE MODERN DEVELOPMENT OF CONTRACT LAW, 66 Geo. Wash. L. Rev. 508 (1998)

d. Juliet M. Moringiello, "Signals, Assent and Internet Contracting," 57 Rutgers L. Rev. 1307 (2005)
e. Rachel S. Conklin, (Student Articles), "Be careful what you click for: An Analysis of online contracting," 20 Loy. Consumer L. Rev. 325 (2008)

Choose one article and prepare a summary of the legal concepts in the article.

8. Locate the following legal resources:
   a. Section 90 of the Restatement of Contracts Second: What is the title of this section?
   b. Second 207 of the Uniform Commercial Code: What is the title of this section?
   c. UCITA: How many articles encompass this model law?
   d. Magnuson-Moss Act: What is the citation for this Act? What Congress passed this Act?
   e. *Specht v. Netscape Communications Corp* (2nd Cir. 2002). What is the citation for this case? What are the main issues in this case?

9. Go to a law library or use the Internet and determine whether your jurisdiction has the following legal resources. For each source note the title and author(s) of the publication:
   a. state legal encyclopedia
   b. state transactional practice guide
   c. state formbook
   d. state Law Review Journals
   e. state bar association journals
   f. state paralegal journals, periodicals or newsletters

10. Locate your state's consumer protection statute and answer the following questions.
    a. When was the legislation passed?
    b. What is the citation for the Act?
    c. What are the penalties for violation of the act?
    d. Who is covered by the Act?
    e. What are the legal requirements to commence a lawsuit in your state?

    (If your state does not have a consumer protection statute, choose Texas, California, or New York for this question.)

CASE ASSIGNMENTS

1. Your attorney has requested that you research your state's electronic signature requirements. What steps must his client take to sign a legal document electronically? Prepare a detailed memorandum of your findings to your attorney. (Be sure to include the name and citation of you state statute with a copy of the Act attached for reference.)

2. Your attorney wants you to draft a release and settlement agreement between Mrs. Hartley (from our facts in section 1.3) and Luxury Boats, Inc. Locate three examples of a Release and Settlement Agreement and prepare a document for your attorney's review.

Chapter 2

Contract Basics: An Overview

Outline

Just Suppose . . .

You are working for a restaurant chain called "Scooters." Your boss says that whoever sells the most beer this month will earn a "new Toyota" automobile. Um, doesn't that sound great, especially since you need a new car and were actually thinking of quitting; that gives you some incentive to stay on a while longer. This gives you some new hope. During the month, you work long and hard hours. Your boss even mentioned that he didn't know if the Toyota would be a van, an SUV, or a sedan. When the month comes to a close and the tallies are in, you sold the most beer of all the wait staff in the restaurant. Excited about seeing your new "Toyota" your boss blind folds you and walks you to the back parking lot where he unveils a "Toy Yoda." (Yes, *Star Wars* fans, a "Toy Yoda.") Of course, you don't think your boss is funny and want what he promised, a "new Toyota vehicle." He looks at you like you are from another planet and says, "You really didn't think I was going to buy you a new Toyota for selling beer." You believe that he owes you a new Toyota and ask your brother-in-law for advice, since he's a lawyer. He thinks you have a case and decides to pursue the matter with your boss and Scooters. The big question is whether a contract was created when Scooter's boss made the offer, which you accepted by selling the most beer. This chapter will focus on what basic elements are needed to create a contract and the different kinds of contracts that can be established.

2.1 DEFINING A CONTRACT: WHAT IS IT?

The age-old question is: What is a contract? A *contract* is an agreement between parties for value, which is legally enforceable. Simply stated, a contract is an agreement that the law will enforce—whether you think so or not! That means that when a court analyzes whether a contract is enforceable, they apply an objective viewpoint rather than a subject one. As you will learn throughout the next few chapters, sometimes that objective viewpoint may have unintended consequences. You should always ask yourself a few basic questions:

- Did the parties have an agreement?
- What is the subject of that agreement?
- What rights and obligations were created under that agreement?
- Did the parties perform those rights and obligations under the agreement?
- If yes, they (most likely) have a contract?
- If no, what obligations were not performed by the either one or both of the parties to the agreement?
- If some party failed to perform under the terms of the agreement, what is the measure of damages for the party who properly performed the agreement?

These questions are seemingly straightforward, but as you probably already know, some things are easier said than done. Of course, in many instances the answer is simple, but too often there are more sides to the story, or in our case—the contract—than realized.

Learning the Legal Jargon

There is no way around the fact that the law has many unfamiliar sounding words and special terminology it uses in referring to certain concepts and contracts is no different. The law has formal names for the parties to a contract. The person who initiates the contract—namely, the one who makes the promise—is referred to as the **promisor**. The person to whom the promise is made is the **promisee.** Frequently, these terms are used when setting forth the parties' contractual obligations. Knowing and understanding the terminology is half the battle to learning contract law. Take the time to learn it.

promisor
A person who makes a promise

promisee
A person to whom a promise is made

Notice the endings—the suffixes—in the words promis*or* and promis*ee*. You will see these endings used frequently in the law and often in contracts. Usually, the person who is creating the obligation ends in "or" with the person who is responding to the obligation usually has "ee" at the end of the name. So, when you see words such as offer*or*—the one making the offer—or pay*or*—the one creating the financial obligation to pay, these are the parties initiating the transaction whereas the one who responds is the offer*ee*—the one who the offer is directed to or pay*ee*—the one who gets the money.

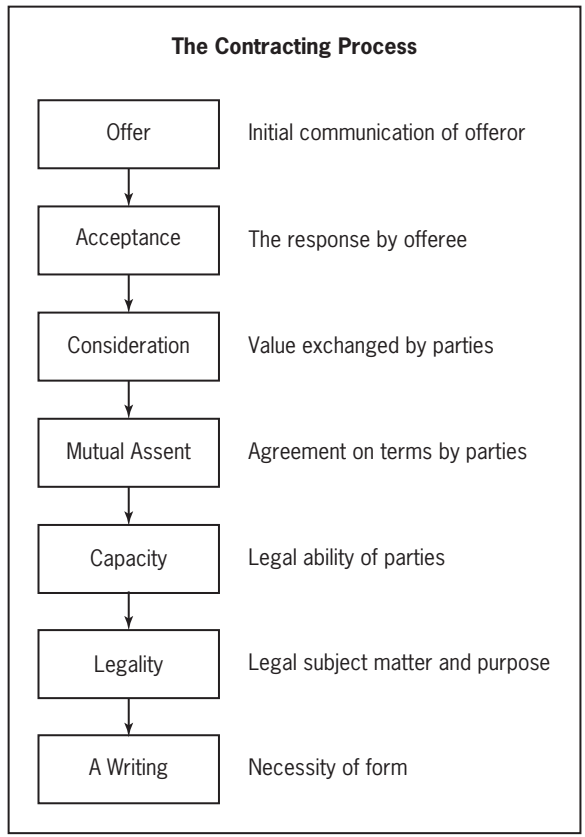
Another part of the legal jargon is learning its shorthand. For example, the shorthand term for the word contract is "K." This reference is universally recognized by everyone in the legal profession. In contracts as with any legal subject, you will read cases. The plaintiff is the one who brings the lawsuit and the defendant is the one responding to the lawsuit. There are shorthand usages for the terms plaintiff and defendant. Use either

P or the Greek sign "π" (pi) for Plaintiff and D or the Greek sign "Δ" (delta) for Defendant. These shorthand terms are common and are recognized by all legal professionals. However, use the shorthand for taking notes and drafting, but do not use it in a formal document. It is simply a convenience.

Now continuing with our discussion of legal terminology, to have a binding contract, there must be two competent parties who intend to be bound by their promises. Critical to the definition of contract is the necessity of intent. The parties must desire to be bound to a contract, or the contract may fail. If the requisite intent is present and the promises are broken, the law may enforce the promise, usually through a lawsuit.

The law goes beyond mere intent, however. It also provides that a contract must have certain elements to be enforceable. Those elements include offer, acceptance, consideration, mutual assent; but, having those elements are not sufficient. The contract must have a legal purpose and the person entering into the contract must have the capacity to contract. If any of these elements are missing, it is likely that a contract has not been created. For a diagram of the contracting process, review Exhibit 2-1.

EXHIBIT 2-1 Contract process



Another requirement that needs to be considered in determining if a contract exists is whether or not the contract must be in writing. Although contracts can be either oral or written, in some instances, the law requires that certain types of contracts must be in writing to be enforceable; this suggests that that some contracts may not be binding and enforceable unless written. This area of the law encompasses what is known as the Statute of Frauds. As the name suggests, this requirement was created to prevent fraud in certain categories of contracts. This complex area will be discussed in greater detail in Chapter 8.

Although it would be nice to think that to create a binding contract all you need are the basic elements mentioned and if one is missing, there is no contract. We know that is too easy. In later chapters, we will discuss not only legality and capacity as impediments to creating a contract, but we also will address defenses to a contract, such as mistake, fraud, misrepresentation, and duress. All the elements of the contract may *appear* to be there, but because of some underlying circumstance, the contract may be unenforceable.

legalese
Legal jargon

Not only have you just learned some of the basic components of a contract, but you are also becoming familiar with some of the legal jargon or **legalese**. Actually, some may simply refer to these terms as legal gobbledygook, but they are terms that cannot be avoided—unfortunately.

Components of a Contract

Important to all who enter into contracts is their enforceability. Without reasonable assurances that the promises of parties are enforceable, contract law would be chaotic. An understanding of the general elements needed to bind parties to a contract is necessary. This is merely an overview as each component will be discussed in greater detail in later chapters.

The Offer

offer
A proposal made with the purpose of obtaining an acceptance, thereby creating a contract

offeror
A person who makes an offer

offeree
A person to whom an offer is made

An **offer** is a communication to a party of an intent to enter into a contract. The party initiating the offer is the **offeror** and the party to whom the offer is directed is the **offeree**. The offeree has the power to accept the offer, beginning the process of contracting. As we will learn, the offer must be sufficiently definite with terms that the offeree can knowingly accept. This concept is discussed more fully in Chapter 3.

Using our example from the beginning of the chapter, who was the offeror from our Scooter's scenario? The Boss, of course. The offerees from our Scooters scenario were the wait staff at the restaurant. As we will learn in later chapters, an offer may be made to more than one person with multiple possibilities of who can accept.

The Acceptance

acceptance
The assent by the person to whom an offer is made. Acceptance is a fundamental element of a binding contract

The **acceptance** is the response by the offeree to the offeror of an intent to contract—to be bound by the terms and conditions set forth in the offer. Unless an acceptance occurs, the contracting process ends. The offer and acceptance are basic prerequisites if a contract is to evolve. Chapter 3 also delves into this area.

Now, in our Scooters scenario, did our waitress accept? Let's review the facts. Our boss offered a "new Toyota" for selling the most beer in a month at Scooters. Our waitress

remained at her job selling beer all month determined to be the highest seller of beer at the restaurant. Her actions indicated that she accepted her Boss' offer. As we will explore in the next chapter, acceptance of an offer may be through actions not just words or in writing.

Consideration

consideration
That which is given in exchange for performance or the promise to perform; the price bargained and paid; the inducement. Essential element of a valid and enforceable contract

Every contract must have **consideration,** which is the value paid for the promise. There must be an exchange of value between the contracting parties, such as money, property, or services. All contracts must have consideration to be enforceable. Look to Chapter 4 for a detailed discussion.

From our definition above, consideration can be more than just money; it can be services as well. Our waitress from our example performed services in exchange for earning the car for being the highest seller of beer in the restaurant. She also had additional value by continuing to remain employed at Scooters when she intended to quit. It looks like we have consideration.

Mutual Assent

mutual assent
A meeting of the minds; consent; agreement

Critical to contracting is the element of **mutual assent.** Each party must have the same understanding of the terms and conditions of the contract. Was there a "meeting of the minds" regarding the contract? If one party withholds vital information which induces a party to contract, then mutual assent does not exist and there is no contract. This area of law is discussed in Chapter 5.

Determining mutual assent may be a little trickier. From our introductory example, we do have some facts that indicate mutual assent. First, we have the boss announcing the offer to the staff. During the month, he also stated whether the "new Toyota" would be a van, an SUV, or sedan. Our waitress heard the offer and acted on it by selling more beer than any of her peers during that month. The facts indicate that both parties knew of the basis of the offer and our waitress acted on that offer or promise. Therefore, we have a case for mutual assent between the parties.

Capacity

capacity
1. Competency in the law. 2. A person's ability to understand the nature and effect of the act in which he or she is engaged

For a contract to be created and binding, both parties to the contract must have the legal ability to enter into a contract. Under the law, **capacity** constitutes being over the age of 18 and of sound mind. Persons who are under 18 (minors), drunkards, or mentally insane generally do not have the capacity to contract. Incapacity is difficult to show and presents unique problems in contract law. Chapter 6 focuses on capacity as an issue in contracts.

Continuing with our example, although our facts do not state whether our waitress was over the legal drinking age, for our purposes, we will assume that if she was working in a restaurant that sold beer, she was of legal age and thus had capacity to contract.

Legality

legality
The condition of conformity with the law; lawfulness

All contracts must have a legal purpose to be enforceable. They must have not only a legal purpose, but also legal subject matter. Although the element of **legality** seems clear, under society's changing needs and mores, new issues are analyzed every day. Is a surrogate

motherhood contract legal? Can you contract to have your body frozen after you die, or can you enter into a contract with a physician for an assisted suicide? What is illegal today may be legal tomorrow—same-sex unions, for example. Issues like these are addressed in Chapter 7.

Our final element in our example is whether there was a legal purpose. In this scenario, earning a "new Toyota" for selling the most beer in a month is a legal purpose. It appears that all the elements of a contract are present. Our waitress seems to have a good case and is on her way to driving away in that new Toyota and not with the "Toy Yoda."

The Legal Form

Statute of Frauds
A statute, existing in one or another form in every state, that requires certain classes of contracts to be in writing and signed by the parties. Its purpose is to prevent fraud or reduce the opportunities for fraud

Although the law states that there are six general components necessary to create a binding contract, one additional element *may* exist: the need for writing. The statute that guides parties in making this determination is the **Statute of Frauds,** which suggests that certain contracts must be in writing to be enforceable. Sometimes parties may think they have a contract, but unless it is in a suitable written form, it may not be enforceable. This element is critical to the contracting process and is further discussed in Chapter 8.

For our purposes, we can assume that the offer by the boss at Scooters to the wait staff did not have to be in writing. We do not have a Statute of Frauds issue here.

Therefore, all the components must be present for a contract to be binding and the contracting process to work. Miss one element and the contract may be unenforceable. Consequently, when you begin analyzing the process as to whether a contract exists, ask yourself:

- Was there a sufficiently definite offer by the offeror for which the offeree can accept?
- Was something of value exchanged between the parties—consideration?
- Did the parties understand the terms and conditions creating mutual assent?
- Was there an impediment to the contract's formation, such as capacity?
- Did the contract have a legal purpose?
- Were the terms of the contract communicated orally or in writing?

These questions are only some of the preliminary ones to get you started thinking about the process. As we progress, you will begin to refine your analysis as you build your legal knowledge. One aid in helping refine your analytical skills is learning how contracts are classified.

State Your Case

After 15 years of faithful service, Janice Weaver's washing machine and dryer finally gave out. Janice drives on over to her local household goods store—Home Appliances World—and decides to buy the Westag washer and dryer in navy blue. As part of the transaction, the sales person offers delivery and installation of the washer and dryer for $100.00. Of course, she includes that in her purchase. The delivery man arrives three days later with the new appliances. He installs them that same day and leaves. One week

later, Janice smells something funny coming from the dryer. She immediately calls Home Appliances World and tells them of the problem. They come over but do not see a problem. After some research, Janice determines that her new dryer requires a special vent to be installed. Home Appliances World did not install the dryer with the special vent in accordance with the manufacturer's specifications. Home Appliances World claims that the $100.00 was only for delivery and not installation. The only document that Janice signed at the time of purchase was a "loading ticket," which had the following checklist:

1. Inspect the unit for damage
2. Ensure all bolts and wires are secure
3. Check all drip pans and leveling units
4. Connect, tighten, and check all water line connections for leaks
5. Install and connect dryer vent
6. Test unit for proper installation
7. Wipe down unit
8. Present owner's manual to customer

Home Appliances states Janice only purchased delivery and not installation of the dryer. Did Janice have a valid installation contract based upon the elements required to create a contract?

2.2 CONTRACT CLASSIFICATIONS: WHAT'S IN A WORD

Contracts are classified in a variety of ways. Some classifications focus on the method of contract formation and others focus on the contract's legal effect. The classifications discussed in this section are not mutually exclusive.

Contracts may be classified as: (1) bilateral and unilateral; (2) express and implied; (3) executed and executory; (4) void and voidable; and (5) formal and informal. A contract can belong to more than one of these classifications; for instance, a contract can be bilateral, express, and executed.

Bilateral and Unilateral Contracts

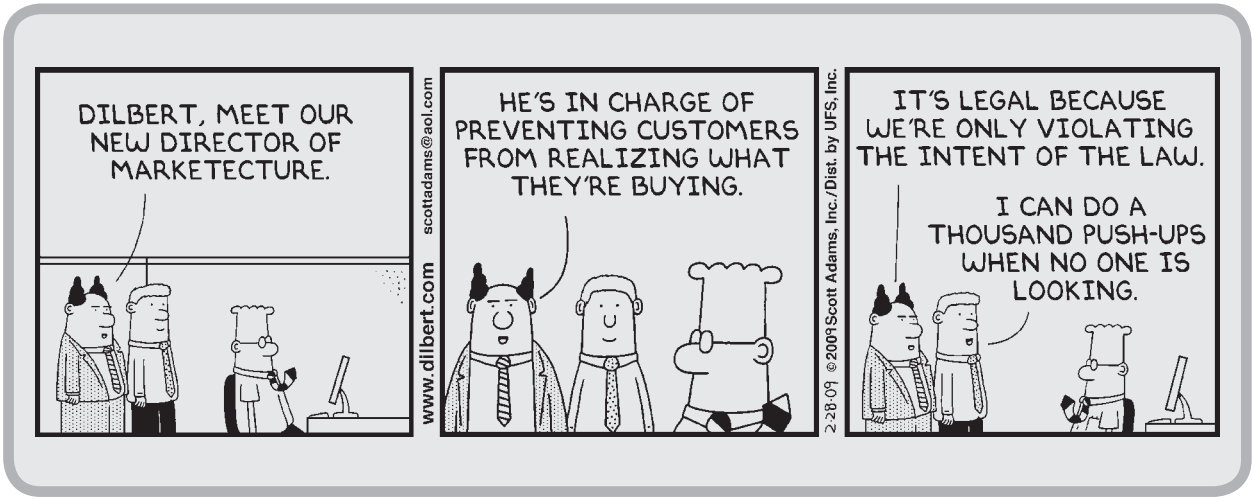
bilateral contract A contract in which each party promises performance to the other, the promise by the one furnishing the consideration for the promise from the other

A **bilateral contract** is perhaps the most common type of contract in which each party exchanges a promise for a promise, binding the parties to a contract. This usually occurs when someone makes an offer and an acceptance follows.

EXAMPLE 1: Ms. Matthews asks Mr. Dayle, "Will you come paint my garage tomorrow for $200?" Mr. Dayle replies, "Yes, I will paint your garage tomorrow for $200."

EXAMPLE 2: Greenleaf Company offers Recycling R Us $1000 to pick up its empty plastic bottles every Monday. Recycling R Us agrees to pick up the plastic bottles every Monday for the fee of $1000.

Both examples create bilateral contracts. Each party has made a promise to the other. Through the exchange of mutual promises, a bilateral contract is created. If one



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of the parties does not fulfill its promise, then the harmed party can enforce the contract through a breach of contract action, as discussed in Chapter 9.

unilateral contract
A contract in which there is a promise on one side only; a unilateral contract is an offer that is accepted not by another promise, but by performance

In contrast, a **unilateral contract** does not involve an exchange of promises. Only one party makes a promise, with the other party required to do some act in return. In a unilateral contract, the act of performing is the acceptance. There is no exchange of promises or an exchange of communications. Let's modify the examples:

EXAMPLE 1: Ms. Matthews promises to pay Mr. Dayle $200 if he paints her garage. No more communication occurs between the parties. The next day, Mr. Dayle shows up and paints Ms. Matthew's garage. A unilateral contract has been formed.

EXAMPLE 2: Greenleaf offers to pay $1000 to Recycling R Us if the plastic bottles it accumulates are picked up every Monday. Recycling R Us picks up the plastic bottles on Monday and every subsequent Monday after that.

A distinguishing characteristic between bilateral and unilateral contracts is timing. In a bilateral contract, the exchange of promises binds the parties almost immediately. The offeror cannot take back the offer (revoke it), as the acceptance has already occurred. However, with a unilateral contract, the acceptance does not take effect until performance begins. The only way to accept the offer is to actually perform the requested act. Until performance commences, the offeror can revoke the initial offer.

Line of Reasoning

In a recent case from the Sixth Circuit Court of Appeals, *Seawright v. American General Financial Services, Inc.*, 507 F.3d 967 (6th Cir. 2007) the Court was faced with interpreting whether an employee assented to

an arbitration agreement by continuing employment with the company. Although the Court held that the continued employment created acceptance of the arbitration agreement, the noteworthy portion of the case was found in the dissent. Judge Boyce F. Martin, Jr. discussed the law of unilateral contracts by using Homer Simpson of (yes!) *The Simpsons* television show as an example of some of the challenges presented in contract interpretation. The Judge stated and quoted in a footnote as follows:

> Homer Simpson is talking to God: "Here's the deal: you freeze everything as it is, and I won't ask for anything more. If that is OK, please give me absolutely no sign. [No response.] OK, deal. In gratitude, I present you this offering of cookies and milk. If you want me to eat them for you, please give me no sign. [No response.] Thy will be done." *The Simpsons:* "And Maggie Makes Three" (Fox television broadcast, January 22, 1995).

Questions for Analysis

Review *Seawright v. American General Financial Services*. What was basis of the majority opinion finding that a valid arbitration clause existed? Was a bilateral or unilateral contract created between Homer Simpson and God? What were the distinguishing characteristics of the majority opinion and the dissenting opinion? Explain your response.

State Your Case

Al and Melissa go to a party together. Melissa says to Al "go dance with Rose over there and I will pay you $50." A few hours go by and Al yells over to Melissa, "Hey look at Rose and me dancing. Now who owes me $50!" Melissa refuses to pay Al. Does Melissa owe Al $50? Was a contract created, and if so, what kind?

Express and Implied Contracts

express contract
A contract whose terms are stated by the parties

An **express contract** is one that is specifically stated. Each party knows the terms and conditions of the contract, whether oral or written. It is prudent to reduce an oral express contract to writing, lest Statute of Frauds issues arise (see Chapter 8). Using our previous examples, Ms. Matthews and Mr. Dayle had an oral communication between them to paint the garage for $200 creating an oral express contract; the example involving Greenleaf and Recycling R Us also created an oral express contract. Had Greenleaf and Recycling R Us reduced their agreement to writing, the contract would be an express written contract. Each contract is an express contract with a difference in form.

Implied contracts are different. An implied contract is created by the acts of the parties involved. It is inferred from the facts and circumstances surrounding the transaction.

implied in fact contract
A contract in which the law infers from the circumstances, conduct, acts, or relationship of the parties rather than from their spoken words

Behavior dictates the terms of the contract. Assume you go into a restaurant whose rules require you to pay after you have eaten. The restaurant has given you the food that you ate and it is implied that you will pay. This type of contract is also referred to as an **implied in fact contract.** Each party to the contract expects something from the exchange, even though no formal agreement was expressed. Both express and implied contracts are enforceable.

State Your Case

Every week Taylor drives up to her neighborhood gas station to fill up for the week. As always, she goes to the pump and puts in the gas. Right before she went to pump the gas, she had an argument with a co-worker. She was really upset. Taylor pumped her tank full and drove off. The cashier began running after Taylor, but it was too late. Next week when Taylor arrived to fill up her tank, the owner of the station came out and told Taylor she had to pay for last week's fill-up. She refuses as she knows she paid for her fill-up last week. Was a valid contract created between Taylor and the gas station?

implied in law contracts
Quasi contracts are those imposed by the law, usually to prevent unjust enrichment

quasi contract
An obligation imposed by law to achieve equity, usually to prevent unjust enrichment

unjust enrichment
The equitable doctrine that a person who unjustly receives property, money, or other benefits may not retain them without some compensation to the other party

Another type of implied contract is an **implied in law contract** or **quasi contract.** This kind of contract focuses on the need for fairness.

Quasi Contracts

A contract that is created by a court is an *implied in law contract* or a *quasi contract*. It is a type of contract that promises fairness and prevents injustice. A quasi contract is based upon the premise that although the parties may not have intended a contract, if one party benefits unjustly to the detriment of the other party, the court will compensate the party who did not benefit, to avoid unjust enrichment. **Unjust enrichment** occurs when the circumstances surrounding a situation create a benefit to a party, even though no formal contract was created. If the benefiting party does not pay for what was received, another party will be harmed. To prevent this unfairness, courts compensate for the reasonable value of the benefit so that no one will be "unjustly enriched." An example of a quasi contract is when someone renders emergency aid, such as a physician, or when someone performs work under an unenforceable contract. A court will award a reasonable value for the services performed preventing unjust enrichment of one of the parties.

Now, let's use our earlier example with Ms. Matthews and Mr. Dayle and change it slightly.

EXAMPLE: Ms. Matthews left Mr. Dayle a note requesting that her garage be painted tomorrow and stated, "Let me know by 8:00 pm. I have bought the paint, which is in the garage." Mr. Dayle never contacted Ms. Matthews, but simply showed up and painted half the garage by 9:00 am when Ms. Matthew woke and yelled, "No, I've hired someone else to paint it starting tomorrow." Ms. Matthews has received a benefit from Mr. Dayle, and a court would probably award Mr. Dayle a reasonable amount of money for his services. This is a quasi contract.

State Your Case

Based upon the same facts above, would Mr. Dayle be entitled to a reasonable value for his services if he went out and bought some paint and then painted the garage another color? Mr. Dayle could not get access to the garage, so he went out and bought some sunflower yellow paint for the garage when Ms. Matthews wanted it painted egg shell white. What is the result?

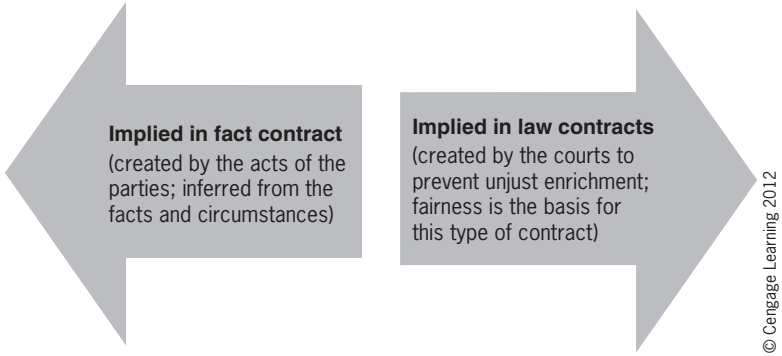
Care should be taken not to confuse an implied in fact contract and an implied in law contract. The former is a contract created by the acts and intentions of the parties, whereas the latter is one created by the courts. That distinction is critical to any analysis as to type of contract.

A difficult question to answer under the quasi contract theory is "How much compensation is just?" Generally, courts look at the reasonable value of the benefit and the cost of the benefit. That does not mean, however, that the reasonable amount is that which is ordinarily charged. The courts normally look to the prices charged in a community to determine a fair value. Consequently, under quasi contract, a benefit received may not be paid under a party's usual fee, as the court will determine what is reasonable and just. See Exhibit 2-2.

quantum meruit Reasonable compensation that a party should receive based upon the benefits or services received by the other party

Since we are focused on legal terminology as we begin building our contracts vocabulary, courts often use the Latin term **quantum meruit** when dealing with a quasi contracts and unjust enrichment. The term literally means "as much as he has deserved." This concept focuses on the reasonable compensation that a party should receive based upon the benefits or services received by the other party.

EXHIBIT 2-2 Two types of implied contracts



Line of Reasoning

The distinction between an implied in fact contract and an implied in law contract was discussed in *Slick v. Reinecker,* 514 Md. App. 312, 839 A. 2d 784 (2003). In this case, an attorney's neighbor was in an automobile accident. The neighbor asked for the attorney's assistance in processing and pursing the

claim with the insurance company. The attorney moved away but continued to help his former neighbor. The attorney did not establish a formal contractual relationship with his neighbor. When the claim was concluded, the attorney sought his portion of the settlement, which his neighbor denied. The attorney sued for his fees based upon the theory that he either had an implied in fact contract or an implied in law contract. In its opinion, the court distinguished the two types of contracts. An implied in fact contract is "implied from the circumstances or acts of the parties" to the contract. On the other hand, an implied in law contract is "not a contract at all," does not involve "mutual assent" or "a meeting of the minds" between the parties. They involve reasons of justice so that one party does not improperly benefit from the acts of another. The court found that there was not an implied in fact contract but rather an implied in law or quasi contract.

Questions for Analysis

Review *Slick v. Reinecker*. Pay attention to the court's analysis. (Notice that the case was not completely as it seemed.) What facts did the court find supported an implied in law contract rather than an implied in fact contract? What was the basis of the court's award of attorney's fees? What facts would have changed the Court's result between the parties?

Executed and Executory Contracts

executed contract
A contract whose terms have been fully performed

Executed contracts are fully performed contracts. No further performance is necessary by the parties, as there is a completed contract. In our garage painting example, when Mr. Dayle completes painting the garage and Ms. Matthews pays him, you have a fully executed contract.

Note that the term *executed* has another meaning in contracts. It also means "to sign an agreement." For example, Ms. Waters and Mr. Springer executed (signed) their contract for the purchase and sale of Ms. Waters' beach house. In this context, the term executed does not mean that the parties have fully performed their contractual obligations. In fact, this is exactly opposite of the parties intentions. None of the parties' obligations have been performed. The contract is actually an executor contract.

executory contract
A contract yet to be performed

When parties sign a contract, there often are future obligations to perform. When nothing has been done as in the above example, or the duties have been only partially performed, the contract is said to be *executory.* An **executory contract** is a contract under which a condition or promise has not been performed by one or all parties to the contract. This does not suggest that the contract is not binding on the parties as promises have been exchanged. This simply means that the performance has not commenced. The example between Ms. Waters and Mr. Springer has obligations that must be performed before the contract is fully executed. Assume that Mr. Springer, the buyer, must qualify for financing. At the time the contract is signed, the contract is executory. When the Mr. Springer, gains the financing, the seller, Ms. Waters, will tender the deed and other documents to complete the sale. After this occurs, then the contract will be executed. Be careful with terminology, as a word may have several meanings and have different effects depending upon the context in which it is used.

Strictly Speaking: Ethics and the Legal Professional

Ethics plays an important role for the paralegal not only in contracts but also in every aspect of your professional career. You must be mindful of your position and how you interact with the attorneys with whom you work, as well as the clients the firm represents. Key to understanding that role is that you do not represent the client—the attorney does. This becomes particularly sensitive when you, for instance, work in a practice when a lawyer may play a duel role, such as in a real estate transaction. A client may not necessarily need an attorney to represent them in the purchase of a piece of property or a home, but if the client chooses to hire an attorney, the lines must be drawn as to what you can and cannot do for that client. You do not represent them when they are seeking legal advice for the transaction. Can you be a real estate agent and a paralegal? The answer is "yes." But, when the client relies on you for legal advice, you may be skirting the line of the unauthorized practice of law. Know your role in the transaction and be clear to the client on that role.

Void, Voidable, and Unenforceable Contracts

To have a valid contract, all the elements of a contract must be present, making it legally binding and enforceable. Not all contacts are valid, however.

void contract
A contract that has no legal effect

A **void contract** is one that never has any legal effect. Even at the contract's attempted inception, it can never come into existence. For example, George hires Vincent "The Pro" Marshal to kill his business partner, Sam. George refuses to pay "The Pro" because he failed to dispose of the body as promised. "The Pro" cannot file a lawsuit in court and request a court to enforce the contract because the subject matter of the contract is illegal. The contract between the parties is void. Even if "The Pro" is entitled to the money, under the law the contract does not exist.

voidable contract
A contract that may be avoided or cancelled by one of the parties

A **voidable contract** is one that may be avoided or cancelled by one of the parties. Usually voidable contracts arise with minors, intoxicated, or insane persons. A contract also may be voidable when one party to the contract fails to act honestly, such as by committing fraud or misrepresentation. The person who has been harmed has the right to cancel the contract. Unless a party attempts to avoid the contract, the contract is presumed valid. Unlike void contracts, which are automatically invalid, in a voidable contract, someone has to disaffirm or reject the contract. Until the act of **disaffirmance** happens, the contract may be valid.

disaffirmance
The act of rejecting a contract

An example seen in both real life and movies is when two people go to Las Vegas, drink too much, and wake up the next morning married. Neither party often remembers getting married, but yet a legal marriage exists. The question is whether the marriage is valid or voidable. The marriage is valid unless when one of the two parties awakens and decides it was not the intention to get married (think of the movie *What Happens in Vegas*), then the marriage can be avoided. Because the parties were drunk when the marriage ceremony was performed, the contract of marriage is voidable. Drunkenness is a

legal means to avoid a contract. It only takes one party to avoid the contract, thus making it voidable.

Unenforceable contacts are different. Because of some intervening factor, a contact that appears to have all the necessary elements may not be enforceable. This occurs when a statute, such as the Statute of Frauds, dictates the necessity for a contract to be in writing, or a law is passed which make a contract unenforceable.

EXAMPLE: Marvin has a terminal illness and contracts Dr. Appleby to assist him to commit suicide. If after the contract is consummated, but prior to the suicide, a law is passed that outlaws assisted suicide, the contract would be unenforceable by a court.

State Your Case

Mary and Marie were married in California after that state passed a statute allowing for same-sex marriages. Mary and Marie were married for two years when the California Supreme Court held that the statute was unconstitutional and invalid. Is Mary and Marie's marriage valid? Is the marriage void, voidable, or unenforceable? What if Mary and Marie marry in the state of Iowa where same-sex marriage is legal? Would the marriage be valid, void, voidable, or unenforceable in California? Explain your response.

seal
An imprint made upon an instrument by a device such as an engraved metallic plate, or upon wax affixed to the instrument. The seal symbolizes authority or authenticity

formal contract
1. A signed, written contract, as opposed to an oral contract.
2. A contract that must be in a certain form to be valid

informal contract
A contract not in the customary form, often an oral contract

Formal and Informal Contracts

In earlier days, the common law required the parties to engage in certain formalities when contracting. For example, the law required that certain contracts be under **seal.** This formality required persons to affix a wax imprint or insignia to the document. For the contract to be valid, this formality had to be followed, therefore creating **formal contracts.** Additionally, formal contracts had to be in writing, signed, and often witnessed.

Many of these formalities have been eliminated, but one notable exception is in the real estate area. Contracts for the transfer of real estate require adherence to certain formalities. A general warranty deed requires, for example, the identity of all parties, a description of the real property, signatures of the parties, notarization, delivery, and filing. These requirements often are dictated by statute and failure to comply with the statutory requirements could cause the document to be invalid.

Informal contracts have become the standard today. With less formality, the focus is on the parties' intent. No special language is required. All that is required is that the parties' obligations be expressed in the agreement. Most standardized forms will do, and even a handwritten document signed by the parties will suffice. The key to an informal contract is the expression of the parties' intent. Thus, informal contracts may be oral or written or implied from the parties' actions. They regulate many of our daily activities, which illustrates the importance of contract law to our lives. Exhibit 2-3 is a summary of the different types of classifications of contracts.

Cybercises

Locate some examples of contract forms on the Internet and identify the elements of a contract within the documents; then classify the type of contracts you have found.

EXHIBIT 2-3 Contract classifications

Bilateral and unilateral contracts	Express and implied contracts	Executed and executory contracts	Void, voidable and enforceable contract	Formal and informal contracts
• Promise for a promise • Promise for an act	• Specifically stated • Created by actions of parties: implied-in-law and implied-in-fact	• Fully performed contract • Conditions or terms in contract unperformed: incomplete contracts	• No contract exits • Contract can be avoided by a party: 1. Minor; 2. Drunkenness; 3. Insanity; 4. Fraud; 5. Other defenses • Intervening event, such as passage of law, renders contract unenforceable or requires writing (Statute of Frauds)	• Contracts under seal or in writing with specific formalities, such witnesses • May be written; lacks formality; expresses obligations of the parties

State Your Case

Using the facts from the Hypothetical in the beginning of the chapter, analyze what type of contract may or may not have been created. Present your arguments first for why a contract was created, and second, why there is not a contract.

Line of Reasoning

The case of *Domingo v. Mitchell*, 257 S.W. 3d 34 (Tex. App. Amarillo, 2008) has all the elements of a drama gone bad. But more importantly, it broadly discusses the elements of a contract. How many of us have joined lottery pools, hoping to strike it rich. Well, that was the case for Betty Domingo and Brenda Mitchell. Betty and Brenda were friends and coworkers who participated in a lottery pool at work—the Texas Lottery. They began this practice sometime in early 2004 where Betty and Brenda pooled their money to purchase tickets and would split all the winnings equally. Sometimes Brenda would advance Betty's portion, where Betty would promptly repay her. Brenda received an e-mail from a coworker, Cindy, on March 9, 2006, asking whether she wanted to join a lottery group. Brenda agreed. With other coworkers, Cindy created LGroup, a Texas Limited Partnership. Later that month, Cindy called a meeting and advised the group that if they knew of other interested parties, they could invite them to the meeting. Betty did not participate in the March meeting or March lottery. However, she claims that Brenda invited her to participate in the April lottery drawing. Betty agreed to participate and asked Brenda how much money she needed to contribute. Brenda offered to cover her share and be reimbursed. On March 30, 2006, a meeting took place where the group determined the current members, the contributions, and the numbers for the next lottery. It was determined that each member would

contribute $17.00. Brenda contributed her amount, but did not have enough to cover Betty's amount. Of course, on April 29, 2006, one of the tickets from the group won totaling over $20 million—the cash value option. Betty wanted her share of the winnings. Brenda refused. After consulting an attorney, Betty filed a breach of contract action against the Limited Partnership and Brenda. Brenda responded by basically stating that she never made an offer; there was no valid acceptance; there was no meeting of the minds; and there was no consideration. In her lawsuit, Betty contended just the opposite. To avoid a trial, Brenda filed a motion for summary judgment, which the trial court granted. Betty appealed. The Court of Appeals analyzed the elements required for a valid contract. As the court stated, for a contract to exist, there must be an offer, acceptance, and consideration. The contract could be oral. In determining whether a contract existed, the court looked to how the parties interacted and communicated, using an objective standard of review. The court then analyzed what constituted an offer, acceptance and consideration. The court also focused on whether there was a "meeting of the minds," which can be implied from the facts and circumstances of the transaction (as opposed to express). Brenda argued that they never reached a price or agreed on the numbers to submit. The court stated that the price could be reasonably implied. After witness testimony was presented in the lower court, the Court of Appeals agreed with Betty that "her friend" Brenda had agreed to advance her share of the lottery pool, that their past conduct confirmed this and as such, the court found that sufficient evidence of a contract existed between Betty and Brenda and reversed the lower court's decision.

Questions for Analysis

Locate a copy of the *Domingo* case and review the court's reasoning. Would the court's result have changed had Brenda told Betty that she would have had to advance her own share to participate? Why or why not? What if the Limited Partnership had not offered to invite other members to participate, would Brenda have been responsible for Betty's share? Explain your answer.

The Internet has presented many challenging issues in contracts. How do you know when a contract is created when the parties are in cyberspace? The difficulties and how the rules of the game have new meaning have not escaped both the courts and legislators. Courts now are being faced with determining when, how, and if a contract has been consummated and what terms are binding on the parties. For example, when a consumer purchases a computer, terms and conditions are agreed to either at the time of purchase or upon receipt. Do you know anyone who actually reads the terms and conditions either on the Internet or in the pamphlets that accompany the computer? When problems arise, how should they be resolved? Should they be resolved in a court of law or through arbitration? This is an issue that the courts have been faced with throughout the country with differing results. Gateway computers have been the subject of a number of precedent setting cases, which have had incongruous results. *Klocek v. Gateway, Inc.* 104 F.Supp. 2d 1332 (D. Kan. 2000) and *Hill v. Gateway 2000, Inc.*, 105 F. 3d 1147 (7th Cir. 1997) *cert. denied,* 533 U.S. 808 (1997) represent similar facts with different results. In both

cases, Gateway tried to enforce arbitration clauses on unsuspecting consumers. These clauses were tucked away in the fine print of the terms and conditions stuffed in the box with the new computer. The *Klocek* court did not hold the clause enforceable, whereas the *Hill* court did. Unless and until, the U.S. Supreme Court hears this issue, each jurisdiction must evaluate its approach and interpretation of the law. As paralegals and legal professionals, issues, such as those raised in the *Gateway* cases are often daunting as each day the rules may change shifting the paradigm ever so slightly, bringing new concerns to the forefront. Contracting and contracts law are at the cutting-edge of the technological revolution. What is an acceptable standard today may change with a new technology tomorrow. What this means for you is be vigilant in your work and remember that the Internet brings new twists to some of the old ingrained concepts in contracts law.

2.3 PRACTICAL APPLICATION

Under the law, contracts take on many different forms. When drafting a contract, keep in mind the concepts discussed in this chapter. One of the best examples is a real estate contract. Review Exhibit 2-4 for practical application of the legal issues in this chapter.

EXHIBIT 2-4 Contract form with elements annotated

Offer

Legal Form Agreement in Writing-Satisfies Statute of Frauds

Parties/Capacity

Bilateral contract
Express contract

Indicates mutual assent

Offer & acceptance of parties

Subject matter of contract (legality)

REAL ESTATE SALES AGREEMENT

This Agreement is entered into, by, and between Robert Wynn ("*Seller*"), and Dennis Barclay ("Buyer").

In consideration of the mutual covenants contained herein and other valuable consideration received, and with the intent to be legally bound, Seller and Buyer agree as follows:

1. SALE OF PREMISES. Seller agrees to sell and convey to Buyer, and Buyer agrees to purchase from Seller, the following Premises:

[Identify the complete property description including the address]

The sale shall include all improvements and fixtures attached to the Premises. The sale shall also include the following:

[Identify any personal property that may be included in the sale]

These are the only items to be included in the sale of the property. For any personal property sold, the Seller will deliver to Buyer on the closing a bill of sale for any personal property sold to Buyer.

Consideration

2. PURCHASE PRICE. The purchase price for the property and any items of personal property are *$350,000* payable on the closing as follows: "*150,000.00 in cash, and 200,000.00 in mortgage to seller.*" All payments must be with cash or certified funds. Seller acknowledges receipt from Buyer of a deposit in the sum of $35,000 to be held in escrow pending the closing. The deposit will be applied to the purchase price at the closing.

3. DEED. On the closing, Seller will convey the property by a good and sufficient warranty deed conveying a good and marketable title, free of all liens and encumbrances. Seller, at its sole cost, shall furnish Buyer with a preliminary report or abstract of title from a reputable title company as soon as possible after the execution of this Agreement. Buyer shall give written notice to Seller of any objections to title within 15 days.

4. CLOSING. The deed will be delivered and the purchase price paid on *date sale will he finalized March 11, 2011,* unless extended in writing by the parties. The closing will be held at the seller's attorney's place of business. At the closing, Seller and Buyer agree to execute and deliver to the other all instruments required by law. The following closing costs will be paid by Seller:

The following closing costs will be paid by Buyer:

Conditions of acceptance Buyer

5. TERMINATION DUE TO DEFECTIVE TITLE. If Seller shall be unable deliver to a free and clear title, Buyer, at its option, may (i) terminate this Agreement whereupon the deposit shall be immediately refunded to Buyer and all obligations of the parties shall cease, or (ii) waive the defects and accept whatever title Seller is able to convey, without any reduction in the purchase price and as a full performance by Seller.

6. POSSESSION. On the closing, the Premises and all improvements, fixtures and items of personal property, if any, will be delivered to Buyer in their present condition, reasonable wear and tear excepted. Buyer shall be allowed to inspect the Premises prior to the closing to determine whether the Premises complies with this section.

7. ADJUSTMENTS. Current property taxes, regular and special assessments, water and sewer charges, fuel, rents, interest, insurance, operating expenses and other customary matters, if any, shall be prorated between the parties on the closing.

8. RISK OF LOSS. Seller, at its sole cost, shall keep the Premises insured for the full insurable value until the closing. Seller shall bear the risk of all loss or damage to the Premises from all causes until the closing.

Conditions of acceptance for Seller

9. MORTGAGE CONTINGENCY. The obligations of Buyer under this Agreement are expressly subject to Buyer obtaining a written commitment for a mortgage loan in the amount of $200,000 at prevailing interest rates. Buyer agrees to apply for such mortgage with all due diligence. If Buyer shall be unable to obtain such mortgage commitment by February 28, 2011, Buyer shall inform Seller in writing by such date and this Agreement will terminate and any deposit will be refunded to Buyer.

10. INSPECTION(S). The obligations of Buyer under this Agreement are expressly subject to Buyer obtaining, at Buyer's expense, a satisfactory inspection report from a qualified professional for the following:

[List required inspections, such as termites, roof and water damage.]

Conditions of acceptance Buyer

Buyer shall furnish Seller with a copy of such inspection report(s) by February 15, 2011. If any such inspections reveal conditions unacceptable to Buyer, Seller may, at its option, repair such conditions or afford Buyer a credit at the closing, or Buyer may terminate this Agreement and any deposit will be refunded to Buyer.

Additional terms

11. BUYER'S DEFAULT. Upon default by Buyer, Seller, at its option, may (i) retain the deposit as liquidated damages as its sole remedy, or (ii) enforce this Agreement and pursue any and all remedies available at law or equity, including an action for specific performance and damages.

11. SELLER'S DEFAULT. Upon default by Seller, Buyer, at its option, may (i) treat this Agreement as terminated and be entitled to the return of the deposit, or (ii) enforce this Agreement and pursue any and all remedies available at law or equity, including an action for specific performance and damages.

14. BROKER'S COMMISSION. Seller and Buyer promise that they have not dealt with any broker or finder in connection with this sale. In the event of any claim by any broker or finder, the party who procured such broker or finder will pay the claim in full.

15. ATTORNEY'S FEES. In the event of any litigation or other proceeding between the parties relating to this Agreement, the prevailing party shall be entitled to recover all costs and expenses incurred, including reasonable attorney's fees.

16. ENTIRE AGREEMENT. This Agreement contains the entire agreement and understanding between the parties. This agreement shall be binding upon the heirs, personal representatives, successors and assigns of both the Seller and Buyer. This Agreement may only be amended in writing and signed by both parties. Time is of the essence in the performance of this Agreement.

17. GOVERNING LAW. This Agreement shall be governed by and enforced in accordance with the laws of the state of *[add in your state] If jurisdiction should be exclusive in a state or county, state it in the document.*

18. SPECIAL PROVISIONS: [Any special provisions between the parties should be listed here.]

Signature: acceptance of terms by parties giving mutual assent

SIGNED THIS *10th* day of *January*, 20*11*.

Jan 10, 2011	*s/ Robert Wynn*
DATE	SELLER
Jan 11, 2011	*s/ Dennis Beerely*
DATE	PURCHASER

[Always check laws of state to determine whether the signatures of the parties need to be witnessed or acknowledged.]

SUMMARY

2.1 A contract is an agreement between two or more parties for value that is legally enforceable. All contracts must have six elements to be binding. The elements are offer, acceptance, consideration, mutual assent, capacity, and legality. Another element to consider is proper form, such as under the Statute of Frauds.

2.2 Contracts can have different classifications: (1) bilateral and unilateral; (2) express and implied; (3) executed and executory; (4) void, voidable and unenforceable and (5) formal and informal. In a bilateral contract, the parties exchange a promise for a promise, whereas in a unilateral contract only one party makes a promise, with the other party required to do some act in return. An express contract is one that is specifically stated. It can be oral or written. An implied contract, however, may be one of two types. There is an implied in fact contract, which is inferred from the facts and circumstances of the transaction, or an implied in law contract, which is court created. Contracts may be executed contracts, which are fully performed contracts, or executory contracts, in which a condition or promise has not been performed by one or all of the parties. Another classification distinguishes void, voidable and enforceable contracts. A void contract has no legal effect and can never become a contract; whereas a voidable contract can be canceled or avoided by one of the parties. An unenforceable contract is one that may have all the elements of a contract, but because of a formality or supervening event, such as the passage of a statute, the contract is unenforceable. The final category is formal and informal contracts, which a formal contract requiring the parties to fulfill certain legal formalities. An informal contract, in contrast has no special legal requirements. It focuses on the intention of the parties.

KEY TERMS

promisor
promisee
legalese
offer
offeror
offeree
mutual assent
acceptance
consideration
capacity
legality
Statute of Frauds
bilateral contract
unilateral contract
express contract
implied in fact contract
implied in law contract
quasi contract
unjust enrichment
quantum meruit
executed contract
executory contract
void contract
voidable contract
disaffirmance
seal
formal contract
informal contract

REVIEW QUESTIONS

1. State the definition of a contract.
2. What are the formal terms for the parties to a contract?
3. What is the difference between an offeror and an offeree? Promisor and promisee?

4. List the components of a contract.
5. What statute determines whether a contract needs to be in writing?
6. Define a bilateral contract and a unilateral contract.
7. What is an implied in fact contract? Distinguish it from a quasi contract.
8. What is the difference between an executed and an executor contract?
9. How are formal contracts different from informal contracts?
10. List the classifications of contracts.

EXERCISES

1. List five examples of an implied contract from your daily life.
2. Holly receives a text message from the Sumptuous Cookie Company letting her know that the cookie company delivers freshly baked cookies right to your door step. A week later Holly notices a small colorful box on her front porch from the Sumptuous Cookie Company. She opens up the box and sees a dozen double fudge chocolate cookies. Not wanting the cookies go to waste, she and her family eat them. A week later she receives another box of cookies. This time they are peanut butter fudge. But, this time there is a bill for two dozen cookies in the amount of $37.00 plus a delivery charge of $10.00. The owner of the company texts Holly requesting payment for the cookies. Holly refuses. Does Holly owe Sumptuous Cookie Company any money? Is there a valid contract between the parties? Explain in detail your response.
3. In the letter below, identify:
   a. Is it a valid contract? Why or why not?
   b. Who are the parties?
   c. Are all the elements of the contracting process (Exhibit 2-1) present?
   d. What do you think will happen to the agreement if Wood sells the garage?

September 30, 2011

Dear Mr. Whitney,

Please feel free to store your Toyota Highlander on the left side of the garage at any time and for as long as you wish free of any charge whatsoever. Am enjoying your lovely and handy TV stand. Will give your key to the garage attendent so if you wish to start car or work on it, you can. There's a light switch on left near the door.

Regards,
Erison L. Wood
Owner, Wood's Repair & Company

4. Carmen places an advertisement in the local newspaper to sell her collection of antique dolls for $5,000 cash. Marvin Hollister sees the advertisement and thinks this would be a great present for his wife for her birthday. He goes to Carmen's house and knocks on the door, but no one answers. He leaves his business card with a note saying that he is interested in purchasing the dolls and to call him. Carmen never calls. Carmen has the dolls delivered to his office. Has a contract been created between Marvin and Carmen? If so, what kind of contract has been created?

5. The following scenarios may create different types of contracts. Identify the type of contract created and give an explanation to support your position.
   a. I promise to pay $300, if you clean up the garage.
   b. If you clean up the garage by 5:00 p.m., I will pay you $300.
   c. I promise to pay you $300 for your promise to clean up the garage.
   d. I cleaned up the garage yesterday.

6. Answer the following true/false questions:
   a. All contracts must be in writing to be enforceable.
   b. A bilateral contract is an exchange of promises.
   c. A contract may be both express and executed.
   d. A quasi contract prevents unjust enrichment.
   e. Consideration consists only of money.
   f. When an offeror communicates an offer to an offeree, a contract is formed.
   g. A contract must have a legal purpose.

7. It is strawberry season, and Franny sees a sign to pick strawberries for $2.00 a quart. Franny decides that picking strawberries sounds fun, so she stops by the farm and picks 6 quarts of strawberries. What kind of contract has Franny created with the farm? Explain your answer.

8. Brian decided that he wanted to build an addition to his house, a new family room to be exact. He contacted Better Builders, Inc. to do the construction. After some discussion, Brian and Better Builders decided to execute a contract. None of the work was due to start until 30 days after both parties signed the contract. What type of contract has been executed and why?

9. Using the facts from exercise 8, Better Builders has prepared the design drawings for the new family room. However, before the work was scheduled to begin, Brian loses his job and decides not to build the family addition. Is there a valid contract between the parties? Provide support for your answer.

10. Every Saturday, Mica, who is 17 years old, walks the Norris family's golden retriever, Rex. She has been doing it for two years. Last week, Mica walked Rex as usual, but Mrs. Norris didn't leave her the $30.00 she normally leaves on the kitchen counter. The next day she calls Mrs. Norris and suggests she must have forgotten to leave her pay. Mrs. Norris tells her that she didn't forget, but that she no longer needed her services. Did Mica and Mrs. Norris have a contract? If so, what type of contract? What are some of the issues that arise based upon the facts in this scenario?

CASE ASSIGNMENTS

1. Your attorney just received a call regarding a new contracts case. He wants you to find some examples of straight-forward real estate purchase and sale agreements and a basic construction contract for house renovations. He thinks that the property his clients want to purchase needs some work because there was some discussion that the house was a "fixer-upper." In preparing for the meeting with the client, find at least three examples of each so your supervising attorney has some choices when he begins drafting the contracts after the client conference.
2. You are preparing for a meeting with a new attorney in your office. He wants you to perform some legal research for a case he has been working on. He needs some authority in your jurisdiction that defines a bilateral and unilateral contract. Apparently, the case is a bit tricky, and he really needs to know how the law in your state interprets these issues. Prepare a memorandum for the attorney citing the case law in your jurisdiction. (Since you do not have any facts, prepare a general memorandum discussing the legal distinctions and concepts of bilateral and unilateral contracts only.)

Chapter 3

Formation of a Contract: Offer and Acceptance

Just Suppose . . .

You're watching television and see this soda commercial that offers free merchandise simply by collecting "Soda Points." The commercial shows a young man relaxing on his fifty-foot yacht in an azure blue sea clearly enjoying himself. As the commercial ends, the following tag line is displayed: GRAND YACHT . . . 700,000 Soda Points. Well, you think, that seems intriguing. The commercial prominently mentions a "Soda Catalog," which presents items with their equivalent point total for purchase from the promotion. You acquire a copy of the catalog. Within the catalog are items with their associated point equivalents. There is an option also to buy "Soda Points" for 15 cents, but this must be accompanied by at least twenty original "Soda Points." Evaluating the situation, you initially believe you can consume enough bottles of soda to acquire the yacht, but soon realize that you would have to consume massive amounts of soda for the rest of your natural life. So, you devise a plan "B." You decide you can buy "Soda Points" and purchase the yacht for $700,000—a fraction of its real value. Although the catalog does not have a yacht, you fill out the order form, submit the $700,000 check and wait for your yacht. The company writes you back and states that the commercial was just that—a commercial, an advertisement—and sends you back your $700,000 check. Not happy, you write them back and state that they made an offer, which you accepted. The company did not respond. Your next stop is the courthouse; you want your yacht. That commercial was definitely an offer, at least, so you thought!

Outline

Of course, our fact scenario at the beginning of the chapter sets the stage for the subject of this chapter: What constitutes a valid offer and acceptance? As we explore the topic, we will begin to understand that a seemingly simple question does not always have a simple answer. What I may think is an offer, you may consider a mere invitation or solicitation. Conversely, what I may intend to be only an invitation or solicitation, you may consider to be an offer for which you have the power to accept. You will learn that it is not what you or I believe in our "subjective minds," but rather what "objective minds" conclude when evaluating the facts and circumstances surrounding the making of the actual offer. Would a "reasonable person" (yes, that is our elusive legal standard) believe that an offer is being communicated that is sufficiently definite to accept? The answer is easy, right? If it were so easy, there would be no conflicts that courts must decide. The simplest facts may produce the most complex, and often confusing, of results as you will see.

3.1 AN OFFER OR PRELIMINARY NEGOTIATION: WHAT IS IT?

offer
A proposal made with the purpose of obtaining an acceptance, thereby creating a contract

offeror
A person who makes an offer

offeree
A person to whom an offer is made

The contracting process develops in stages, with the first stage being the offer. An **offer** is a communication by the **offeror** to another party, the **offeree,** of an intent to be bound to a contract. The *Restatement (Second)* of contracts § 24 defines an *offer* as:

> The manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to the bargain is invited and will conclude the bargain.

Critical to the definition is the intent of the party making the initial offer. Unless the offeror has the requisite intent to be bound to the proposed bargain, an offer will not follow. As case law developed, courts evaluated the "objective" intent—an intent that could be independently determined by actions of the offeror through what the law refers to as the "reasonable person" test as opposed to the parties "subjective" intent. At this point, surely you must be wondering how can you objectively define what a "reasonable person" may think or believe. Courts often struggle with this term (as do I), but there has developed a way to determine what is considered reasonable in evaluating whether an offer—and ultimately the acceptance—has been communicated.

The Objective Test: Who Is That "Reasonable Person?"

In areas of the law, such as torts and contracts, courts (and professors) often refer to the elusive "reasonable person." The reasonable person standard suggests that words, conditions, and even time periods are given their ordinary meaning and not a technical one. It is the meaning that an ordinary reasonable person—like you—would understand the terms to be. For example, when someone fills out a health insurance policy where the company is offering coverage, the policy more than likely requires that the applicant be in "good health." Having the occasional headache would normally not affect what we would consider to be "good

health," but someone who suffers from chronic migraines may be a different story. The company would apply a "reasonable person" standard to the definition of "good health." There is no "subjective" interpretation of "maybe it was" or "maybe it wasn't." The action of the party or parties shows that no matter who views the actions or communications, a legal intent exists. With the law, the theory is often much more difficult to put into practice.

In short, has the offeror communicated a belief to the offeree that would induce the offeree—the reasonable person—to belief that an offer was transmitted? What you are looking for in the offer is precision, definiteness, and specificity without which an offer cannot be created. Let's use our fact pattern from the opening of the chapter. First, who is our potential offeror? The soda company. Second, what is the offer that is being communicated: Acquire or buy points to purchase merchandise from the soda company's catalog. Third, does that communication include an offer to purchase a multimillion yacht for a fraction of its price? Ah, the question then becomes would a reasonable person believe that the soda company offered to "the public" a yacht for a sum substantially less than its value and merchandise not found in its catalog. Applying an objective standard to the facts, you would have to conclude that there was not a valid offer communicated by the soda company. No one would believe that (1) the company would offer something that it would lose millions of dollars on and (2) realistically in order to purchase the yacht incomprehensible amounts of soda would have to be consumed—over 150 bottles per day for at least 100 years. No reasonable person could believe that the television commercial was a valid offer.

Offeror Must Have Objective Intent

As our discussion from the previous section suggests, the first question that must be asked is whether the offeror has a serious—objective—intent regarding the offer or is simply testing the waters through preliminary negotiations. **Preliminary negotiation** is discussed in the Restatement (Second) of Contracts § 26 as follows:

preliminary negotiation
Parties who commence the contracting or bargaining process. A form of solicitation

> A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain.

Preliminary negotiations are considered a form of solicitation and normally will not constitute an offer. Lacking is the commitment of a promise by the offeror to be bound to an offer. Assume that a student is considering selling some old textbooks. She places a sign on a kiosk saying, "Am interested in selling my old textbooks, would consider around $10 a book." A second student contacts the first student and says, "I will take all your books for $10 a book." This situation does not create an offer. The first student was only soliciting bids from people. A firm promise or commitment does not exist; there is no intent. Now, let's change our example slightly. The sign now states: I want to sell my old textbooks. I will sell each book for $10.00. An offer is created. The student is offering each used textbook for the price of $10.00. This offer is clear and passes our "objective" intent test.

The common law rule is clear that an offeror must intend to be bound to the contract. If the intent of the offeror is lacking, the assumption is that an offer did not exist. The tricky part is determining a party's objective intent to make an offer and begin

the contract process, as opposed to a mere proposal or even making an offer in jest. Following our reasonable person test: Would a reasonable person in the offeree's position believe that the offeror intended to be bound to a contract?

Proposals or Invitations

Simply stated a proposal or invitation is not an offer. It does not possess the required intent to constitute a valid offer. A typical place that you will see proposals or invitations for offers is in the procurement and construction arenas. Usually, an offer to bid on something or bid on a project occurs. The question invariably becomes at what point, if at all, was an offer created.

EXAMPLE: Carl has a concrete company and needs to hire some companies to buy sand. He faxes to five companies the following: "Need your best price for supplying sand for my concrete company. Respond in writing no later than Friday at 5 p.m." Carl receives five responses. One of the companies, Tropical Sand and Gravel, sends a truck full of sand and asks Carl where to unload the sand. Carl says that he has not ordered any sand from Tropical and sends the trucker back to his employer. Was an offer made? The answer is no. There was only a solicitation from Carl to the five companies. Carl was just making an inquiry. At this point, he can accept or reject all the responses.

EXAMPLE: Same facts as above, except that Carl faxes to Tropical Sand and Gravel the following: "Received your response and want 2 tons of sand for your stated price. Need the sand immediately." Tropical faxes Carl back and states, "It is on its way." Carl has made an offer. Applying the objective intent standard, Carl has made an offer which Tropical now can accept.

Offers Made in Jest

It is no surprise that an offer made in jest does not meet the tests required to instill in the offeree the power to accept the offer. The basis for this is that the offeror did not have the requisite intent to be bound by the offer. How many times have we heard someone cry in frustration when their computer freezes up or does something unexpected? If you were to say to one of your friends, "Man, if someone would give me $20 bucks for this piece of junk computer, they can have it!" You pull out $20.00 from your pocket and say, "Here, I'll take it!" Is that a valid offer? Of course not! But, is there an offer in the fact pattern below?

State Your Case

You are studying late at the library one night and your computer screen goes blank. You are furious and say to your friend: Hey, want to buy my laptop for $50.00? Although your friend thinks you are insane, he takes out $50.00 from his pocket and says, "Sure, I'll take it!" You pocket the $50.00. After you have calmed down, the next day, you attempt to return the $50.00. Is that a valid offer for the laptop?

Line of Reasoning

Perhaps one of the most famous contracts case that deals with offers made in jest is *Lucy v. Zehmer*, 196 Va. 493, 84 S.E. 2d 516 (1954). It is an old case, but the principles enunciated from the case still hold true today. In that case, two friends are drinking at a bar. Mr. Lucy had always wanted to purchase Mr. Zehmer's farm, known as the Ferguson farm. Lucy offers Zehmer $50,000 and says, "I bet you wouldn't take $50,000.00 for that place." And Lucy replies, "Yes I would too; you wouldn't give me fifty." So, Zehmer gets one of those "restaurant guest checks" and writes on the back "I do hereby agree to sell to W.O. Lucy the Ferguson Farm for $50,000 complete." Mr. Lucy then says that he had better get Mrs. Zehmer's consent on the agreement, too. Zehmer tears up the restaurant check and executes a new one adding that "we" sell the Ferguson Farm to Lucy and has Mrs. Zehmer sign the back of the restaurant guest check as well. Lucy even tried to give Zehmer $5 to bind the deal, but Zehmer refused basically saying that the whole thing was in jest and that he was "as high as a Georgia pine." Zehmer said that the two were "just a bunch of two doggoned drunks bluffing to see who could talk the biggest and say the most." Later on Lucy tries to enforce the contract that the parties executed that night at the bar. Zehmer says they he was drunk, and he had no intention of selling the Ferguson Farm to Mr. Lucy. The Court agreed with Mr. Lucy and enforced the handwritten offer and acceptance as a contract—even with the alcohol consumption. The key to the court's reasoning was that Mr. Zehmer had done too many deliberate actions indicating that he was not so intoxicated to not know what he was doing. The court found an offer had been made, creating an enforceable contract even though it was written on the back of a restaurant guest check and after claims of drunkenness.

Questions for Analysis

Read *Lucy v. Zehmer* and pay close attention to the court's reasoning. After reviewing the case compare it to a recent case *Leubbert v. Simmons*, 98 S.W. 3d 72 (Mo.App. W.D. 2003). Was the reasoning in *Lucy v. Zehmer* followed by the Missouri court? What issues were similar in *Leubbert* and what were the salient points that the Court determine were critical in reaching its final result? Did the Lucy case apply the "objective" or "subjective" theory of contracts? Support your response.

State Your Case

Applying the principles of *Lucy v. Zehmer*, what if Zehmer had written his offer on Lucy's arm, would that have been an offer? What if Zehmer had written the offer on his shirt where both he and his wife signed the shirt? Let's modify the facts of the *Lucy v. Zehmer* case and assume that Mr. Lucy offered $10,000 for the Ferguson Farm and Mr. Zehmer had written the agreement on a napkin where he and his wife signed the napkin. Would the result change? Support you position using the facts and principles set forth in *Lucy v. Zehmer*.

Use caution in making offers that you do not intend to be taken seriously. As our examples and cases show, enforcement of a contract is based on the objective intent, and courts may enforce an agreement even if that was not your true intention. Oftentimes, it is the effect upon the offeree's understanding of the communication, along with a court's application of the objective test, which determines whether an offer exists.

Nothing is absolute, however. Some courts are revisiting the objective view of contracts and leaning toward a more subjective view. Be aware that this is a trend in some courts, such as West Virginia: *Sprout v. Bd. of Educ. of County of Harrison*, 599 S.E. 2d 764 (W. Va. 2004).

Terms of the Offer Must be Definite and Certain

Not only must an offeror have intent but also the terms of the offer must be sufficiently certain and definite so that the offeree knows what to accept. The more specific the terms, the higher the likelihood an offer exists. If terms are left out or the parties are still haggling over terms, the transaction will probably constitute a preliminary negotiation rather than an offer.

Unfortunately, what constitutes definite, clear, and certain terms is a question of fact for a judge or a jury. Sometimes the law sets out specific requirements, such as for real estate contracts, as to how definite an offer must be to be effective, but this is the exception and not the rule. To be safe, an offer should specify, at a minimum, the material terms, which are considered to be: (1) the parties; (2) the price; (3) the subject matter of the contract; and (4) the time of performance of the contract.

The Parties. The persons intending to be bound to a contract should be clearly identified. There should be no question as to who the offeror and the offeree are and thus who will ultimately be responsible under the contract. Failure to identify the parties in an offer is fatal to the process.

EXAMPLE: Harry offers to sell to Robin his 1970 Ford Mustang for $15,000. One of Harry's friends William overhears the conversation and says, "I'll take the Mustang for that price." Can William accept Harry's offer? No, the offer was directed to Robin and only Robin had the power to accept the offer from Harry.

An offer does not have to be directed to one party. It can be directed to a group of people or the public, such as in a classified advertisement. The important question is what the offeror intended and what the conduct indicated in making the offer. If Harry had posted the offer on a kiosk at his university and William saw the offer, William could accept if he met the price. Harry, as the offeror, did not direct the offer to a particular person.

The Price. The specific price the parties intend to pay for the subject matter of the contract is important. Under the common law of contracts, the law does not permit the price term to be uncertain and negotiated at a later date. The offer must contain the specific price, or the offer will be considered merely an invitation to negotiate or a preliminary negotiation, but not an offer.

EXAMPLE: Harry has a conversation with Robin that he would like to sell his 1970 Mustang. She says, "I'll buy it." Has Harry made a valid offer to Robin? No, Harry has not stated a specific price and was merely having a conversation that could be interpreted as an invitation to negotiate or a preliminary negotiation.

In later chapters, we will discuss the Uniform Commercial Code—U.C.C.—and how it interprets the terms of a sales contract. There are many variations in the U.C.C.'s interpretation of the common law rules of contract formation. Specifically, it should be noted that price terms under the U.C.C. need not be certain for a definite offer to exist. Distinctions between the common law and the U.C.C. are essential when determining whether an offer exists. For example, if a transaction involves the sale of goods, usually the U.C.C. applies; otherwise, the rules of common law will apply to the transaction. As discussed in Chapter 1, you will have to determine whether the common law or the U.C.C. applies to a transaction. This becomes important as the results are often different depending on whether the contract falls under common law standards or the U.C.C.

The Subject Matter. Certainty of the subject matter is a requirement for an effective offer. The subject matter must be easily identifiable and not subject to question. How specific the identity of the subject matter must be depends on the subject matter itself. Real estate requires substantial detail, whereas an offer for the purchase of an iPod would probably require less. Statutes may dictate how definite the subject matter of the offer must be, so the best rule to follow is to be detailed enough so that reasonable persons could not differ on the subject matter of the offer.

EXAMPLE: Jay offers to sell Bill his classic Mustang convertible for $5,000. Jay has two classic Mustang convertibles, one worth over $10,000. Since Jay was not specific with the "subject matter" of his offer, Bill could not accept because the subject of the offer was indefinite. Had Jay offered to sell Bill his 1970 classic red Mustang for $5000, those terms would be sufficiently definite unless of course both of Jay's Mustangs were both red and from the year 1970.

Output and Requirements Contracts: An Exception

output contract
Contract where seller/offeror agrees to sell all its product to one buyer/offeree

An **output contract** is one where the seller or offeror promises to sell all of its production to a designated buyer/offeree. That means for example, that as a seller and producer of potatoes, it is agreed that whatever is produced, the buyer will purchase. The subject matter is indefinite regarding the exact quantity. Neither the seller nor the buyer knows exactly the amount of potatoes that will be produced. Each party is relying on the other to act honestly or as the legal term denotes in "good faith." Good faith between the parties is implied when both parties have a legal duty to act properly. This tells us that the seller cannot then sell his production of potatoes to another buyer for a higher price since he has already entered into an agreement with the buyer.

requirements contract
Contract where buyer/offeree agrees to purchase all required supply from seller/offeror while contract in force

A similar concept in the reverse is a **requirements contract**. In a requirements contract, the obligation focuses on the buyer rather than the seller. The buyer agrees to purchase "all his requirements" from a specific seller. Suppose in our previous example, our buyer agrees to purchase all the potatoes required for his fast food business and seller agrees

to supply the buyer with the "amount of potatoes he needs." That would be a requirements contract. The seller does not have to sell his entire "output" to this buyer and can contract with other buyers so long as the seller can meet the first buyer's requirements.

EXAMPLE: El Paso Oil, Inc., needs drill bits and agrees to purchase "all it requires for one year" from Oil Parts Suppliers Corporation (requirements contract).

Oil Parts Suppliers Corporation agrees to sell to El Paso Oil, Inc., all the drill bits it produces for one year (output contract).

The Time of Performance. When the parties perform their obligations could be critical to the transaction, such as in a construction contractor or real estate transaction. Often parties will specify a date for performance and set conditions if the performance is not met. Offers are not open indefinitely. Many offers do impose a time period for which the offer remains open. When a time period is not specified, a "reasonable time" period will be inferred. This is the standard under common law contracts. Each transaction will dictate what is considered reasonable, or the time will be determined by case law.

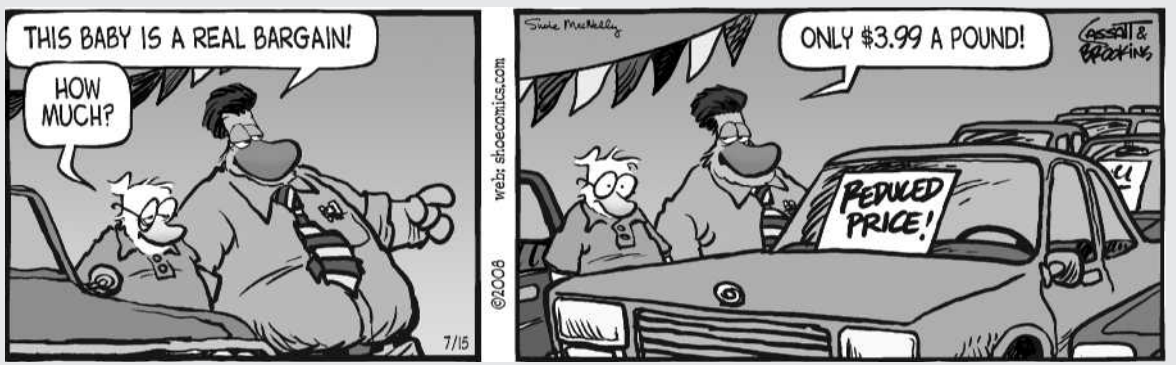
Offers also may include a "time of the essence" provision. This provision sets forth the specific requirements for the time of performance and any deviation from that performance may result in either rejection of the offer by the offeree or in the case of a contract, a **breach.** The most common place you will see "time of the essence provisions" is in the sale of real estate. In these contracts, there actually will be a provision that states as part of the offer that "time is of the essence," and that unless the transaction is closed within the specified period of time, the offer either is revoked or expires.

breach
Failure of a party to perform contract obligations

EXAMPLE: Sam wants to sell his house as soon as possible as he is moving from Texas to Missouri for a new job. Tom and his wife, Hannah, want to purchase Sam's house and make an offer that Sam accepts. As part of the offer, Sam has stated that the house must close within thirty days of the offer, no exceptions. Tom and Hannah apply for a loan at the bank but the bank is requiring additional paper work from the couple. On the thirtieth day, Sam and Hannah still do not have an answer from the bank. Since the offer had a time provision set that was specific, the offer is no longer valid and Sam is free to pursue other buyers of his house.

State Your Case

Memorial Ambulatory Center and Cardio Services want to enter into a service contract where Cardio Services will perform, 24 hours a day, all echocardiograms that Memorial needs for its patients. The language of the contract is as follows: "Cardio Services agrees to perform all echocardiograms required by Memorial during the term of the contract." Memorial wants to use the services of another company in addition to Cardio Services. Does the above language create an offer that is sufficiently definite or is it an invitation to negotiate? Could this language create an output or requirements relationship between the parties? Consider all aspects and support your response based on the concepts discussed thus far.



SHOE © 2008 MACNELLY, KING FEATURES SYNDICATE

Offeror Must Communicate Offer

An offer cannot be valid unless it is communicated to the offeree. The offeree must know of the offer in order for there to be a power of acceptance. This observation may seem inane, but look at it in the context of a reward. Assume that the Hilliard children's pet turtle escapes his cage. The family is frantic. They post on one of the trees at the end of their street a sign offering $50.00 for the safe return of Charlie, their pet turtle. Two days later, one of the neighbors comes by and says that Charlie has wandered into their yard. Grateful, the Hilliards rush to the neighbor's house to pick up Charlie. Can the neighbor claim the $ 50.00? No, the neighbor knew nothing of the offer, which makes him ineligible to accept and receive the $50.00. The law requires that the offeror communicate the offer and that the offeree know of the offer's existence for there to be a valid power of acceptance.

Advertisements and Solicitations

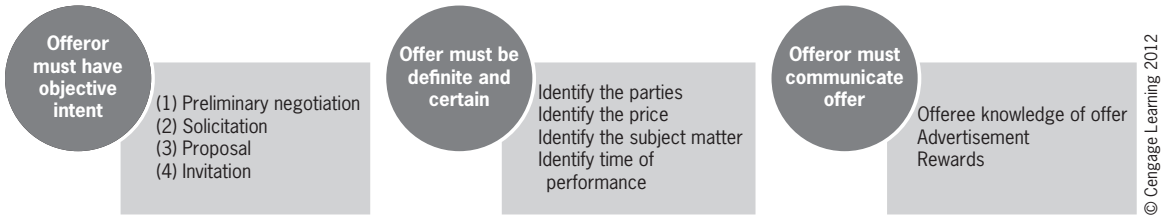
Some offers appear to be offers, but are treated as invitations to make offers. An advertisement is a typical example of an invitation to make an offer, also known as a preliminary negotiation. An advertisement is not generally found to be an offer, because it lacks specificity and definiteness of terms. On the surface, an advertisement suggests a desire to enter into a contract, but the law has construed advertisements as mere **solicitations** or invitations to negotiate.

solicitation
Invitation to negotiate a contract

Typical advertisements lack certainty as to quantity and the number of intended offerees. With the advent of consumer protection legislation in many states, however, advertisements are becoming more specific and closer to real offers. Today's advertisements often state a specific item; limited quantity, price, and model number; and set a time period for the advertisement to remain in effect. Any question as to whether the advertisement has the needed material terms to constitute an offer is erased. Recall our

case at the beginning of the chapter, could the advertisement by the soda company be considered an offer which could be accepted. No, a court would definitely construe the advertisement as a solicitation because the terms and conditions were not reasonable, at least to the "average" person. See Exhibit 3-1 for the requirements for a valid offer.

EXHIBIT 3-1 Requirements for a valid offer



Line of Reasoning

An early and classic contracts case dealing with the advertisement problem is *Lefkowitz v. Great Minneapolis Surplus store, Inc.,* 251 Minn. 188, 86 N.W.2d 689 (1957). In that case, the retailer offered for sale a certain fur coat. (Remember, the case was in 1957; wearing fur did not have the connotations that it has today!) The advertisement offered on a first-come, first-served basis three brand new fur coats for $1.00. Mr. Lefkowitz was the first to respond to the offer and indicated his willingness to pay the $1.00. The company refused to sell Mr. Lefkowitz the coat as the company claimed that the "house rules" provided that the offer was intended for women only (even though it was not specified in the advertisement). Mr. Lefkowitz tried a second time to purchase the coat, even knowing the "house rules." He eventually sued the retailer. The court held that the offer was sufficiently definite, clear, and explicit for Mr. Lefkowitz to accept. The court's decision was in favor of Mr. Lefkowitz. This case is the hallmark upon which most advertisement cases are evaluated. The key in this case was the specificity of the offer and its failure to limit acceptance to a specific group.

Questions for Analysis

Review the *Lefkowitz* case. Would the results have changed had the fur company stated in its advertisement the offer is limited to women only? Since Lefkowitz knew the "house rule," was the court correct in finding a valid offer was made? Why or why not?

State Your Case

Compare the advertisements in Exhibit 3-2 and determine which one is a solicitation for an offer and which one could be construed as an offer. What terms could be added to each advertisement to make it a valid offer? Who are the offerees in the advertisement? What kind of contract is created if an offeree accepts?

EXHIBIT 3-2

Advertisements for companies

Advertisement A	Advertisement B
HOLIDAY SALE **iPODS $99.95** Quantities Limited First Come – First Served* No rain checks for this product. All sales final.	**HOLIDAY SALES EVENT** **ALL iPODS $99.95** Any color Model #A1263B2124 Quantities Limited to 10 Hurry While Supplies Last

Cybercises

Find five advertisements from some of your favorite retail Web sites. Analyze whether the advertisements constitute offers and state the basis for your conclusions.

3.2 ACCEPTANCE OF THE OFFER

acceptance
The assent by the person to whom an offer is made

Once an offer is communicated, it can be accepted. The **acceptance** is the response by the offeree to the offeror of an intent to be bound to the terms set out in the offer. Only the person to whom the offer is directed has the power to accept. Unless a party knows of the offer, that party has no power of acceptance.

An acceptance by the offeree of the offer may be written, oral, or implied. Each mode of communication has a common thread: it must be unconditional and unequivocal-there can be no question as to the offeree's intent.

Written Acceptance

The offeree may respond to the offeror in a written communication. This form may be an appropriate method of acceptance, but a caveat arises when an offer states a specific manner of acceptance. If the offer states a particular manner of acceptance, then, to be effective, the acceptance must comply with the terms of the offer. This is a stipulation that effectively sets limitations on the acceptance. For example, assume that Mr. Williams has made the following offer to Ms. Henson:

January 5, 2011

Dear Ms. Henson:

I need 10 paralegals to work on a special project for thirty days beginning March 1, 2011. I will pay $20.00 an hour. Please respond to me only by fax or certified mail by February 1. If I should need to extend the project, I will notify you on the third week of the project.

Sincerely,

Mr. David Williams

This example limits the mode of acceptance. If Ms. Henson replied through another method, such as express mail or e-mail, the acceptance would be ineffective.

Let's change the Williams example. If the offer by Mr. Williams ended by stating only, "Please respond," this would allow the offeree to communicate the acceptance in whatever method she chose. Because no time for the response is stated, a reasonable time period would be implied. The best tactic for Mr. Williams to use to avoid any ambiguity is to specify both the mode of acceptance and the time period for acceptance. Otherwise, the offer is open for an indefinite period of time, with no specific medium for acceptance, and the offeror is clearly placed at a disadvantage.

The Mailbox Rule

mailbox rule
Rule in contract law that acceptance of an offer is effective upon dispatch (i.e., mailing) by the offeree and not upon receipt by the offeror

When an offer is communicated by mail, the acceptance can be made through the same medium—the mail. The **mailbox rule** states that when an offer is communicated in the mail, the acceptance is effective upon deposit in the mail, regardless of receipt by the offeror. This rule can have chaotic results, as the offeror may not know that any offer has been accepted and revoke the offer prior to receiving the acceptance. The revocation is effective upon receipt by the offeree, but the acceptance is effective upon deposit in the mail, regardless of receipt by the offeror. Therein lies the problem with the mailbox rule.

Because the mail is often an unpredictable mode of communication, it is wise for the offeror to set out conditions or a stipulation for the acceptance. A better method to control or obviate the mailbox rule is to state in your offer a time period for acceptance. For example, state in your offer, "The acceptance must be received by the offeror by 5:00 P.M. on March 1, 2011."

Line of Reasoning

There are not many recent cases that address the mailbox rule. *American Heritage Life v. Koch*, 721 S.W.2d 611 (Tex. Ct. App.-Tyler 1986) is a good example of how it works. The results may surprise you. In the this case, Mrs. Koch wanted to recover $50,000 from an accidental death insurance policy issued to Mr. Koch by American Heritage. On February 24, 1984 Mr. Koch enrolled in a group insurance policy that provided for $100,000 in accidental death benefits. Sometime in 1985, the insurance company sent Mr. Koch a premium notice that included an application to increase his death benefits by $50,000 to $150,000. Mr. Koch signed the application on March 26, 1985 where his wife mailed it with a check on March 29. The application and check were sent to American Heritage's agent. The agent received the application and check on April 3. The application contained a provision that stated increased coverage would "become effective upon the first day of the month following the receipt of my premium payment." Mr. Koch died in an automobile accident on April 16. The insurance company paid $100,000 and not $150,000. Mrs. Koch sued stating that the coverage became effective on the day it was placed in the mail. In her arguments, Mrs. Koch relied on the mailbox rule asserting that her coverage became effective on March 26 since she used the mail as her agent. The court rejected this argument and stated that although the mailbox rule states that an acceptance is effective upon depositing in

the mail if the offer is made by mail. However, when the offer has a condition or stipulation that the acceptance must be "received" prior to acceptance, the stipulation supersedes the mailbox rule and does not apply. The plain language of the offer sets forth the terms and conditions, the acceptance was not effective until May 1, which was after the death of Mr. Koch. The court ruled in favor of the insurance company.

Questions for Analysis

Review the *Koch* case. What is the important lesson learned by the Koch case? Would the decision have been different if the agent received the application and the check in his office on March 31, but did not open it until April 3? Suppose that March 31 was Good Friday and the agent had the day off. Would that fact change your response, and if so, why?

Communication of the acceptance by the same mode used by the offeror is effective when delivered through that same medium (e.g., if the offer is by e-mail and the acceptance is by e-mail, the acceptance is effective when transmitted). However, if the acceptance is by a different medium than that used by the offeror, the acceptance is effective upon receipt by the offeror. Using the Williams example again, suppose that the offer did not stipulate a manner of acceptance. If the offer was faxed and the acceptance was mailed, the mailbox rule would not apply, and the acceptance would be effective only upon receipt by the offeror, not upon dispatch. For an offeror, controlling the method of acceptance is critical, and it can later also avert headaches and legal hassles. Therefore, the mailbox rule can be averted by merely setting a specific mode of acceptance instead of leaving it open.

Oral Acceptance

An acceptance may be communicated orally as well as in writing. When negotiating face-to-face, a verbal acceptance of an offer is effective. When the offeror hears the words "I accept" or a similar expression of assent, the acceptance is effective. This proposition applies when the telephone is used as well. When the offeree utter words of assent, the acceptance is effective at that moment. Suppose that an offer is communicated by telephone and the offeree contacts the offeror within the time period specified and responds affirmatively to an answering machine or voice mail. Is that considered the same mode of communication? The courts have not decided this issue, but arguably it is the same mode of acceptance.

Implied Acceptance

An offeree's acceptance may be accomplished by performance by the offeree. Some believe that lack of communication or silence is assent to an offer. This is not the case. Unless both parties agree, silence is not normally considered an acceptance of an offer. If that were the case, imagine how the law of contracts would be turned upside down! This would place too much burden on the offeror.

There are exceptions to the rule, however. The Restatement (Second) of Contracts § 69 sets out three situations in which silence constitutes acceptance:

1. Where an offeree fails to reply to an offer, his silence and inaction operate as an acceptance in the following cases only:
   a. Where an offeree takes the benefit of an offered service with reasonable opportunity to reject them and reason to know that they were offered with the expectation of compensation.
   b. Where the offeror has stated or given the offeree reason to understand assent may be manifested by silence or inaction, and the offeree in remaining silent and inactive intends to accept the offer.
   c. Where because of previous dealings or otherwise, it is reasonable that the offeree should notify the offeror if he does not intend to accept.

Line of Reasoning

In *First Texas Savings Association v. Jergins,* 705 S.W.2d 390 (Tex, Civ. App. Ft. Worth, 1985), Ms. Jergins entered a contest called the "5,000 Scoreboard Challenge." As required, she completed an entry form and deposited it with First Texas Savings Association. The winner of the contest received an $80 savings bond and four tickets to a Mavericks game. Another provision was that if the Mavericks held their opponent to 89 or fewer points, the winner would receive an additional $5,000 money market account certificate. Drawings were conducted monthly from October through March. Mrs. Jergins' completed her form and deposited it with the Bank on or about October 13, 1982. The Bank amended the rules and stated that in order to win the $5,000, the Mavericks would have to hold their opponents to 85 points or less. Sometime around December 29, 1982, Mrs. Jergins' form was drawn and notified that she had won. She went to a game between the Mavericks and the Utah Jazz. Upon receipt of the tickets, the Bank notified Mrs. Jergins of the change in the terms for the $5,000. The Jazz scored 88 points that night. Mrs. Jergins claimed her $5,000. The Bank refused to pay her. The issue before the Court was at what time was an offer made and unconditionally accepted. As the Court observed, all that was required of Mrs. Jergins was that she complete the form and deposit it with the bank. The Bank claimed that by accepting the tickets, she accepted the modification of the point total. The Court stated that was not the case. In its reasoning, the Court wrote: Jergins accepted what she was entitled to receive under the contract and patiently waited to see if she would be entitled to any further award. She in no way indicated an acceptance of the attempted modification of the contract. She was entitled to the $80 and four tickets when her name was drawn and [the bank] would have had no valid reason to refuse the reward regardless of whether Jergins protested the attempted modification. The law requires an acceptance, not a protest. *First Texas Savings Association v. Jergins* focuses on the terms of an offer and when an acceptance occurs. Here silence does not constitute acceptance by the offeree.

Questions for Analysis

Locate a copy of the *Jergins* case. What if Mrs. Jergins had deposited her form with the bank on November 15, 1982, would that have changed the result? Why or why not? What if the bank had stated on the box where Mrs. Jergins had deposited the completed form that all rules of

the contest are filed in the main branch of the bank. One of the terms of the offer was that the bank could change the rules without notice to an entrant? Would those terms or conditions have changed the court's result?

Notice in the *Jergins* case that once Mrs. Jergins had deposited her entry form, her acceptance was effective. A later change in the terms of the offer did not affect her, and for good reason. Imagine if an offeror did not like the terms of an offer created and decided to change those terms after an acceptance. If the law permitted this kind of conduct, the law of contracts would be in a constant state of chaos. The *Jergins* court had to enforce the original offer to preserve the integrity of contract law.

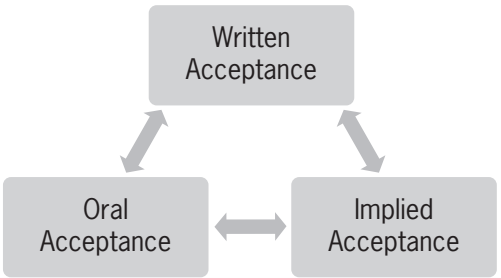
Mirror Image Rule

Whether an acceptance is communicated through writing, orally, or impliedly, under common law the acceptance must match the offer exactly. The rule is known as the *mirror image rule*. The rule states that an offer and acceptance must be exact. They must mirror each other, and any deviation from the terms of the offer is a counteroffer. A **counteroffer** is a new offer. Under the mirror image, it does not matter how slight the deviation or qualification is between the acceptance and the offer. The rule is interpreted strictly and, unless the counteroffer is accepted by the original offeror, an agreement is not formed. Exhibit 3-4 illustrates different forms of an acceptance.

counteroffer
A position taken in response to an offer, proposing a different deal; new offer

EXHIBIT 3-4

Types of acceptances



The U.C.C. has a different approach and has substantially modified the mirror image rule. If all the material terms are agreed to even though the offer and acceptance are not exact, a contract will exist. This rule is expressed in section 2-207 and discussed more fully in Chapter 12.

EXAMPLE Anna offers to give piano lessons to Margo's son on Thursday evenings at 7:00 P.M. for $50.00 an hour. Margo has PTA meetings on Thursday nights and accepts Anna's offer to give her son piano lessons, but on Wednesday night instead of Thursday. Margo's offer did not mirror Anna's offer and therefore could not create a contract.

EXAMPLE Simon wanted to give Kurt assistance in his budding singing career. Simon offers to represent Kurt for 25 percent of all his bookings for five years. Kurt accepts Simon's offer but

wants to reduce the percentage to 15 percent. Simon says "no." Kurt relents and offers Simon 20 percent of which Simon accepts. Kurt created a counteroffer of 20 percent of his bookings, which Simon ultimately accepted. A contract is created even though Kurt changed the offer.

TECH CHECK

The Internet introduces new aspects of the conventional offer and acceptance scenario. Prior to the electronic age, there usually was some form of direct communication between the parties. In the virtual world, we often times have no idea with whom we are contracting which presents new and interesting problems. How many times have you gone on a Web site to purchase a product and there is a long legal looking document that pops up before the retailer will allow you to continue on the Web site. You have to click "I accept" or "I agree" before you can proceed any further. And, of course you read every word of the agreement and fine print! If you do not accept the terms and conditions of the Web site, you are effectively barred from continuing. You have no real power other than to click "I accept" or find another Web site that does not have the same requirements. These types of agreements are known as **"clickwrap" agreements** and are basically a "take it or leave it" proposition. These agreements often contain onerous terms that leave the "offeree" or "accepting party" little, or no, choice. Cases involving clickwrap agreements and other Internet-based agreements are just starting to get court attention as they make their way through the system. At present, the law is developing in this area with cases and legislation being considered at both the federal and state levels. The best solution to understanding the issues surrounding an acceptance on the Internet and other electronic means is to monitor the development of the law, especially legislatively to determine how Internet contracting is being treated. Clickwrap agreements and other Internet-based contracts are discussed in detail in Chapter 16.

clickwrap agreement Internet contract that requires a person to click to accept online

3.3 TERMINATING THE OFFER: DIFFERENT METHODS TO END THE PROCESS

There are a number of ways to end the contract formation process, terminating the offer. Depending on the circumstances, offers can terminate upon the happening of certain events, by the action of the parties, or by the operation of the law. Each method results in the same thing: termination of the offer.

Cybercises

Find five Web sites that have "clickwrap" style agreements that must be accepted prior to proceeding on the site. Compare the terms and conditions of the agreements and analyze what is being accepted.

Action of Parties

Various actions of the parties can terminate an offer. Typical actions terminating an offer are a counteroffer, rejection, revocation, and expiration of time. What is important to remember is that an offer can only be accepted if it is still valid or alive. An offeree cannot accept an offer that is no longer effective.

EXAMPLE Franklin has been interviewing for a position at a number of banks. He receives an offer of employment from National Bank for a salary of $55,000 and benefits. In the offer letter, National states it will keep the offer open until April 10, 2011. He also

receives an offer from American Bank for $58,000 and benefits. He decides to accept the offer from American Bank and sends a letter of acceptance. After visiting the offices, he decides that National may be a better fit for him. He sends a letter of acceptance to National on April 12, 2011. National informs him that they have hired someone else for the position since he did not respond by the date set forth in the letter. The offer from National was no longer effective.

The Counteroffer

A change in terms, however slight, of the original offer creates a counteroffer. The power of acceptance is now switched, with the offeror having the power to accept the new offer. The formation process begins again, thus terminating the original offer. The common law is strict in its interpretation of deviations from the original offer. As previously discussed, any change in the terms of the original offer terminates the offer. Virtually no exceptions exist under this common law rule.

Line of Reasoning

A case between Princess Cruises and General Electric present some interesting issues. In *Princess Cruises v. General Electric*, 143 F.3d 828 (4th Cir. 1998), Princess needed a required maintenance inspection for one of its cruise ships. Since General Electric (GE) had performed the electrical and engineering on the ship originally, Princess decided to hire GE to perform the inspection. Princess sent GE its standard purchase order setting forth its requirements under the inspection with a "proposed" amount of $260,000. On the back of the purchase order were the terms and conditions of its offer. After review, GE countered with its own proposal offering to perform certain services for $201,888. After some discussion between the parties, GE realized that its proposal was in error and contacted Princess with a revised proposal for $231,925. The parties agreed, and GE submitted its proposal on its documents, which provided a number of terms different from the Princess purchase order. Those terms and conditions were a counteroffer to Princess' original offer on its purchase order. Princess verbally approved GE proceeding with the work where GE submitted the final proposal and limiting the contract to its terms and conditions which were set forth in its letter of confirmation. The work ran over the initial schedule because while cleaning a rotor, GE removed some of the good metal causing an imbalance in the ship. Because of this, Princess had to cancel an Easter cruise, costing it millions of dollars. One of the issues the court was faced with was what law applied: the common law or the U.C.C. But the main issue the court needed to resolve was which terms applied to the transactions and whether Princess had accepted the counteroffer of GE's terms and conditions which would govern the transaction. The Court held that Princess had accepted GE's counteroffer with the modifications of the contracts terms. The court remanded the case back to the trail court to revise the judgement in accordance with its opinion.

Questions for Analysis

Review *Princess Cruises v. General Electric*. What was the court's analysis in applying the common law instead of the U.C.C.? What facts were critical to the court finding for GE? How would the court's decision have changed had Princess objected to the different terms and conditions? Explain your answers.

Rejection

rejection
Any act or word of an offeree, communicated to an offeror, conveying his or her refusal of an offer

In effect, a counteroffer is a rejection of the offer. **Rejection** occurs when an offeree does not accept the stated terms of an offer. The negotiating terminates unless a new offer is communicated.

Rejection is a typical method to terminate an offer. An acceptance can be written, oral, or implied, and so can the rejection. Using the earlier Williams example, if Ms. Henson faxed a letter that stated, "I am in receipt of your offer, however, at this time I must reject it," this response would terminate the original offer.

A rejection can also be verbally communicated, either face-to-face or by telephone. Finally, a rejection may occur when the offeree's behavior suggests a nonacceptance. This is a more difficult and ambiguous situation.

EXAMPLE: Suppose James, an attorney, decides he wants to redecorate his office and update it with the newest electronics. He offers to sell you his desk and chair for $500. You, however, go out and purchase a new desk and chair. That action would, in effect, be an implied rejection of James' offer.

Revocation

revocation
A cancellation, or withdrawal of an offer

Prior to an offer being accepted, an offeror may withdraw the offer at any time. This act is known as **revocation.** Some acts or events invite revocation. Presume that an offer is communicated and that no acceptance has been received by the offeror. The offeror withdraws the offer by mail, and the offeree receives the withdrawal prior to acceptance. This constitutes revocation. The exception is when the acceptance has been mailed and the revocation has not been received by the offeree. Assume that Marc mails the offer to James on the 15th of the month. It arrives on the 16th. On the 25th, Marc mails a revocation, which does not arrive until the 28th. James mails his acceptance on the 27th. Because James mailed his acceptance before he received Marc's revocation, the acceptance stands. This illustrates another aspect of the mailbox rule.

Exception to Revocation: The Option Contract

option contract
An offer, combined with an agreement supported by consideration not to revoke the offer for a specified period of time

irrevocable offer
An offer made in a signed writing, which, by its terms, gives assurance that it will be held open and not terminated by the offeror

When an offeree pays the offeror money to keep an offer open for a specified period of time, an **option contract** is created. The offeror cannot revoke the offer, as the payment creates an **irrevocable offer.** The value paid restricts the rights of the offeror and enhances the power of the offeree. As long as the option is in effect, the offeror cannot revoke the offer, even if someone makes a better offer. Assume that you have been reading the advertisements for cars and you find a 1989 Jaguar for only $10,000. After viewing the car and having a service person check it out, you decide you want it. Unfortunately, you are short of cash and cannot afford $10,000 at this time. You ask the seller, if you pay $1,000, will he hold the offer open only to you for 15 days? The seller agrees and you tender the $1,000. An option contract is created. The offer is irrevocable, because you paid for the power to accept within that period of time and for the seller not to make any offers on the car to anyone else during the 15-day period. Any attempted revocation by the offeror would be ineffective.

Cybercises

Using the Internet, find examples of option contracts.

Expiration or Lapse of Time

Another means of terminating an offer occurs automatically when a time limit has been set on the offer and it expires or lapses. If the offeror states in the offer that the acceptance must be received by a specific date, the offer automatically terminates unless acceptance is received by that specific time. An offeror may set time limits in which the offeree must accept the offer. If the offeree does not accept within the specified time period, the offer is automatically terminated and expires or lapses due to the time limitation. This method of termination is very useful, as it sets restraints on an offeree's power to accept. An offeror does not want to leave an offer open indefinitely.

Although case law suggests that an offer that does not have a specific time deadline will expire upon the reasonable passage of time, this rule leaves open the age-old question of what is "reasonable." The courts will review each circumstance to determine reasonableness. When time appears to be an important factor, the court will imply a shorter time period. Unfortunately, there is not an exact time period for "reasonable period of time." Therefore, to be safe, a definite termination date is the best protection.

statute of limitations Time period in which a lawsuit must be filed

Strictly Speaking: Ethics and the Legal Professional

What would happen if someone hit your car and you were offered $30,000 to settle all claims between you and the motorist? Your attorney communicates the offer to you, which you accept. You sign all the documents that are required from your attorney and the insurance company. You think you have a done deal. A small fact has escaped our transaction; the attorney waited nearly three months to communicate your acceptance to the insurance. The offer was no longer available. To make matters worse, the time in which you had to file a lawsuit—the **statute of limitations**—against the motorist has passed. You now have no case and no money. Such was the situation in *Brzezinek v. Covenant Insurance Co.,* 810 A. 2d 306 (Conn. Ct. App. 2002) where the Brzezinek's did all they were supposed to do but their attorney did not. In that case, two important issues are present. The first is the court discussed what is considered a reasonable time between an offer and its acceptance. In that case, the offer was made on December 3 with the statute of limitations on the underlying tort action expiring on December 28. The attorney did not communicate his client's acceptance until February 14. In this situation, a reasonable time for the offer to remain alive was arguably until December 28, the time when the statute of limitations expired. In the *Brzezinek* case, the court effectively stated so. However, the court did not address an underlying, yet ever present, second issue—the actions of the attorney. The Brzezineks likely have an action in malpractice against the attorney. This is important to note for a few reasons. First, always be mindful of the statute of limitations on cases that you are working on, whether they are contracts cases or some other type of case. Under most circumstances, when a statute of limitations is missed, the cause of action for the client ceases as well. Missing a statute of limitations is not a good thing and in most instances is malpractice. Second, leaving a settlement sit nearly three months without any action is cause for concern. In the case, all the documents had been executed by the Brzezineks.

All that was left was forwarding the documents to the insurance company and wait for the final check. The lesson learned from this case is more than what is a reasonable time for an offer to remain open but rather pay attention to your cases or run the risk of your attorney, and possibly you, committing malpractice.

Operation of Law

Offers also can be terminated due to some intervening factor over which neither party has control. Under the law, a party making the offer will not be held to the offer. Typical methods of terminating an offer by operation of law are (1) legality; (2) death; (3) insanity; and (4) destruction of the subject matter.

Legality

When legislation is enacted that makes the subject of the offer illegal, the offer is terminated. Suppose that a winery offers to a supplier a container of Chilean red wine. The U.S. government then determined that Chile has had many human rights violations and the U.S. Congress passes an embargo on Chilean goods imported into this country. The offer would not stand because it would be illegal to import the goods into this country. The offer would be terminated by a superseding illegality. Neither party has control over the circumstances nor would be inappropriate to hold the offeror to the offer.

Death

Death of the offeror automatically terminates the offer. No communication is necessary to the offeree, but, as a practical matter, it makes good business sense to let an offeree know that an offeror has died. Note that if the offeree dies, the power to accept by that intended offeree is terminated as well.

Insanity

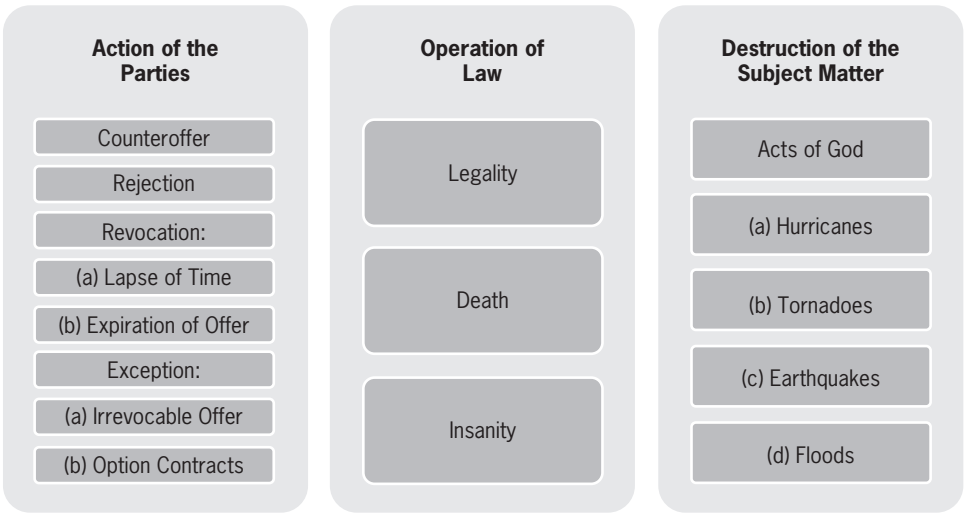
Persons who have been declared by a court to be of unsound mind or insane do not have the power to create an offer. The basis behind this mode of termination is that the offeror does not have the legal capacity to make the offer. This area is treated in more depth in Chapter 6.

Destruction of the Subject Matter

When an offer is communicated and the subject matter of that offer is then destroyed, the offer is terminated. This often occurs when acts are out of the offeror's control. For example, a farmer in Florida offers to a national grocery chain her entire crop of oranges for that season. While the grocery chain is evaluating the offer, a hurricane destroys the crop. The offer is terminated.

Destruction of the subject matter often occurs because of acts of God, such as tornadoes, earthquakes, hurricanes, and floods. Termination, under these circumstances, occurs because the thing or entity essential to the contract—the subject of the contract—is destroyed. Exhibit 3-5 summarizes the different methods of terminating an acceptance.

EXHIBIT 3-5 Methods to terminate an offer



State Your Case

Daniel decided that he wanted to hire a new assistant to help manage his personal errands. He contacted Kendra to see if she was interested. Daniel was going to pay $15.00 per hour. Kendra told Daniel she needs a few days to think about it, but wanted $20.00. Daniel offered the position to Tara who immediately accepted the offer. Tara started the next day at $21.00 an hour. In the meantime, Kendra called Daniel to let him know that she would take the position. Daniel informed her that the position was filled. Kendra wants to know whether she can sue Daniel for the position since she asked him "to hold the position open for a few days." Discuss all issues.

Unilateral and Bilateral Contracts Distinguished

unilateral contract
A contract where the acceptance is the act of performance

As we discussed in Chapter 2, when all that is required of the offeree is performance, a **unilateral contract** is formed upon performance. The mode of acceptance is the conduct or actions of the offeree. No exchange of responses is necessary to indicate assent to the offer; rather, performance indicates the acceptance. Acceptance of an offer through performance causes uncertainty. The most common type of unilateral acceptance is a reward situation.

EXAMPLE: There has been a rash of carjackings in your neighborhood. The police want information from anyone that will lead to the capture and arrest of the person committing the carjacking. The police offer a $5000 reward for information leading to the arrest and conviction of the person. When someone comes forward with information and the person is convicted of the crime, you would be entitled to the reward. You accepted the contract by performing the act of providing the information to the police.

bilateral contract
A contract where there is a mutual exchange between the parties

On the other hand, courts favor a clear assent by the offeree to the offeror, creating a **bilateral contract**. An exchange between the parties is clear. Until communicated, an acceptance is ineffective, which leaves less room for uncertainty about the offeree's actions.

Line of Reasoning

The distinction between when an offer is accepted and how it is accepted was the focus in *Ketcherside v. McLane*, 118 S.W. 2d 631 (Mo. Ct. App. 2003). In this case, the court had to decide whether a contract had been formed by the unilateral acceptance of one of the parties to the transaction. Ketcherside was an auctioneer firm that McLane Realty approached to auction all the equipment and goods from a former grocery store tenant. Detailed discussions took place where McLane said to Ketcherside, "you have the job, go ahead and prepare for the auction." Ketcherside inventoried all the items and placed a value on the items. No date had been agreed to for the auction, but the auctioneer firm continued to prepare. Prior to the actual auction, McLane stated that she had discussed hiring another auction firm, which she did. Ketcherside sued McLane for breach of contract citing that a unilateral contract had been created. The court agreed. In that case, the court stated that an "offer to make a unilateral contract is accepted when the requested performance is rendered." When performance has commenced, the offer cannot be revoked. Although McLane claimed that there were essential elements of the contract terms that were not decided, the court nevertheless found that those terms were not essential and found that a contract had been created by the unilateral acceptance of the auctioneer.

Questions for Analysis

Review the *Ketcherside* case. Was the court correct in finding that all the essential terms were agreed to? Defend your response. Prepare an opinion that argues that a unilateral contract was not created. Use your jurisdiction's case law to support your opinion.

3.4 PRACTICAL APPLICATION

Most paralegals will find themselves involved in the formation stage of contracts when drafting an offer to purchase, a letter proposing an offer, or a letter of acceptance. Each form memorializes the intentions of the parties and begins the contracting process. To assist in this task, some examples of documents showing how an offer and an acceptance are used in everyday situations are shown in Exhibits 3-6 to 3-8.

EXHIBIT 3-6 Offer specifying manner of acceptance

July 1, 2011

Mr. Chase Brown
124 Main Street
Chicago, Illinois

Dear Mr. Brown:

I offer to sell you my vintage 1990 Jaguar if you agree to pay me $30,000.00. You need to pay me a $10,000.00 down payment with the remainder in payments of $600.00 monthly until paid. Please notify me on or before the close of business on July 15, 2011 by certified mail if you wish to accept the terms and conditions of this offer. Your acceptance shall not be effective until actually received by me on that date or before.

Sincerely,

A.C. Granger

EXHIBIT 3-7 Offer containing form of acceptance

July 1, 2011

Mr. Chase Brown
124 Main Street
Chicago, Illinois

Dear Mr. Brown:

We have discussed the sale of my vintage 1990 Jaguar to you. It is my understanding that you have agreed to pay $30,000.00 with $10,000.00 as a down payment. The remaining balance shall be paid monthly at $600.00 per month.

If this letter reflects all the terms of our agreement in a manner satisfactory to you, please indicate your acknowledgment by signing one copy of this letter in the space designated below and returning the signed copy to me by July 10, 2011. Your signature will make this agreement effective and binding between us.

Sincerely,

A.C. Granger
A.C. Granger

Accepted: _____
Chase Brown

_____
Typed Name

_____
Date

EXHIBIT 3-8 Revocation of offer

STATE OF NEW JERSEY
COUNTY OF SALEM

KNOW ALL MEN BY THESE PRESENTS:

That Anna Webb, of the County of Salem and State of New Jersey, of and in consideration of the sum of $1,000.00 receipt of which is acknowledged, grants to Harvey Little, of the County of Cumberland and State of New Jersey, the option and right to purchase for the sum of $50,000.00, Block Two, Woodland Subdivision, Salem County, New Jersey. The option must be exercised by the close of business on June 15, 2011 by giving written notice of the exercise of the option to me by fax at (555) 426-1883 accompanied by a payment of $2,000.00 earnest money, and the execution and delivery within ten days after the exercise of the option of a note and mortgage securing payment of the remaining balance.

In the event that this option is not exercised by June 15, 2011, it shall automatically and immediately terminate without further notice, and all your rights under this option agreement will then terminate.

SIGNED this _____ day of _____, 2011

Signature of grantor of option

Anna Webb

Anna Webb

Typed Name of Grantor of Option

SUMMARY

3.1 An offer is a communication by the offeror to an offeree of an intent to be bound to a contract. The offeror must have intent to be bound to a contract, must communicate it, and must create specific terms. An offer should include the material items, such as the parties, the price, the subject matter, and the time of performance. Advertisements may be an invitation or an offer, if definite enough.

3.2 The acceptance is the response by the offeree to the offeror of an intent to be bound to the terms of the contract. The acceptance can be written, oral, or implied. If an offer is communicated in the mail and the response is communicated through the mail, the mailbox rule applies. An acceptance must match the offer exactly. This is the common law rule referred to as the mirror image rule.

3.3 There are a number of methods to terminate an offer. An offer can be terminated by the actions of the parties or by operation of law. Through the actions of the parties, an offer can be terminated by a counteroffer, rejection, revocation, or expiration of time. Other methods to terminate are by operation of law, including illegality, death, insanity, or destruction of the subject matter.

KEY TERMS

offer
offeror
offeree
preliminary negotiation
output contract
requirements contract
breach
solicitations
acceptance
mailbox rule
counteroffer
clickwrap agreement
rejection
revocation
option contract
irrevocable offer
statute of limitations
unilateral contract
bilateral contract

REVIEW QUESTIONS

1. What is an offer?
2. What elements must an offer include to be valid?
3. Are advertisements offers? Why or why not?
4. Distinguish between an offer and a solicitation?
5. Define acceptance.
6. How can an acceptance be communicated to the offeror?
7. Define the mailbox rule.
8. What is the mirror image rule?
9. What are ways to terminate an offer by the action of the parties? By operation of law?
10. What is an option contract?

EXERCISES

1. Review your local newspaper for its advertisements. Pick five and determine if the advertisements are invitations to offer or offers. Discuss the basis of your conclusion.
2. Ray Chapman is a wealthy (at least his father is) world traveler. Ray's father wants him to come home and join the family business, but he does not know where Ray is. Mr. Chapman hires Investigative Services to locate Ray and bring

him home. Mr. Chapman offers Investigative $10,000 to find Ray and bring him home. Within one month, Investigative finds Ray, but he refuses to come home. Investigative demands full payment of the $10,000. Mr. Chapman refuses to pay. Was there a valid offer and acceptance. Is Investigative entitled to the $10,000? Explain your answer.

3. At precisely 11:00 A.M., the Driftwood, a bar in the lower Greenville area, opens its doors. At 11:03 A.M. Donald Taylor, a well-known real estate developer, enters the Driftwood and orders a beer from the bartender. Donald is a likeable guy who enjoys good conversation and good drink. As the day passes, Donald leisurely drinks beer after beer, never getting wasted but maintaining a "good buzz."

   At 4:55 P.M., J. R. Reynolds enters the Driftwood and sits down next to Taylor. They have the following conversation:

   J.R. What a day! (sigh) Hey, could you pass the pretzels? Yo, bartender, let's have a beer down here!

   D.T. Had a rough day, have you?

   J.R. Nag, nag, nag. That's all my wife does is nag. All day she's been on my back about moving out of our apartment. She knows I've been busting my butt trying to find an affordable house but, as you may know, good real estate isn't easy to find. I just can't take her pressure anymore.

   D.T. [In his stupor, he decides to have some fun with this pathetic soul.] Sir, this may be your lucky day. You see, I'm a real estate agent, and I can offer to sell you this beautiful two-bedroom, two-bath house for the low, low price of $25,000. [D.T. takes a picture out of his breast pocket and shows J.R. a luxurious home. In reality, this is Donald's own home and it has a fair market value of $900,000.] It is located on 123 Estates Avenue.

   J.R. [With genuine excitement in his voice] Oh my goodness, what a deal. I must have it! What must I do?

   D.T. Well. A lawyer friend of mine once told me that all transactions in land must be in writing, so we will draw up a contract.

   D.T. Grabs a napkin and writes the following:

   CONTRACT

   1. Donald Taylor, hereby agree to sell the house located at 123 Greenville to J.R. Reynolds upon payment of $25,000.00. This agreement is meant to be a final and binding contract between the two parties.

   Sincerely,

   Donald Taylor

   J.R. ecstatically takes the napkin contract and rushes out the door, saying he must go home and break the good news to his wife. As soon as he leaves, Donald bursts into laughter and shares his story with his barroom buddies.

   Did D.T. sell his house? Is there an offer?

4. Dave was tired of his job as a gardener. The days were hot and long and the pay wasn't that great either. He began looking for another job and saw this advertisement in one of his magazines.

> NOW HIRING: TRUCK DRIVERS
>
> EXPERIENCED DRIVERS NEEDED
>
> ALSO OFFERING TRAINEE COURSE: MUST HAVE A VALID DRIVERS LICENSE AND NO FELONY CONVICTIONS.
>
> BACKGROUND CHECK REQUIRED PRIOR TO STARTING EMPLOYMENT.
>
> COME TO HIGHWAY FREIGHT CORPORATION FOR AN APPLICATION.
>
> INTERVIEW REQUIRED ALONG WITH A PSYCHOLOGICAL EVALUATION AND DRUG SCREENING PRIOR TO HIRING.
>
> FOR ADDITIONAL INFORMATION, CONTACT CHUCK MASON AT (222) 555-5555.

Dave thought this looked like a great opportunity. Even though he had no experience, they were willing to train him. The only problem was that when he was 17 years old and in high school, he had a little marijuana habit that landed him in juvenile detention for six months. He thinks that the matter was sealed, but he can't remember. Hey, that was twenty years ago, and he hasn't touched the stuff since then.

Dave contacts Chuck who mails him an application. He fills out the application, but where it asks whether he has been convicted of any felonies he answers "No." His application is accepted. He quits his job and is excited about his new prospects. He sails through his interview and is scheduled for his psychological testing next week. Right before his testing begins, he receives a telephone call from the Human Resources Department telling him that his interview is cancelled. He doesn't know why. Everything was going so well. Was there a valid offer and acceptance between Dave and Highway Freight Corporation? Discuss all issues.

5. Jason has been having some trouble in college lately. As his parent, you want to help him. Over the telephone, you try to be encouraging and have the following conversation:

Jason: Mom, I have had enough of college. I just want to get a job and work. Hey, lots of people never finished college and they have done fine. Look at all those Internet moguls!

Mom: I know, but finishing college is important. You never know where the economy is going and having a degree is something you will always have. No one can ever take that away from you.

Jason: But, mom, I just want to work and make some money.

Mom: Okay, you have two more years of college left. If you finish college, I will buy you a new car of your choice.

Jason: Really mom, that's great. I will work really hard and make you proud.

Mom: I am already proud. If you make Dean's List for the last three semesters, I'll even consider a cash bonus.

Jason: Wow mom, that's great.

Jason graduated with honors two years later. He even made the Dean's List for four straight semesters. When Jason's mom came to watch him graduate, he told her that he couldn't wait to get his new Jeep. She looked at him in surprise and said, "What are you talking about." He said, "Mom, don't you remember our conversation where you promised me a car if I finished school and a cash bonus if I made the Dean's List for the last three semesters." His mom replied, "Oh honey, I just was trying to get you focused. I never could afford to buy you a car." Jason was devastated. He wanted his car and money. He wants to sue his mom. Does he have a legal basis to challenge his mom? Explain in detail your response.

6. Using the same facts from Exercise 5 with the following additions: Jason's mom has been in and out of counseling for years. She was committed last year for three months where the clinic finally found a combination of medications that worked for her. She has good days and bad days, but is hoping that time heals all. With these additional facts, does your response to exercise 5 change? Support your position.

7. Gramps is just the best. He offered to loan his granddaughter Haley some money for her new business, $500,000 in fact. She is elated. She always wanted to be a consultant for healthcare companies and now with Gramps help, Haley can realize her dream. In preparation, Haley buys a new computer and printer with a scanner. She also figures she needs suitable office space and furniture, so she rents space at an office building near her home. Life couldn't be better. Haley calls Gramps to let him know everything she is doing, but there is no answer. She does not leave a message because Gramps does not believe in answering machines. Haley calls a few days later, but still no answer. Turns out that Gramps has a new girlfriend and they are on a world cruise. Your mom told you that he cannot be reached. Sadly, a month later, Haley received a telephone call that Gramps had passed away. What is she going to do, she made all these commitments based on her telephone conversation with Gramps. Was there a valid acceptance of Gramps' offer? Did Gramps make a valid offer that can be enforced? Discuss all issues.

8. Alex offers to sell his skateboard to Jason for $350. In reply to Alex, Jason says, "I'll pay what I can." Is this a valid acceptance? Support your response with a discussion of the law.

9. There has been a surge of bank robberies in your area. The local city council posts a reward of $10,000 for anyone who catches the bank robber. One afternoon, a tourist, who knows nothing about the robberies, is walking up

Main Street and spots a man with a ski mask running out of the bank holding a bag and a gun. The tourist grabs the bank robber as the police run to aid in the arrest. Can the tourist claim the reward money?

10. Southeast Groceries offers to purchase from Vine Ripe Tomatoes of Florida, Inc., all of its crop for the season. Before Vine Ripe can accept, Hurricane Barney rolls through Florida flooding the entire central part of the state including Vine Ripe's crop. Southeast Groceries needs tomatoes for all its stores and sues Vine Ripe for failure to deliver its crop of tomatoes. Is Vine Ripe liable to Southeast Groceries for its failure to deliver the tomatoes? Present a detailed response of the arguments for each side.

CASE ASSIGNMENTS

1. Marilyn pays her credit cards on time. She has had her bank card with her local bank for over 20 years. She had the "standard" credit card agreement. Her interest rate on her credit card was 11 percent. She was very proud that she never was late on a payment. Her bank was just bought out by one of the big banks. She receives a welcome letter from the new bank. Two months later she receives another letter from the new bank detailing a host of changes to her credit card agreement. They were changing her interest rate on the card from 11 percent to 23 percent. She was upset and wanted to challenge the change. (For this assignment, choose a standard credit card agreement and review the terms. Use your form as the basis for your response to this question.) Your attorney wants you to research the issue. Does she have any recourse against the bank? Was the modification to her credit card agreement proper? Did the bank have the right to change the terms of her credit card agreement? Did Marilyn accept the terms and conditions at the time she acquired her card initially with her bank? What if the new bank added new conditions which were not part of Marilyn's original acceptance with her old bank? Discuss all issues only in the context of offer and acceptance.

2. (a) Jonah wants to hire a company to develop a marketing plan for his fishing business. He mainly has caught fish and sold them to vendors, but business is slow. He wants to broaden his base to offer deep sea fishing. He hears that Strategic Alliance is a great company and has helped many of his friends with their marketing plans. Jonah wants to hire your law firm to assist in preparing all the legal documents, but first Jonah must reach an agreement with Strategic. Jonah's budget is $10,000. He wants your firm to draft the offer letter to Strategic. Prepare an offer letter to Strategic.
   (b) Strategic rejects the offer. The company wants $15,000 and an expense account of $5,000. Prepare the rejection letter with the counteroffer.
   (c) Jonah is willing to offer $13,000 with a $2,500 expense account as long as the plan is prepared and delivered to him within 30 days of Strategic's acceptance. Prepare the counteroffer letter.
   (d) Strategic is willing to accept Jonah's new offer. Prepare Strategic's acceptance letter with the agreed terms and conditions.
   (e) A twist: Prior to Strategic's acceptance, Jonah's boat is destroyed by fire. Prepare the letter revoking the offer.

Chapter 4

Consideration: The Value for the Promise

Outline

Just Suppose . . .

You are sitting with a friend, RJ, at a local bar lamenting his failed business deal. He tells you his story. He invested nearly $200,000 in two corporations with his friend Raj, but the investments proved unsuccessful. After many rounds of drinks, Raj asks the bartender for a safety pin. Pricking his finger, he begins to write a promissory note with his blood. The document states: "Please forgive me. I am sorry for your loss in the business venture. I feel responsible as you have suffered financially. I will repay you the money you invested in the two corporations to the best of my ability." The document is signed by Raj. RJ waited a year, but Raj never paid the debt and defaults on the promissory note. So, RJ decides to sue for the default on the promissory note and fraud. The big question was whether there was "value" exchanged between the parties—legal consideration. Determining this issue would be crucial to the enforceability of the "blood contract."

4.1 THE NATURE OF CONSIDERATION

In any discussion of contracts, invariably the concept of consideration is debated. Everyone thinks that they know what consideration is, but, as will be seen, it may not be what you think. In understanding consideration, let's establish a few ground rules. First, rid yourself of the notion that consideration is only money. It is *not* only money, as will be seen later in this chapter. Second, consideration deals with value; it is what the parties think is valuable, even if others do not. Consequently, think of consideration as something personal between the parties and look at the concept objectively. Finally, consideration may be something of great value or little value: *the amount does not matter.* The most important point to keep in mind while learning about consideration is that it is a necessary element in a valid contract and courts often will do whatever is necessary to find it. With few exceptions, consideration must exist for there to be a binding contract.

consideration
That which is given in exchange for performance of the promise to perform; the price bargained and paid; the inducement

value
The worth of a thing in money, material, services, or other things for which it may be exchanged

Putting all the myths aside, a working definition of **consideration** is necessary. *Consideration* is a benefit to the promisor or a detriment to the promisee, which is bargained for and given in exchange for a promise. For consideration to exist in a contract, there must be an exchange of something of value. **Value** is defined as something of worth to the parties. In addition, there must be a bargained exchange between the parties. The parties must suffer a legal benefit or legal detriment; that is, something must be given up in exchange for the promise. Also, the consideration must be legal. Therefore, for consideration to exist, there must be (1) a detriment or benefit; (2) that is a bargained exchange of the parties (3) for value (4) of a promise and (5) that is legal. Dissecting the elements will assist in understanding the meaning of consideration.

4.2 THE ELEMENTS OF CONSIDERATION

The required existence of consideration proves the serious intent of the parties to bind themselves to the promises exchanged. If consideration was not needed, many could walk away from contracts, suggesting that the promise was merely a **gift** and therefore unenforceable. This would allow persons to abandon their contracts and probably promote even more lawsuits than presently exist. Consequently, consideration is a valuable part of the process.

gift
A voluntary transfer of property by one person to another without any consideration or compensation

benefit
Anything that adds to the advantage or security of another

detriment
Undertaking some responsibility one is not legally bound to undertake or in refraining from exercising some right one would otherwise have been entitled to exercise

A Detriment or Benefit

The first part of the definition of consideration states that there must be a benefit or detriment to the parties. Each party to the contract gains something or gives up something in the contracting process. When a gain to a party is found, a legal **benefit** will exist; when a sacrifice occurs by one of the parties, a legal **detriment** exists. Legal detriment is usually found when parties do something or act in some way that they do not legally have to or refrain (forbear) from doing something that they have a legal right to do.

EXAMPLE: Assume that a friend offers you $100 for not eating chocolate for one month. You have a legal right to eat chocolate, but if you want to earn the $100, you must give up

chocolate (that is, "forbear" from eating it). That is a valid detriment and a benefit to the parties. Your friend benefits from your eating healthy and your detriment is not eating the chocolate you love.

Line of Reasoning

The classic consideration case is *Hamer v. Sidway*, 124 N.Y. 538, 27 N.E. 256 (1891). This case involves the promise of an uncle to his nephew to pay him $5,000 if he refrained from drinking, using tobacco, swearing, and playing cards or billiards until he reached 21 years old. His uncle, William E. Story, Sr. made this agreement in front of a room of people to which his nephew Willie agreed. When Willie turned 21, he wrote his uncle letting him know that he had performed his part of the agreement. On February 6, 1875, Uncle William wrote Willie the following letter:

Dear Nephew,
Your letter of the 31st came to hand all right, saying that you lived up to the promise made to me several years ago. I have no doubt but what you have, for which you shall have five thousand dollars, as I promised you. I had the money in the bank the day you were twenty-one years old that I intended for you, and you shall have the money certain. Now Willie, I do not intend to interfere with this money in any way till I think you are capable of taking of it, and the sooner that time comes the better it will please me. I would have very much to have you start out in some adventure that you thought all right, and lose this money in one year. The first five thousand dollars I got together cost me a heap of hard work. . . .Willie, you are twenty-one, and you have many a thing to learn yet. This money you have earned much easier that I did, besides acquiring good habits at the same time, and you are quite welcome to the money. Hope you will make good use of it. I was ten long years getting this together after I was your age. Now, hoping this will be satisfactory.
Truly yours,
W.E. Story
P.S. You can consider this money on interest.

Willie actually consented to his uncle's terms. Sadly, Uncle William died on January 29, 1887 without paying Willie his money (and interest). Willie sued Uncle William's estate. The issue that the court was faced with was whether Willie had a valid contract with Uncle William and whether that contract created a valid debt for which the estate was indebted. The court focused on the issue of consideration. The court recognized that consideration may be "some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered, or undertaken by the other." What the court made clear was that consideration is not just money or profit, but mainly that one of the parties is abandoning a legal right, limiting a freedom of action as an inducement for the promise. The court held that Willie was entitled to the $5,000 plus interest from Uncle William's estate.

Questions for Analysis

Review *Hamer v. Sidney*. What was the consideration between Uncle William and his nephew Willie? What was the Court's reasoning for finding for Willie? Assume the same facts as in the case, but that Uncle William died before Willie turned 21 years old. Was there consideration for the promise? What if Uncle William had stated at the party that he would give $5,000 to Willie when he turned 21 years old and then died one week after Willie's 21st birthday? Is the promise enforceable?

Bargained Exchange of the Parties

mutuality
Two persons having the same relationship toward each other with respect to a particular right, obligation, burden, or benefit

Not only must a benefit or detriment be involved, but there also must be a bargained-for exchange by the parties. Here, a promise is exchanged for another promise, as in a bilateral contract; or a promise is exchanged for an act, as in a unilateral contract; or a promise is exchanged for the forbearance of an act. The focus is on the exchange of promises between the parties of benefits and detriments. This concept is known as **mutuality.** Mutuality exists between the parties, furnishing each with some form of detriment or benefit. Using the chocolate example, the exchange is that one party promises to give the other party $100 for not eating chocolate.

State Your Case

A local radio station makes the following announcement: We play five songs in a row. Always. If we don't, we will pay you $50,000. Every day you listen to only that radio station and on June 15, you catch them playing three songs followed by a commercial, then two songs. You immediately call the radio station to claim the $50,000. The radio station refuses to pay you the money. Did the radio contract create a valid contract with you? Analyze all issues.

For Value

Critical to the concept of consideration is that the exchange must be something of value to the parties. Note that the parties decide on the value—it need not be what you or I would deem value. Value may consist of money, services, property, or the act of forbearing. Each type of value is valid as consideration.

Money

The most typical kind of value (or consideration) is money. In most contracts, the consideration bargained for is the exchange of money. For example, a contractor offers $5,000 to an electrician for installing all of the electrical wiring in a house. The exchange of promises is that the electrician will provide wiring in exchange for $5,000 of money from the contractor.

Property

Exchanges of property between the parties also constitute value and, therefore, consideration. For example, assume Henry owns only a computer and needs the use of a printer. He finds Mike, who has a printer but no computer. The parties could contract as follows:

> I promise to allow you to use my printer three times a week in exchange for the use of your computer every morning from 9:00 A.M. to 11:00 A.M., Monday through Friday.

The consideration is the exchange of property, and therefore value, to each party.

Services

Another "thing" that is of value to parties is services. An exchange of services between parties is also considered valid consideration. A court will look merely for an exchange, not necessarily what the exchange is. Suppose a farmer needs workers but does not have much money to pay wages. The farmer requests that the workers work 30 hours per week in exchange for free food and lodging. The value is the exchange of services for property. Courts have held this to be value, as it is a bargained-for exchange between the parties.

Acts of Forbearance

Requesting persons to refrain from doing something that they have a legal right to do also is considered value. Here, the value may be unique or personal to the parties, but it is nevertheless something of value. Suppose a friend states: "If you stop smoking, I will give you my 2008 Honda." An outsider might look at this exchange and ask, "Where is the value?" The value is in the giving up of something of value—a Honda—for the detriment of not smoking. Courts have held such exchanges to be valid, and thus they constitute consideration. This example is just like the situation between Uncle William and Willie in *Hamer v. Sidway*.

A Promise Between Parties

The parties must have made a promise to each other for something of value, or consideration will not be found. For example, I promise to give you my ring. You take it. What is the promise between the parties? There is none. Giving up a ring in exchange for nothing is gratuitous; this would be a gift. There is no promise between the parties; no exchange, no benefit, or detriment, no value. If I promise to give you a ring in exchange for $300, then that is a promise between the parties and enforceable.

Value Must Be Legal

The value exchanged must be legal. If the parties, exchange something that they do not have the legal right to exchange, the consideration is nonexistent. For example, Lillie offers to sell her child to Rachel, who is childless, for $25,000. The consideration here would be illegal and unenforceable in court. See Exhibit 4-1 for the elements of consideration.

EXHIBIT 4-1 Elements of consideration

Consideration
1. Legal benefit/detriment
2. Bargained exchange (mutuality)
3. Exchange must be of value to the parties – Money – Property – Services – Acts of forbearance
4. A promise between parties
5. Value must be legal

Cybercises

Find five examples of contract cases where the consideration is something other than money. Identify the consideration and the court's basis for finding consideration.

4.3 THE ADEQUACY OF CONSIDERATION

Courts do not have a predetermined set of rules to decide how much consideration is enough to bind a contract. In fact, courts shy away from inquiring into the adequacy of the consideration bargained for in a contract. The reason behind this arm's-length approach is that courts encourage freedom of the bargaining process and believe that the responsibility of how much consideration is sufficient rests with the parties to the contract. Even if the value bargained for seems inadequate or unfair, courts generally will not inquire into the reasons why parties agreed on a particular amount or type of consideration. The courts do not consider their role as your "protector." Someone's bad judgment or bad deal is not a sufficient basis to avoid a valid contract. Of course, sometimes there are legal defenses, such as intoxication or age, but let us not forget Mr. Lucy from chapter 3. He was as "high as a Georgia pine," but the court still found a valid contract. The lesson from that case is "don't rely on the courts to rescue you from yourself or a bad deal."

As a result, consideration may be for $10 or some other small sum, even though an outsider looking in may wonder why the consideration exchanged is so small. Sometimes in contracts, parties will use a minimal sum to complete the formalities of the contracting process, as shown in the following examples:

(1) For and in consideration of the sum of $10.00, the parties do hereby agree to sell the property located at 104 Main Street, New City, U.S.A.
(2) For and in consideration of the mutual promises and agreements, the parties agree to research a cure for ALS.

These examples demonstrate that although the stated value is often minimal, it shows that there was an exchange between the parties, no matter how small. Courts will, however, inquire into adequacy if the consideration appears to be nominal and perpetuating a sham. The indication in those situations is that there was no bargain at all and therefore

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no consideration. When sham consideration is found, the courts will not enforce the promise between the parties. Courts do not like to evaluate the adequacy of consideration between parties to a contract. That principle was followed in *Hejl v. Hood, Hargett & Associates, Inc,* 674 S.E. 2d 425 (N.C. App. 2009), where a post-employment noncompetition clause was at issue.

Line of Reasoning

In *Hejl v. Hood, Hargett & Associates, Inc*, Phillip Hejl, an account executive, had been employed with Hood, Hargett & Associates an insurance company for 14 years, when the company offered Hejl $500.00 to sign a noncompete agreement in January, 2005. The noncompete agreement essentially forbids Hejl from working in the states of North and South Carolina for a period of two

years in the insurance industry. Hejl claims that the contract was not supported by adequate consideration, thus making the agreement void. His employer, of course, argued that the contract was supported by adequate consideration. The North Carolina Appeals Court first reviewed the issue of consideration and specifically the law regarding noncompete agreements. The Court stated that a noncompete agreement is valid if it is: "(1) in writing, (2) entered into at the time and as a part of the contract of employment, (3) based on valuable consideration, (4) reasonable both as to time and territory embraced in the restrictions, (5) fair to the parties, and (6) not against public policy." There is a caveat to the six areas cited in that if the noncompete is entered into after employment commences, there must be "new consideration" to support the agreement. New consideration in post employment relationships have been found in a raise or bonus, a promotion, continued employment for an agreed period of time, additional training to name a few. But the consideration cannot be illusory. The Court remained steadfast in its opinion that it would not evaluate the adequacy of the consideration and it is for the parties to determine what is adequate, not the court. The slightest consideration is sufficient, so long as there is no fraud and the "parties have dealt at arm's length," the court will not set aside a contract because the results seem harsh. Since there were no allegations of fraud or other legal consideration issues, the court found that the agreement for the noncompete was supported by consideration. [Note that the court did find the noncompete unenforceable finding that it was too broadly drafted. Hejl was forbidden to work in the insurance field for two years and in both North and South Carolina. The court determined that the geographical area was too extensive to serve its business purpose.]

Questions for Analysis

Review the *Hejl* case. What facts would have changed the court's result? Would the result have changed had the consideration been identified as "$10.00"? What if Hejl had been given two weeks additional vacation for signing the noncompete agreement, would that have been adequate consideration? Why or why not?

Exceptions to every rule exist, even though inquiries into the adequacy of the consideration are few. When issues of fraud, misrepresentation, mistake, duress, undue influence, and unconscionability (the defenses discussed in the next chapter) are raised, the adequacy of the consideration may also become an issue. However, such instances are unusual.

Strictly Speaking: Ethics and the Legal Professional

The issue of who has authority to enter into a contract is often raised when trying to undo a contract. But often, those who rely on the "apparent" authority of an individual, such as a president or CEO of a company, to enter into a contract may risk a contract's unenforceability. In *Goldston v. Bandwidth Technology Corp.*, 859 N.Y.S. 2d 651 (N.Y.A.D., 1 Dept, 2008), a law firm was faced with this issue. A CEO entered into a contract—retainer agreement—for the services of the law firm without consulting the board of directors. The law firm relied on the authority of the CEO. The court analyzed the acts of the President calling them "unauthorized" acts of a dishonest employee, but did not penalize the law firm for relying on the president's authority to enter into the retainer agreement. The corporation had benefited from the services provided by the law firm. The court was asked

to review the issue of consideration, but found that the "adequacy of the consideration" was not a subject for judicial scrutiny. Aside from the consideration issue, the case also raises the issue of legal representation on two fronts: (1) who has authority to bind a corporation and (2) what effect does a retainer agreement have when a partner leaves the firm. In this case, the actions of the president may have presented legal issues for the corporation itself, but the law firm had relied on his authority to bind the corporation to the retainer agreement. Additionally, when an attorney who signs an agreement leaves a law firm, is the signed retained agreement still a valid contract? The *Goldston* case responded with a "yes." Here the CEO acted in his representative capacity. When working with individuals who are in a representative capacity, as a paralegal determine the scope and validity of that authority. You do not want to be caught in the middle if a transaction goes south. A corporate resolution giving the representative the authority to enter into the transaction, regardless of the type, is always a good practice. This shows the intent of the board and avoids fraud and misrepresentation claims.

4.4 ABSENCE OF CONSIDERATION

When consideration is absent, a court will not enforce the contract made between the parties. Because consideration is a necessary element in contract formation, the lack of it will render the contract invalid, unless an exception exists. Instances in which courts have found consideration lacking or absent involve gifts, illusory promises, moral consideration, past consideration, and contracts under the preexisting duty rule (see Exhibit 4-2).

Gifts

will
An instrument by which a person makes a disposition of his or her property to take effect after his or her death

The promise of a gift is unenforceable, as it lacks adequate consideration. If someone promises to bequeath a gift in a **will** and does not fulfill that promise, courts will not find that a contract existed between the parties, because there was no consideration. In a gift situation, there is no bargained-for exchange nor a benefit or detriment to the parties. The exchange is one sided, with only one party benefiting and no legal detriment being suffered. No expectation of a bargained-for exchange occurs, and therefore there is no enforceable contract. Assume that a relative states, "I will give you my diamond ring when I die." If she dies and gives the ring to someone else, can you go to court and have the promise enforced? No. There is no bargained-for exchange and therefore no contract.

However, the situation is different once the gift has been tendered or completed. The individual that tendered the gift cannot take the gift back. The act is final.

EXAMPLE: Your friend Amy is having a 40th birthday party. You bring her a bracelet as a gift. Later on in the year, the two of you have a falling out. You demand the bracelet back. Does she have to give back the bracelet? The answer is "No."

State Your Case

Ella and Kyle are engaged. He gives her a two-carat diamond ring. Two months before the wedding, Ella calls off the marriage. Does Ella have to return the ring? What if Ella caught Kyle cheating on her, would that change your response? Under those circumstances, if Kyle demands the ring back would Ella have to return it?

Illusory Promises

illusory promise
A promise whose performance is completely up to the promisor; the promise cannot form the basis of a valid contract

Promises based upon a party's wishes, desires, or hopes are not an adequate basis for a contract. Expressions that create such indefiniteness are considered illusory and create illusory promises. An **illusory promise** is one that gives a false impression of a contract and in reality does not obligate the party making the promise to do anything. There is no bargained-for exchange between the parties. Words that suggest an illusory promise are:

We will order your products when we need them.

We will order the product as demand dictates.

We will request shipment of your product when we wish.

None of these promises creates a *mutuality of obligation* between the parties; therefore, they lack the necessary consideration to be binding. Because, illusory promises lack consideration, they are unenforceable contracts.

Now, let's return to our facts from the introduction. RJ and Raj have been drinking, and Raj expresses his regret for encouraging his friend, RJ, to invest in two businesses. Raj writes in blood that he will do his best to pay his friend back for the investment he made in the failed corporations. Of course, the question is "What is the consideration for Raj's promise to pay his friend back on the investment in the two corporations?" Does Raj have a legal obligation to pay his friend back the money? No, he did not guarantee success in the investment, so Raj has no obligation to pay RJ back his investment.

Moral Consideration

A promise to compensate for a past moral obligation is unsupported by consideration and unenforceable. There is no bargained-for exchange between the parties, as one performs the act gratuitously without regard to contractual considerations. Courts generally will not find consideration for a past moral obligation.

EXAMPLE: Tom fell ill while hiking in the mountains. He was discovered by a family who nursed him back to health. Grateful, Tom promised to send the family a 4x4 SUV to help them during the tough winter months. Tom never bought or sent the truck to the family. A court would not enforce his promise because there was no consideration. The obligation may have been a moral one, but not a legal one.

EXAMPLE: Sophie saved Fran from her abusive husband, Allan. One day Allan was coming at Fran with a pot, and Sophie stepped in and knocked Allan out. However, in the process, Sophie was injured. Fran could not believe what had happened and promised to pay for Sophie's medical bills. However, Fran could not afford to pay Sophie's medical bill and instead offered to take her to dinner instead. Fran was not obligated to pay for Sophie's medical bill since there was no consideration.

Past Consideration

When an obligation already exists and a promise is made for some future act previously suffered by the promisee, there is no consideration. A pretext appears to exist for a

past consideration Something for value given, which the giver calls consideration in an attempt to create a valid contract

contractual relationship, but mutuality is lacking. The key is that a promise to give value for goods or services previously rendered is **past consideration** and does not create the basis of a new, enforceable contract. However, there may be instances where a court will find an equitable basis to enforce a promise, such as unjust enrichment, even though consideration may be either past or absent entirely.

EXAMPLE: Georgia wants to sell her home. She signs a listing agreement with Randy, a real estate broker. The agreement is for six months. After the agreement expires, Randy finds a buyer for Georgia's house who ultimately purchases the house. Georgia believes that since her agreement with Randy expired, he was not entitled to his commission. A court may not find an agreement because it lacks consideration, but will probably find an equitable basis for awarding Randy his commission, perhaps a quasi contract or implied in fact contract.

The Preexisting Duty

Closely related to past consideration is the *preexisting duty rule.* When a person has a preexisting responsibility to act or refrain from doing something, there is no bargained-for exchange. The obligation exists either by law or prior agreement, and therefore the law will not infer consideration, as no detriment is suffered. Under this rule, consideration cannot be bargained for between the parties, as the responsibility to act or refrain from acting is already a duty.

The preexisting duty rule has been heavily litigated in the public service area. People such as firefighters, elected officials, and particularly law enforcement officers cannot extract benefits from a citizen for a task they are already obligated to perform. Let's assume that there has been a rash of burglaries in your neighborhood. A police officer knocks on your door and states that for $100 the police will patrol your area and watch for any burglars. You agree. Later you find out that you should not have had to pay the additional money, as patrolling was the officer's job anyway. If you were sued by the police officer, the court would find in your favor, as the contract is not supported by consideration. The officer had a preexisting duty to patrol; it was part of the job.

The preexisting duty rule also often arises with regard to construction contracts. Typically, a contractor agrees to provide services for a specific amount. While performing the service, the contractor realizes that the sum contracted for is insufficient to complete the job. The contractor threatens to quit work unless a higher price is paid for the service. The other party usually pays the additional sum to avoid a walk-off. The courts will not enforce payment of the additional sum, however, because a preexisting duty exists.

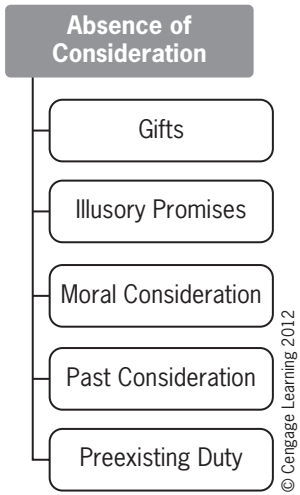
Similarly, in entertainment contracts, actors have threatened to walk off a movie set or television show unless a higher salary is given. When this occurs, the studio can sue the actor because of the preexisting duty to perform under the existing contract.

State Your Case

A young star threatens to walk off the set of his new film unless the studio increases his salary $500,000 to play the role. The studio pays the star the increased salary. After the movie is

complete, the studio sues the actor. What arguments would the studio make in support of its claim? Does the young star have a basis for claiming entitlement to the increased salary of $500,000?

EXHIBIT 4-2 Situations in which consideration is absent



Cybercises

Find two cases on the Internet where a celebrity was sued for failure to perform an existing legal obligation. Locate one case where the celebrity won and one case where the celebrity lost.

4.5 THE EXCEPTIONS: CONTRACTS ENFORCEABLE WITHOUT CONSIDERATION

In the law, there are exceptions to every rule. Under certain circumstances, contracts will be enforceable even though there is no consideration. Some of these exceptions are found in the (1) doctrine of promissory estoppel, (2) promises made after the statute of limitations has run, (3) discharge in bankruptcy, and (4) promises to pay for benefits received.

Promissory Estoppel

promissory estoppel Legal principle that a promisor will be bound to a promise, even though it is without consideration, if he or she intended that the promise should be relied upon or to prevent injustice

The concept of **promissory estoppel** focuses on principles of justice and fairness. Although no consideration is apparent from the promises, if a party changes his or her position in reliance on a promise, courts may imply that consideration exists and find that a contract was created. This concept was articulated in *Restatement (First) of Contracts* section 90:

> A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

As the *Restatement* suggests, promissory estoppel focuses on the need for fairness and the avoidance of injustice in the contracting process. Promissory estoppel has been applied not only when consideration is challenged but also in other areas of contract law. In *Wright v. Newman,* 467 S.E. 2d 533 (Ga. 1996), the court was asked to determine whether

a nonbiological parent can be forced to pay child support. The case illustrates an interesting application of the doctrine of promissory estoppel.

Line of Reasoning

The issue in *Wright v. Newman* was whether Mr. Wright was obligated to pay support to his girlfriend's son. Kim Newman and Bruce Wright had been live-in companions for some time. Bruce had fathered Kim's daughter, but not her son. However, he was listed on Kim's son's birth certificate as the father and held himself out to be the young boy's father. Wright held himself out as the child's father for 10 years apparently until the relationship with Kim broke down. Bruce never formally adopted Kim's child and was fully aware that he was not the boy's biological father. As a result of Bruce's promises to Kim and her son, Kim never sought to establish paternity with the biological father nor establish a relationship between her son and the biological father. Basing her position in contract, Kim argued that she relied to her detriment on Bruce's promise to care and support her son to the exclusion of pursing the biological father in court by establishing his paternity. Bruce argued that he had no legal obligations to Kim's child since he had not adopted him nor was the biological father. The court agreed with Kim's position. Focusing on the contract issues, the court discussed the doctrine of promissory estoppel. It found that

> [a] promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

Then the court discussed the reasons behind finding a legal obligation even if the contract fails in some respects. The court observed that

> [a] party may enter into a contract invalid and unenforceable, and by reason of the covenants therein contained and promises made in connection with the same, wrongfully cause the opposite party to forego a valuable legal right to his detriment, and in this manner by his conduct waive the right to repudiate the contract and become estopped to deny the opposite party any benefits that may accrue to him under the terms of the agreement.

Based upon its interpretation of the law, the court found that Kim had a valuable legal right—pursuing paternity and child support of the biological father—in exchange for Bruce assuming all the responsibilities of a father including being listed on the birth certificate. The result is that Kim had relied to her detriment on Bruce's representations and found a contractual obligation on Bruce's part to continue supporting the young boy based upon the doctrine of promissory estoppel. The *Wright* case had a concurring opinion and dissent where the dissent noted reasons why this case was not one of promissory estoppel.

Questions for Analysis

Locate *Wright v. Newman* and review it. What was the basis of the dissent in the case? What facts did the dissent rely upon to find that promissory estoppel did not exist? What facts were significant to the majority in finding for Kim Newman? What facts would have changed the result of the majority? Suppose that Bruce was not listed on the birth certificate, would the result have been different?

The doctrine of promissory estoppel focuses not only on the fact that the promisee relied to his or her detriment, but that the reliance was reasonably foreseeable by the promisor. Foreseeability is one of the keys in finding promissory estoppel as exhibited in *Wright v. Newman*.

Promissory estoppel also has been used as a means to enforce contracts when charities are involved. Often individuals or entities make charitable pledges but fail to fulfill them. Because charities rely on contributions, courts have held that a contract exists based upon the principles of promissory estoppel. Although a convincing argument can be made that a charitable pledge is merely a gift, charitable organizations rely to their detriment on pledges. They plan their organizations' functions, such as staff and expenses, around pledges. Courts have thus used promissory estoppel as a means to enforce otherwise invalid contracts.

State Your Case

A representative of your alma mater's alumni association contacts you about giving to the annual fund. You pledge $500.00, as you always give something each year. You receive a letter from your school confirming the pledge and enclosing a form with a return envelope for your contribution. However, after you made your pledge, your company cut back on your hours substantially decreasing your salary. You contact your school, explain your situation and verbally withdraw your pledge. The school keeps sending you letters to pay your $500.00 pledge. They sue you. What are the arguments presented by both sides of the lawsuit?

Statute of Limitations

statute of limitations Federal and state statutes prescribing the maximum period of time during which various types of civil actions and criminal prosecutions can be brought after the occurrence of the injury or the offense

State statutes impose time periods, known as **statutes of limitations,** in which a party must file a lawsuit; otherwise that party loses the right to sue. Once a statute of limitation passes, a party cannot validly exercise a right to pursue the claim. Statues of limitations vary from state to state depending on the **cause of action.** What is clear, though, is that a party cannot attempt to enforce a prior obligation, such as a debt, once the statute of limitations has passed, unless the party owing the debt puts the promise in writing. Simply saying "I will pay the debt I owe you" after the statute of limitations has passed fails because there is no consideration.

cause of action Circumstances that give a person that right to bring a lawsuit and to receive relief from a court

Bankruptcy

When a party files bankruptcy, creditors have real difficulty in collecting on contracts made prior to the bankruptcy. Debtors, however, through the laws in the Bankruptcy Code, have the opportunity to reaffirm debts. If the court accepts the new promise by the debtor, the contract will be enforceable pursuant to the Bankruptcy Reform Act of 1978, even though no consideration exists between the parties.

Cybercises

Determine what the statute of limitation is in your jurisdiction for collection of a debt, breach of contract, and consumer protection? Find the statute of limitations for collection of a debt under the Federal Fair Debt Collection Act?

Benefits Received

When a party has received a benefit, such as emergency medical care, whether a contract exists between the parties depends upon whether consideration is found. If the party did not agree to pay for the medical treatment, is there consideration for an enforceable contract? The answer depends upon whether the services were requested by the party. For example, if a person is ambulanced to a hospital unconscious for treatment, there is an implied contract. In this case, consideration will be found to bind the parties to a contract. However, if a doctor happens to be driving by an accident and decides to help out, the services were not requested. Under this scenario, courts will not find that consideration was present.

The second example raises the issue as to whether during an emergency where medical care services are rendered, but not requested, is there a consideration. More importantly, are the doctor's services compensable? Does the doctor have to be the "good Samaritan" and not receive payment for the services preformed? Although consideration may not exist, recall from Chapter 2 the doctrine of quasi contract. Here the court would create a contract based upon principles of fairness and justice, even though no consideration exits. See Exhibit 4-3.

TECH CHECK

Everyday technologies are created that were never anticipated. Think back to the early part of the twentieth century when movies became a significant form of entertainment. Often times when studios contracted for film rights back then they included mediums for which they were aware. No one ever imagined such mediums as video, VHS, or DVD as a means to watch entertainment. Interestingly, when future film rights were anticipated, these new technologies were not included because they were not known or more precisely, not in existence. How do you protect rights of individuals or their families when these technologies were not even in existence? This issue arose regarding the actor Orson Welles of Citizen Kane fame in *Welles v. Turner Entertainment Company*, 488 F.3d 1178 (9th Cir. 2007). His daughter was claiming rights to his movies when the contracts that Welles signed did not include any of the current mediums. Courts are reluctant to create terms that are not present in contracts, but yet what is just in these situations. The important point is to be sure that when contracts are drafted they contain all the required elements and terms in anticipation of future rights to technologies not conceived. Do not risk rights being circumvented or foreclosed because of shortsightedness. Create contracts that provide for the future development of technology.

EXHIBIT 4-3 Enforceable contracts without consideration

Enforceable Contracts without Consideration			
Doctrine of Promissory Estoppel	Promises made after statute of limitations expired	Discharge in bankruptcy through reaffirmance	Promises to pay for benefits received

liquidated claim
Specific sum owed to a person

unliquidated claim
Sum owed unknown or disputed

compromise and settlement agreement
Amount agreed to by parties in settling disputed claims

accord
Compromise or agreement between parties

satisfaction
Payment of the agreed amount

Cybercises

Use www.findlaw.com to locate five examples of language from Compromise and Settlement Agreements or Accord and Satisfactions identifying the consideration exchanged between the parties.

4.6 CONSIDERATION IN DISPUTE

Often disputes arise as to the amount of consideration due under a contract. When this happens, a settlement between the parties may occur. However, for a settlement to result, courts distinguish between whether the disputed amount is a liquidated or an unliquidated claim.

Liquidated Claims

A **liquidated claim** is a specific sum owed to a party. The amount owed is undisputed and known by all the parties to the contract. If the person who owes the amount attempts to tender part payment of the amount as full payment of the obligation, does new consideration exist to discharge the prior debt? No. The party has a preexisting duty to pay the entire debt and part payment will not constitute new consideration for a new contract to cancel the claim.

Unliquidated Claims

The counterpart of a liquidated claim is an **unliquidated claim,** where the sum is either not specifically known or is disputed. Suppose Angela agrees to pay $75 to get a haircut and have highlights put in her hair. When she gets home, a chemical reaction to the highlighting gives her rashes and peeling of the scalp. She quickly runs to her bank and stops payment on the check she wrote to the hairstylist. Now, the amount due is unliquidated and disputed.

To remedy the situation, the parties may agree to a specific amount to satisfy the amount owed or in dispute. This is known as a **compromise and settlement agreement.** When disputes arise between parties, it is not uncommon for parties to agree on a compromise amount (usually a lesser amount). The parties in effect are executing what is known as an *accord* and *satisfaction.* The compromise or agreement between the parties is known as the **accord** and the payment of the agreed amount is known as the **satisfaction.** This solves the problem of consideration. (*Note:* The accord and satisfaction always are prepared together and are treated as one document.)

4.7 PRACTICAL APPLICATION

Paralegals will assist their attorney in analyzing contracts for consideration. Is consideration present? If consideration is not found, does an exception apply? Case law will be your guide in answering these questions.

Contracts are full of provisions showing the element of consideration, which binds the agreement between the parties. Samples of such provisions are found in Exhibit 4-4.

EXHIBIT 4-4 General consideration provisions

General consideration provisions

General Form

In consideration of the sum of TEN THOUSAND DOLLARS AND NO CENTS ($10,000.00) paid to Marjorie Hight by Howard Brown, the receipt of which is acknowledged, Hight agrees as follows:

For Value Received

For value received, Harvey Brownwood agrees with Daniel Charleston to do the following:

Mutual Promises

The parties in consideration of their mutual promises to each other agree as follows:

Services Rendered

In consideration of the performance by Harvey Brownwood of lawn Care services, Daniel Charleston agrees to pay the total sum of $400.00 (Four Hundred Dollars and No Cents).

Love and Affection

In consideration of the natural love and affection that Mary Ann Michaels has for Joan Smith, Mary Ann Michaels agrees to:

Release of Claim Provision

In consideration of the release of the claim brought by Marjorie Hightsman against Howard Brown regarding the alleged defects in construction of her garage, Howard Brown to pay the amount of $4,000.00 to Marjorie Hightsman on or before June 15, 2010, as full and final payment of all claims.

Settlement Provision

In consideration of mutual promises, covenants, and agreements set forth in this settlement agreement, the parties agree as follows:

Real Estate Provision

Purchase and sale of property

In consideration of the mutual promises and covenants set out, Marjorie Hightsman agrees to sell and does sell, and Howard Brown agrees to buy and pay for, and does buy, the property located at:

Conveyance of real property

In consideration of the conveyance by Marjorie Hightsman to Howard Brown of the real property situated in Anytown, USA Howard Brown agrees to pay FIVE HUNDRED THOUSAND DOLLARS AND NO CENTS ($500,000.00) for the property located at:

Devise of real property

In consideration of the agreement by Marjorie Hightsman, contemporaneously with this agreement, to make a will and provide therein for the devise to Howard Brown of the real property more particularly described below, and the agreement not to revoke the devise contained in such will, and further agreement not to sell, transfer, convey, mortgage, or otherwise dispose of such property to any other person, Howard Brown agrees as follows:

Provision for a Gift

Gift of Household Goods

Know all men by these presents, that I, Anna Morris of Chicago, Illinois, in consideration of natural love and affection, give to my daughter, Jenna Morris, all the household furniture and effects, books, pictures, and all other tangible personal property whatsoever in my dwelling house at 128 Main Street, Chicago, Illinois.

Gift of Real Property

Witnesseth, that the Donor, in consideration of his natural love and affection for the done, does hereby give, grant, and convey to the Donee, her heirs and assigns, all the following described real property:

SUMMARY

4.1 Consideration is a necessary element in a contract. It is defined as a benefit to the promisor or a detriment to the promise, bargained for and given in exchange for a promise. For consideration to exist, there must be an exchange between the parties where a legal benefit and legal detriment occur.

4.2 Certain elements must be fulfilled for consideration to exist: (1) a detriment or benefit; (2) a bargained exchange of the parties; (3) for value; and (4) a promise between the parties; (5) that is legal. Value can be money, services, property, or the act of forbearing.

4.3 Courts do not have absolute rules to determine the adequacy of consideration. Whether the consideration is adequate depends upon the value placed on the promises by the parties.

4.4 When consideration is absent, the contract between the parties will not be enforced. Gifts lack consideration because there is no exchange between the parties. Similarly, with an illusory promise, there is no exchange between the parties; only a desire or wish is communicated. A past moral obligation will not be enforced, as consideration is lacking. When a past contractual relationship exists, no new consideration will be found to bind the new promises. The preexisting duty rule provides a basis for the prior contract's enforcement.

KEY TERMS

consideration
value
gift
benefit
detriment
mutuality
will
illusory promise
past consideration
promissory estoppel
statute of limitations
cause of action
liquidated claim
unliquidated claim
compromise and settlement agreement
accord
satisfaction

REVIEW QUESTIONS

1. How is consideration defined?
2. What are the basic elements of consideration?
3. Identify the different types of values that may constitute consideration.
4. How do courts determine the adequacy of consideration?
5. List some situations in which consideration is absent.
6. What is an illusory promise?
7. Define the preexisting duty rule.
8. What are the exceptions to enforcement of a contract that lacks consideration?
9. Under what doctrine have courts enforced charitable pledges? Why?
10. Distinguish between a liquidated and an unliquidated claim.

EXERCISES

1. Find examples in your daily life where consideration might become an issue. Look for contracts, deeds, tickets, and family bequests as situations where consideration is a focal point.

2. Dana was dating Wade, a wealthy real estate entrepreneur. Wade was much older than Dana and knew he needed to offer something "special" to make her stay. Wade told Dana that if she continued dating him, he would pay her $10,000 a month. Wade paid Dana for two years when suddenly, for no apparent reason, he stopped the monthly payments. Dana stayed with Wade for another six months, but decided enough was enough and left. She wanted the $10,000 she was owed for the six months Wade refused to pay her. Is Dana entitled to the $60,000?

3. Using the facts from Exercise 2, Dana decides that she wants the agreement in writing. Draft an agreement between Dana and Wade.

4. Edith Pendergast is a bit eccentric and owns one of the most important collections of American art and furniture dating from the early 19th century. She is 93 years old and is still in good health, but knows she cannot live forever. Many universities and colleges have approached her about her collection. She finally decided to pledge her art and furniture collection to the Art College of Maine when she dies. She notified the college of her decision. Excited, the college went to see Mrs. Pendergast to have her sign a contract memorializing the gift. Mrs. Pendergast said she wanted to have her attorneys review the document before she signed it. A few days later, Mrs. Pendergast had a nasty fall. She was ordered by her doctor to stay in bed until her leg healed. Mrs. Pendergast never signed the agreement from the college before she died. Is the college entitled to the art and furniture? Explain your response.

5. Assume facts in Exercise 4, but now the college had begun construction of the new Edith Pendergast Wing. The college borrowed $3 million and purchased two acres of adjoining property for the construction of the new wing. When the college heard of Mrs. Pendergast's passing, it immediately contacted your law firm to find out its options. The main question for the college is whether they

are entitled to Mrs. Pendergast's art and furniture collection, even though she never signed the agreement. Discuss all issues in your response.

6. Angela's new baby boy was just delivered by Dr. Malcolm Lowe, a staff physician at Regional Hospital. Dr. Lowe was paid a salary from the hospital for delivering babies for patients who were uninsured. Angela wanted her baby circumcised and asked Dr. Lowe to perform the procedure. He said he would do it only if she paid him $100 in cash. Angela told him she did not have $100 but offered him $50. He accepted the $50. When the Medical Director heard of Dr. Lowe's practice, he immediately called him to his office. Dr. Lowe did not see what the big fuss was all about. The Medical Director demanded that Dr. Lowe return Angela her $50. Why did the Medical Director order Dr. Lowe to return the $50? Could Dr. Lowe sue Angela for the $50 for the procedure? Explain your responses.

7. Paul Blackmun owns a 30 acre home just outside of Los Angeles, California. The home is worth over $50 million. Paul has had some financial difficulties lately and owes $10 million to various creditors. He also is behind on the mortgage on his beloved estate. He tries to raise the capital to pay his creditors, but is having no luck. Ronald Crossley, a wealthy land developer in Miami, has always admired Paul's house. He offers Paul $10 million for the home and agrees that Paul can live in the home for his life time so long as he pays all the utilities that are due each month. Paul agrees and has his attorney draft the documents. Both Paul and Ronald sign the document. Two years later, Paul is back on his feet and wants his house back. He claims that Ronald did not pay him a fair price for the home and wants the transaction voided. Does Paul have an enforceable contract with Ronald? Discuss the issues that each party would raise in a lawsuit. (Focus on the consideration issues only.)

8. For each of the following statements, identify and discuss the consideration issues presented.

    a. I promise to give you $8,000 in exchange for you losing 30 pounds in 6 months.
    b. For and in consideration of $1.00, Mr. Strickland will sell his collection of Beatles memorabilia in exchange for Mr. Evans quitting smoking.
    c. I promise to support you in the lifestyle to which you have become accustomed for the rest of your life.
    d. I pledge $3000 to the American Medical Society for research in diabetes.

9. Denny was lucky; his father was wealthy and he could play golf all day—every day. Denny began dating Cara. Cara always wondered what Denny did for a living since she never saw him go to work. Denny wanted to marry Cara, but Denny's father, Nicholas, told Denny that if he married Cara, he would cut him off completely. Denny was in love and knew his father would not carry out his threat, especially after his dad found out he was going to be a grandfather. Just as Denny predicted, his dad was overjoyed and promised Denny and his new bride a new house and an allowance of $15,000 per month as long as they remained married. Unfortunately for Denny, Cara grew tired of his behavior and threatened to divorce him. Denny communicated this to his father who

decided to increase the monthly allowance to $25,000. Cara stayed for a while, but finally decided to leave with her baby daughter. Denny's dad immediately stopped the monthly allowance. Cara is penniless. Cara sues her father-in-law based on the fact that he promised to provide for her as long as she remained married to Denny. Cara had no intention of divorcing Denny only changing her address. Is Cara entitled to her allowance from her father-law? Explain your response.

10. Richard and his brother Allan spend each weekend at garage sales and flea markets. This weekend they are going to an estate sale. While browsing around, Richard finds a box with lots of different items in it for $20.00. Richards thinks, what the heck, it will be fun to see if anything interesting is in the box. He offers $15 for the box that is accepted. The estate sellers ask Richard to provide a name and address for future sales. Richard and Allan bring the box home and begin rummaging through the box. In the bottom, they find an old comic book of Batman and Robin. The comic book appraises at over $500.00. Can the estate seller's reclaim the comic book from Richard and Allan? Why or why not?

CASE ASSIGNMENTS

1. Mildred Whitman was diagnosed with a fatal disease. She had no family. Amelia was Mildred's neighbor of 15 years. Amelia would stop by Mildred's house and bring food. Mildred wanted to die at home, so she asked Amelia if she would consider moving into her house until she passed. In exchange for this, Mildred promised to give her the house and its contents. Mildred hand wrote her wishes on a sheet of paper. She signed the bottom of the paper. While Mildred was alive, she frequently gave Amelia pieces of her jewelry—a ruby and diamond ring, a pearl necklace, a sapphire bracelet with matching earrings and a diamond solitaire pin. Mildred died a few months later. When Amelia began moving her things in the house after selling her house, she received a letter from an attorney stating that Mildred's nephew was claiming that the house was his. The nephew also wanted all Aunt Mildred's possessions, too. Amelia wants to know whether she can keep the house, the contents, and the jewelry. Prepare a memorandum for your attorney, researching and discussing the contract issues.

2. Susanna Star is presently under contract with Network Television where she earns $50,000 per episode for starring in the comedy, "Me and You." It is the number 1 show on the network. Susanna receives a call from her agent who tells her that network called her asking if she would forgo her yearly salary increase as the network was in financial trouble. Her show was expensive to produce, and the show was apparently looking for ways to keep it on the air. Susanna did not like their request. Her agent stated that the studio had an obligation to pay the increase as long as the show was on the air. He also stated that the studio hinted at letting some of her co-stars go in order to pay her salary. Susanna asks her agent to research her contractual obligations. She wants to know what her options are since she just purchased a new house in a suburb of L.A. (Focus only on the issues involving consideration.)

Chapter 5

Mutual Assent of the Parties

Just Suppose . . .

A client comes into your office with the following story:
Hal Litavak divorced his wife, Marion two years ago. Among their assets was a house in Long Island, a condo in Boca Raton and numerous bank accounts, including an investment account with Barney Middorf, a highly respected investment banker in New York city. In early 2008, the Securities and Exchange Commission, SEC, began investigating Mr. Middorf and determined that Middorf was not as he had represented. Their $5 million account was virtually worth nothing. They were one of thousands of investors who had been caught in the biggest Ponzi scheme in American history. The problem is, as Hal tells it, he paid his wife half of the value of their Middorf account at the time of the divorce settlement—just over $2.5 million. Now, Hal realized that the settlement was not based in fact but was really a huge fraud and wants to have the divorce settlement either thrown out or reformed to reflect the true value of the account and have his former wife repay him the value of the estate based upon a new valuation. Hal believes that had he and Marion known the truth, he would never have agreed to pay the cash settlement in the divorce. Hal wants action now as he cannot afford his house payments and is facing foreclosure. Hal believes that he has a case based upon mistake and wants the law firm's advice as to whether he can pursue claims against his former wife.

Outline

5.1 MUTUAL ASSENT DEFINED

One of the most important parts of a contract is the parties' agreement to the terms and conditions set forth in the offer and acceptance. The parties must willingly and genuinely assent to the terms of contract or the contract may be invalid. This is known as **mutual assent.**

mutual assent
A meeting of the minds; consent; agreement

Mutual assent is "the meeting of the minds." Under the law, this concept signifies that all parties have been open and honest in their dealings and that all understand the basis of the bargain. There are no hidden terms or meanings; each term is stated and is what it is. The communication of the offer and the acceptance leads to an agreement between the parties and thus is a necessary element to a contract.

To determine whether mutual assent exists, a court will apply an objective standard. Did the parties to the contract act in such a way that it could reasonably be concluded that the parties show a contrary intent? The essence of mutual assent hinges on the parties having a mutual understanding of the terms and conditions of the contract. As with an offer, critical to the concept of mutual assent is the intent, viewed objectively by a third party. Most terms must be clearly identified so that, objectively, a conclusion can be reached that a contract was consummated. Consequently, when the offer is communicated to and accepted by the offeree, an agreement is reached between the parties known as mutual assent.

5.2 METHODS OF DESTROYING MUTUAL ASSENT

A problem arises when parties are not honest and genuine or make mistakes in their contractual negotiations. When terms are deliberately omitted, or mistakes occur, or parties are placed under undue pressure, the contracting process suffers. When these problems occur, mutual assent does not exist and the contract will fail. The most common ways to destroy mutual assent are fraud, misrepresentation, mistake, duress, and undue influence. If one of these things is proven, the contract will terminate.

rescission
The abrogation, annulment, or cancellation of a contract by the act of a party. May occur by mutual consent of the parties

unconscionability
A form of contract where a dominant party has taken unfair advantage of a weaker party and has imposed terms and conditions that are unreasonable and one-sided

Another method of destroying mutual assent, which has developed over the years, is embedded in public policy. Protecting the public from unfair contracts is a basis for **rescission** of a contract because of lack of mutual assent. A common public policy argument used by attorneys and courts is **unconscionability.** Often, this occurs when a party to a contract takes advantage of the other party by using terms that are patently unjust or unfair.

Whatever the means, all these methods (see Exhibit 5-1) destroy the meeting of minds and thus terminate a contract.

EXHIBIT 5-1

Methods of destroying mutual assent

Destroying Mutual Assent	
Fraud	Duress
Misrepresentation	Undue influence
Mistake	Unconscionability

Fraud

fraud
Deceit, deception, or trickery that is intended to induce, and does induce, another to part with anything of value or surrender some legal right

Fraud is a common method of destroying mutual assent. By definition, it is a wrongful statement of fact or omission of fact knowingly made by one party with the intent to induce another party into entering a contract. Although fraud has many definitions, critical to establishing fraud as a basis for destroying mutual assent is that the party knew that his or her representation or statement was false. To understand fraud, we need to dissect its elements.

Misstatement of Fact

To establish fraud, a party must show that the party initiating the contract misstated a fact or failed to state a fact. Assume that a car buyer asks whether the mileage on the odometer is accurate. A few days before, the salesperson watched the mechanic roll back the odometer. If the salesperson tells the buyer that the odometer is accurate, then a misstatement of fact occurs. Similarly, if the salesperson does not tell the buyer that the odometer is inaccurate, even though he or she knows it is, that constitutes an omission of fact.

Fact is Material

Simply misstating a fact is insufficient. The misstatement or omission of fact must be material to the contract, that is, it must be critical to a party's decision to enter into the transaction. It goes to the heart of the contract. Following the car example, had the buyer known that the mileage was inaccurate, the buyer probably would not have purchased the car. The mileage was important to the buyer in rendering a decision. Inaccurately representing the fact that the odometer had been rolled back and the mileage misstated is material to the contract.

Knowledge of False Statement

Central to proving fraud is proving that the party making the statement had knowledge of its falsity. At the time the statement is made, the party must know it is false. Using the same example, the salesperson knew that the odometer had been rolled back, but still represented that the mileage was accurate. Making this statement with the knowledge that it was false was an element of the fraud. Knowledge is critical to establishing a case of fraud.

Intent to Deceive

A person claiming fraud must prove not only that the statement was made falsely, but also that the person who made the statement had the intent to deceive the party to whom the statement was made. The intent must be deliberate and with total disregard to the actual facts. To establish a claim for fraud, the party making any statement or omission must be shown to have had the intent to deceive the person into entering into a contract. This is critical to a fraud claim. Again, in the odometer example, the salesperson clearly had the intent to deceive the perspective buyer into purchasing the car, as the sales person knew about the odometer rollback. By showing an intentional misstatement of a material fact, a case of fraud is almost complete.

Reliance on Misstated Fact of Representation

In addition to showing the representations made by the person committing the fraud, it must be shown that the person to whom the communication was made relied to his or her detriment on the false representations of that party. If it can be shown that that the person accepted the contract, that the person relied on the representations made, and that the representations proved to be deceptive, a case for fraud is virtually assured. Continuing with the odometer case, the salesperson represented that the lower mileage count was accurate; there is no doubt that the buyer relied on this deception, which became part of the basis for the buyer's entering into the contract. The reliance element is established.

Representation Caused Damage

The final element of fraud is that damage resulted because the defrauded party relied to his or her detriment on the misstatement or omission of fact. This element directly goes to the issue of injury. To successfully establish a case for fraud, a party must show that it has been injured or damaged by the other party's representation and that the representation caused harm. This element is usually easy to show when the other elements are present. Finishing the odometer example, the demonstrable injury or detriment is that the purchaser lost substantial value in the car, because he or she did not pay on the basis of the car's true mileage. As the true mileage was much higher, the value of the car is substantially diminished, causing injury or harm to the purchaser. Therefore, the damage would be the difference between the actual value of the car (with the true mileage) and the amount actually paid by the purchaser.

Effect of Fraud

When a person can prove fraud, the contract is usually voidable by the person who has been injured. The reason the contract is voidable is because a critical element of the contract has been destroyed: the mutual assent. To this end, a court will award a party damages (money) or rescind the contract (cancel it) and place the parties back in the same position they would have occupied prior to consummating the contract. (See also Exhibit 5-2.)

The damages and remedies that a court can award are discussed more fully in Chapter 10. For discussion of fraud and its effect on a contract, examine *Weintraub v. Krobatsch*, 317 A. 2d 68 (N.J. 1974). Notice what the court considered in determining whether fraud was present.

Line of Reasoning

What do you do if you inspect a home and it is later determined it is infested with cockroaches? You sue, of course. This is what happened in *Weintraub v. Krobatsch*. The Krobatsches viewed Mrs. Weintraub's Englishtown home. The buyer's inspected it and entered into a contract to purchase the home for $42,000. There was a provision in the sales agreement that stated that the seller inspected the property and was satisfied with its condition. The agreement further stated that the seller does not make a representation as to its present or future condition. The buyers presented a deposit of $4250 to the broker. The buyers wanted the house fumigated, which was done.

Just prior to closing, the buyers went to see the house one last time. It was empty and dark. When they turned on the lights, they saw roaches running in all directions, up the walls, drapes—everywhere. Immediately, the buyers had their attorney send a letter to the seller telling her that the house was uninhabitable, especially since it had recently been exterminated, and rescinded the contract for the purchase. Mrs. Weintraub rejected the rescission of the contract and filed a lawsuit. Weintraub wanted to keep the deposit and the broker, who became a defendant, wanted to keep his commission. The Krobatsches just wanted out. In the trial court, the judge found not only for Mrs. Weintraub, but the broker—thus, the deposit and the commission. The buyers appealed. The issue was whether there was fraudulent concealment and nondisclosure entitling them to rescind the contract. Mrs. Weintraub claimed that she did not conceal any facts—she simply may have been silent. In analyzing many different lines of cases, the court rejected the position that silence is a fair defense to facts such as these and followed, what was then considered a newer approach, imposing justice and fair dealing in the purchase and sale of real estate. This case made a drastic departure of past precedent and followed the approach that justice and equity require a person to speak whenever fair dealing demands it. In fact, the court recognized that a party who conceals or suppresses a material fact which in good faith should have been disclosed, the silence is considered fraudulent. Citing a number of cases from other jurisdictions where seller silence was determined to be fraudulent, the court found that such silence is fraud when a material fact is knowingly concealed. Even attempts to sell a property "as is" did not preclude the rescission of the contract. Moreover, these principles also applied to the actions and conduct of the broker. Following a number of other jurisdictions, the court stated that the broker had a duty to disclose the known defects, but the failure to do so was considered an affirmative and intentional misrepresentation to the buyer for which there was liability. Therefore, the broker also can be held liable for damages caused by his wrongdoing along with the seller. In its final conclusions that court weighed whether the nondisclosure was material or minor. In doing so, the court compared the nondisclosure to previous cases which dealt with the failure to disclose termite infestation. In those cases, the court considered it a material nondisclosure, especially due to the structural implications. Similarly, the court acknowledged that roaches were not structural, but the impact on the buyers was the same. Here, the buyers were willing to purchase the property until they discovered the roach problem. Therefore, the court found for the Krobatsches and rescinded the contract of sale.

Questions for Analysis

Review *Weintraub v. Krobatsch*. What was the prior precedent that the court did not follow and why? Would the courts result have been different had the Krobatsches moved in and discovered the roaches after the sale had taken place? If the roach problem surfaced six months after the purchase of the home, would the courts result have changed?

State Your Case

Angelo and Maria Rivera are interested in purchasing a new boat for their weekends at the lake. They begin looking at some used boats and found the perfect one. The seller, Edward DeLuca, really needs to sell his boat. He is going through a divorce. Although he loved this time on the boat, the upkeep was just getting too expensive; plus, the constant replacement

of the wood under and around the hull was getting to be annoying. He just couldn't figure out why the wood was in constantly need of replacement—could it be termites? He just was not sure—at least that's what he told himself. The Riveras inspected that boat and decided it was a great deal. The purchase price of $5000 fit their budget. Two days before the closing, Angelo just happened to be walking around the dock and heard some of the boat owners talking about that DeLuca boat. How could Ed sell that boat without telling the buyers about the hull problem? Angelo immediately called his lawyer and wanted out of the contract. What actions should Angelo take against Ed? Would he be successful in a court of law? Explain your responses.

EXHIBIT 5-2 Elements of Fraud

Fraud	
1. Misstatement of fact	4. Reliance on deception
2. Fact is material	5. Representation caused damages
3. Knowledge and intent to deceive	

Misrepresentation

misrepresentation A misstatement of fact designed to lead one to believe that something is other than it is; a false statement of fact designed to deceive

Fraud and misrepresentation have similar characteristics. **Misrepresentation** is defined as a misstatement of fact or omission of fact made innocently without the intent to deceive. The key difference between fraud and misrepresentation is the element of intent. In misrepresentation, the statement is made innocently without the knowledge necessary to establish deliberate conduct.

Using the odometer example from the previous section, assume that the salesperson had no reason to suspect odometer tampering. When asked whether the odometer was an accurate reflection of the mileage, the salesperson answered yes, and misrepresentation occurred. This clearly is a false statement of fact, but in this instance, it is not made knowingly with the intent to deceive—it is made innocently. That is the distinguishing characteristic between fraud and misrepresentation.

The Duty to Disclose

An issue that is a constant source of debate is how far a party's duty to disclose extends. Must all facts be disclosed? Must a party correct a false assumption? The answer, unfortunately, is that it depends. The law requires that parties act honestly in their dealings. Withholding vital or material information can give rise to a claim of misrepresentation. For example, assume a seller puts a house on the market. Prior to placing the house on the market, the seller notices that some of the wood in the house has rotted and as a precaution has a pesticide company spray for termites. While walking through the house, prospective buyers ask whether the house has termites. Does the seller have a duty to disclose that the house was sprayed for termites? The answer is probably yes, because the

Cybercises

Using the Internet, find five cases where mutual assent was destroyed because of fraud and five cases because of misrepresentation. Identify the facts that were pivotal in finding fraud or misrepresentation.

seller suspected termites in the house. Would a negative response to the buyer's question result in a claim for misrepresentation? The answer is probably yes.

Understanding the duty to disclose means understanding what constitutes a material fact. If the matter affects a basic assumption in the contract, the duty to disclose exists. Here the issue is not only materiality of the information, but also that one party is relying on a misplaced assumption. Did the misrepresentation induce the party to enter into the contract? If so, misrepresentation exists.

With the advent of many consumer protection laws and more transparency in business transactions, full and complete disclosure is now the standard. The old doctrine of caveat emptor—"let the buyer beware"—is no longer a safe haven for the dishonest or even the innocent. The law has made a 180-degree turn, from placing limited responsibility on sellers for nondisclosure to placing heavy burdens on sellers for full and complete disclosure. *Zimmerman v. Northfield Real Estate, Inc.,* 156 III. App.3d 154, 510 N.E.2d 409 (1986) follows the current approach taken in fraud cases. The courts now place a higher burden on the party with the knowledge rather than the unsuspecting innocent party.

Line of Reasoning

The Zimmermans purchased a home from the Dunns through Northfield Real Estate, Inc., for $325,000. The contract contained the following exculpatory clause:

> Purchaser acknowledges for the benefit of Seller and for the benefit of third parties that neither the Seller, broker nor any of their agents have made any representations with respect to any material fact relating to the real estate, its improvements and included personal property unless such representations are in writing and further that Purchaser has made such investigations as Purchaser deems necessary or appropriate to satisfy Purchaser that there has been no deception, fraud, false pretenses, misrepresentations, concealments, suppressions or omission of any material fact by the Seller, the Broker, or any of their agents relating to the real estate, its improvements and included personal property.

After the Zimmermans moved in they discovered that the lot was smaller than represented and that the house had numerous defects, such as water damage and leaks in the basement; the living room had a substantial hole in the wall; and the plumbing system did not properly work, to name a few. The Zimmermans filed a lawsuit for fraud, negligent misrepresentation and other statutory violations against the real estate broker and former owners. In analyzing the situation, the court set forth the elements of fraud which are:

> (1) a false statement of material fact was intentionally made; (2) that the party to whom the statement was made had a right to rely on it and did so; (3) that the statement was made for the purpose of inducing the other party to act; and (4) that reliance by the person to whom the statement was made led to his injury.

Intentionally concealing a material fact or failing to speak when a duty exists also may constitute fraud. The brokers were considered a fiduciary of the Zimmermans, and thus had a duty to disclose what they knew about the house to them. Silence is not a defense. Furthermore, the

omissions and false statements were material to the Zimmermans inducement to purchase the house. Apparently, the entire neighborhood knew about the Dunns' flooding problems, calling it "Dunn's Lake." The brokers considered it mere "puddling." Even the lot size had a 40% difference than was represented by the brokers. The broker's characterization of the lot as "somewhat smaller" was more than a misstatement. The court was not persuaded by these stilted representations. Because of these misrepresentations, the Zimmermans spent a considerable amount of money fixing the problems; the lot size diminished the value of the house—they did not get what they purchased. As part of their complaint, the Zimmermans also alleged negligent misrepresentation because of the duty owed to them by the defendants. The next issue the court dealt with was the exculpatory clause. As the court stated, these types of clauses are not favored under the law. Because of the public policy concerns and the higher duty of owed to the Zimmermans, the court held that the exculpatory clause was unenforceable; the parties could not hide behind it to cover up their wrongful actions. In short, the court held that plaintiffs had pled causes of action against the defendants.

Questions for Analysis

Review *Zimmerman v. Northfield Real Estate, Inc*. Could the issues raised have been prevented by the Zimmermans' being more diligent? Why or why not? What actions, if any, could the broker have taken to prevent the accusations of fraud and negligent representation? Are there any facts that would have allowed the sale to be completed knowing all the defects in the property? Explain your answers.

Giving part of the truth creates a misleading impression and will constitute misrepresentation. The duty to disclose is clear.

Duty to Disclose: Fiduciaries

fiduciary relationship
A relationship between two persons in which one is obligated to act with the utmost good faith, honesty, and loyalty on behalf of the other

The duty to disclose is imposed on persons who are in **fiduciary relationships.** Persons who are in positions of trust, where other persons rely upon them to be truthful and honest, are required to disclose all information known to them. This relationship arises between partners, attorney and client, and trustee and beneficiary. A duty of utmost good faith and loyalty exists in a fiduciary relationship. In an ordinary situation, the duty to disclose certain information may not arise, but the reliance of a person on the fiduciary creates a special duty under the circumstances. Therefore, failure to disclose information will lay the foundation for a claim of misrepresentation.

plaintiff
A person who brings a lawsuit

defendant
The person against whom an action is brought

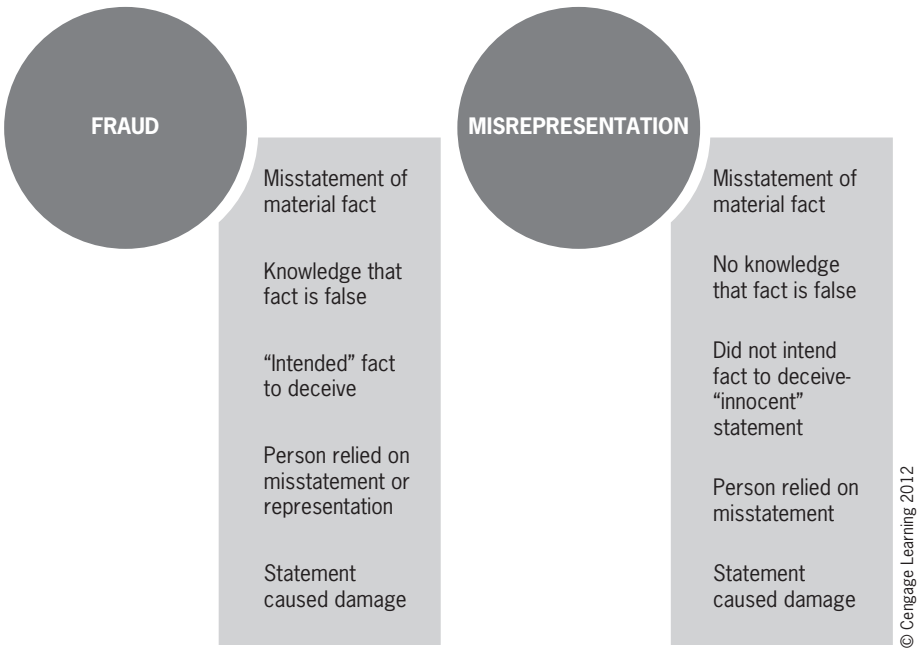
A showing of misrepresentation forms the basis of recovery by a wronged party, the **plaintiff,** against the alleged wrongdoer, the **defendant.** The recovery can be in the form of money (legal damages), or in the form of an equitable remedy such as rescission. When a contract is rescinded, the court basically turns back the hands of time and places the parties in the position they were in before the misrepresentation. In effect, by rescinding the contract, a court erases the obligations and duties of the parties—with one notable exception: The defendant often pays for the injustice caused.

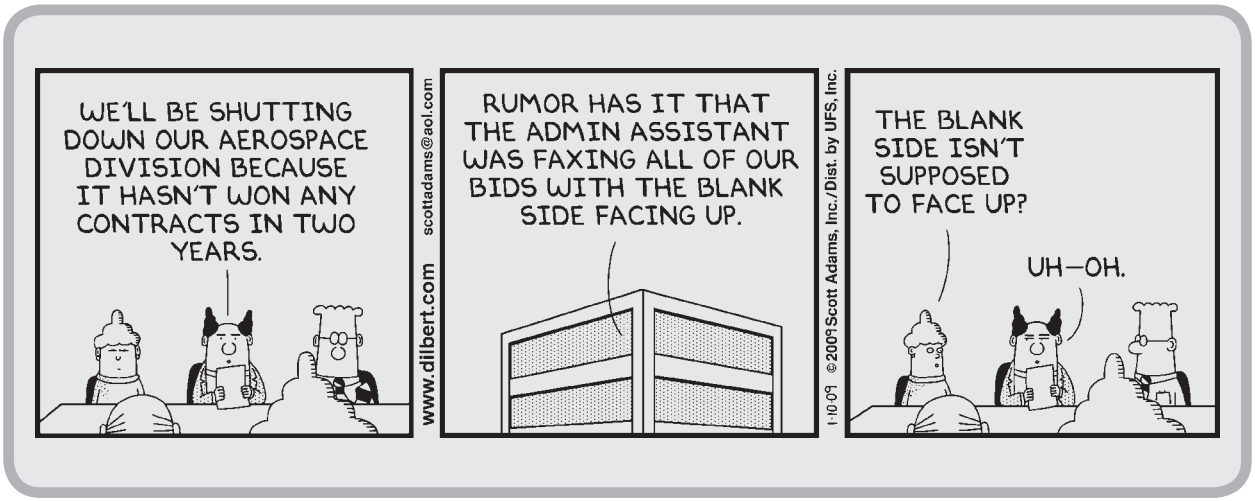
Strictly Speaking: Ethics and the Legal Professional

Attorneys and paralegals are in a position of trust regarding clients. Because of this relationship, the cannons of ethics place a heavy duty on legal professionals to accurately relay facts in transactions on behalf of the client. When legal professionals take advantage of a relationship with a client to the client's detriment, courts' and bar associations' actions are often swift and permanent. As courts have recognized, failure to disclose all material facts may be considered concealment. In a recent case in Texas, In Re TOCFHBI, Inc. 413 B.R. 523, 2009 WL 2382975 (N.D. Tex. 2009), the court noted when and how this duty is breached. It stated that "benefitting improperly from the attorney–client relationship by subordinating the client's interests to [the interests of the attorney], [improperly] retaining the client's funds, engaging in self-dealing, improperly using the client's confidences, failing to disclose conflicts of interest, and making misrepresentations to obtain these results" all can result in a breach of the fiduciary duty. As a result, it is important as a paralegal to be mindful of your relationship with and to the client. You are expected to and are often held to the same standards as an attorney. Thus, even if the facts are hurtful or not in the client's favor, professional responsibilities require the utmost of openness and honesty when dealing with a client's business.

Because the element of intent can be difficult to prove, parties who are alleging that a contract lacks mutual assent because of fraud also often allege misrepresentation. If a party cannot prove the intent element necessary for a fraud case, that party may resort to showing that the statement was made innocently and prove misrepresentation. In this situation, recovery can be awarded by a court. Exhibit 5-3 is chart comparing the elements of fraud and misrepresentation.

EXHIBIT 5-3 Comparison of fraud and misrepresentation





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State Your Case

1. In the fact pattern at the beginning of the chapter, can Mr. Litvak sue his former wife based on fraud or misrepresentation? Be sure you analyze each of the elements of both fraud and misrepresentation in responding.
2. Does Mr. Litvak have a case for fraud or misrepresentation against Barney Middorf? Examine each to determine the basis, if any, of Mr. Litvak's case.

Mistake

mistake
An error, a misunderstanding; an inaccuracy in contract formation

Mistake is another common reason to destroy mutual assent. **Mistake** occurs when the parties to a contract are wrong about some act or event that is material to the transaction. As with fraud or misrepresentation, one of the critical elements is the materiality of the mistaken facts. Ignorance of the law or illiteracy will not form a basis of mistake. The courts will hold such parties to the content of the agreement.

Courts distinguish between two types of mistakes: mutual mistake and unilateral mistake. For a contract to be set aside or rescinded, a mistake normally has to be mutual. In a unilaterally mistake situation, courts normally will not rescind the contract, but will hold the parties to their duties and obligations.

mutual mistake
A misconception common to both parties to an agreement, each laboring under the same set of facts with respect to a material fact justifying reformation of the contract or rescission

Mutual Mistake

In a **mutual mistake,** both parties are wrong about a material fact of the transaction, and thus the court will often rescind the contract. Because there has not been a meeting of the minds, in that the parties to the contract have not agreed on the terms and conditions of the contract, a contract cannot be consummated. When mutual mistake is asserted, either

party may renounce the contract, thus making the contract voidable. The *Restatement (Second) of Contracts* § 152 sets out three basic requirements to prove mutual mistake:

> (1) the mistake must be made as to a basic assumption of the contract; (2) the mistake must have a material effect on the contract; and (3) the party requesting relief cannot bear the risk of the mistake in the contract.

Taking each of the elements from the *Restatement* separately, the following should be analyzed in a mistake case.

1. *Mistake as to basic assumption of contract.* The legal requirement that the mistake must be made as to a basic assumption of the contract focuses on the subject matter of the contract and the parties' intentions. For example, if the parties are contracting for sale of a condominium in a Florida resort and the buyer assumes that the condominium is on the beach and the seller assumes that the condominium at issue overlooks the parking lot, a basic assumption of the contract is misunderstood, creating the basis for a mistake.
2. *Mistake must have material effect on contract.* The next legal requirement, that the mistake must have a material effect on the contract, suggests that if the mistake does not go to the heart of the contract, a mistake will not be found. Continuing with the condominium example, if the buyer assumed that the condominium was on the beach, whereas the seller thought a condo with parking lot view was the subject of the sale, the mistake would have a direct effect on the contract. However, if two beachfront condominiums were for sale and the only difference between the units was the unit numbers, a mistake would not be found that would set aside the contract.
3. *Party requesting relief cannot bear risk of mistake in contract.* The final element is that the party requesting relief cannot bear the risk of the mistake on the contract. In this situation, the mistake cannot be by the party bringing the lawsuit. For example, if the buyer never looked at the condominiums and wrongfully assumed that the condominium was on the beach, then a mistake has not occurred.

If these elements are proven, mutual mistake exists. One of the most famous cases dealing with mutual mistake involves two men contracting for the sale of a cow. *Sherwood v. Walker,* 66 Mich. 568, 33 N.W. 919 (1887) illustrates the concept of mutual mistake.

Line of Reasoning

In *Sherwood*, the plaintiff wanted to purchase a cow apparently to use as food. The defendants, breeders of Angus cows, told the plaintiff that the cows he was examining were probably "barren" and would not breed. Plaintiff picked a cow known as "Rose 2d of Aberlone." The parties agreed on a price and confirmed the sale in writing. Plaintiff attempted to tender $80.00 to the defendants, which was the agreed upon amount for the cow. However, the defendants refused to accept the check because the cow "was with calf." This increased the value of the cow substantially from the

original $80.00 to over ten times its value. (Apparently, a barren cow is worth far less than a pregnant one.) Under the original terms of the contract, both parties believed that "Rose" was barren and would not breed. Focusing on the concept of mutual mistake, the Court observed that "[i]t must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact—such as the subject matter of the sale, the price or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual. The mistake must be a material part of the substance as a whole of the contract." In this case, the court determined that the cow was substantially more valuable as a breeder rather than barren. Based upon this basic assumption, the parties would not have entered into the contract had they believed that "Rose" was capable of breeding. In reaching its conclusion, the court stressed that "the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature that a breeding one. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale, but the mistake affected the character of the animal for all time, and for its present and ultimate use." The court holding that mutual mistake existed, and therefore, the defendants had a right to rescind the contract and refuse to deliver "Rose."

Questions for Analysis

Review *Sherwood v. Walker*. What if "Rose" the cow was not with calf and the sale went through, but the Walkers found out a year later that Rose was with calf; could the contract be rescinded based upon mutual mistake? If the mistake was discovered five years later, would the result have changed? Support your response based upon a discussion of mutual assent and methods of its destruction.

Unilateral Mistake

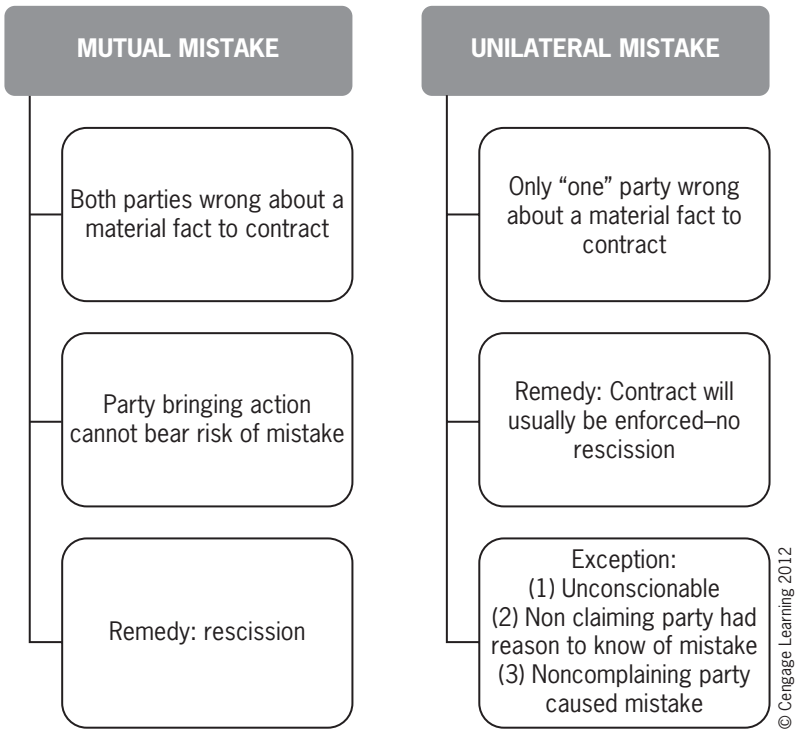
unilateral mistake
A misconception by one, but not both, parties to a contract with respect to the terms of the contract

The situation is different for a **unilateral mistake,** a common basis for wishing to set aside a contract. In a unilateral mistake case, only one party is mistaken about a material fact to the transaction. Traditionally, a court will not rescind a contract based on unilateral mistake. There are some exceptions to this rule, but courts rescind contracts based upon unilateral mistakes sparingly.

For a unilateral mistake, *Restatement (Second) of Contracts §* 153 adds a requirement to those set out under mutual mistake: "enforcement of the contract would be unconscionable *or* the other party (the one not claiming mistake) had reason to know of the mistake *or* the noncomplaining party caused the mistake." If a party can prove all the requirements under Section 153 of the *Restatement,* a contract can be voidable based upon unilateral mistake.

Proving unilateral mistake is difficult and, as a result, courts take care in using unilateral mistake as a basis to cancel contracts. Exhibit 5-4 provides as summary of mutual and unilateral mistake.

EXHIBIT 5-4 Summary of mutual and unilateral mistake



State Your Case

Suppose a food manufacturer runs a contest for the general public. Coupons are printed up with different prizes, with one of the grand prizes being a van. To win, a contestant needed to match a front half of a van to back of the van. Supposedly, only a limited number of cards made a complete van. Unbeknownst to the manufacturer, the printer mistakenly printed too many winning tickets. When numerous contestants won and attempted to claim the prizes, the company refused, stating that there had been a mistake and offered small sums of cash instead. Was a contract created? Was there a basis to void the contract? What defenses could the manufacturer assert to avoid the contract? Discuss all issues.

Now, let's get back to our example from the beginning of the chapter. Hal Litvak wants to have a court review his divorce from his former wife Marion. Hal claims that had he known Barney Middorf had defrauded or misrepresented the value of his portfolio he never would have entered into the settlement with his former wife Marion. The basis of his case is mistake. The first question to ask yourself is whether the case was based upon

mutual or unilateral mistake. That could make a significant difference in the outcome of the case. Hal asserts that both he and his former wife believed their portfolio with Middorf was worth $5 million when in fact it was worth nothing. Applying the elements of mutual mistake, both parties were under a basic assumption in the contract that being the value of the portfolio. Believing the value of the portfolio to be $5 million, Hal agreed to pay Marion her half of the account. The Litvaks relied on the value of the account as presented, which was a material fact in both of them entering into the settlement agreement. And lastly, Hal did not know that Barney had lied to him about the value of the portfolio and could not have performed any due diligence to reveal the fraud. The end result is that Hal has a good case for mutual mistake.

Cybercises

Locate other examples of mutual and unilateral mistake cases using www.findlaw.com or a similar legal Web site.

TECH CHECK

Texting has become a way of life and so have its abbreviations. Many are, or at least should be, common. We often see words shortened or letters replaced as we attempt to quickly respond to a text message. But what you believe is a common understanding of a term may not be the recipients. Many use the letters "lol" to mean "laugh at loud," but can have an alternative meaning, such as "lots of luck." Both phrases have completely different meanings. Similarly, a common response in a text is the short handed response to "okay" with just the letter "k." We also know that "K" in the contracts world means "contract." The point is that know what you mean when you mean what you say . . . or so you thought. Technology is great—there is no denying that. But, when you are a legal professional know that any communication, regardless of the form, can have legal consequences even unintended ones. Texting is great between friends and family, but in the professional setting, texting can be risky and a bit dangerous. Be cognizant of what you are communicating and the mode of communication. What you may have intended may be interpreted in way you never imagined, so think before you hit that "reply" button in a medium that relies on abbreviations as a primary method of communication.

Duress

duress
Coercion applied for the purpose of compelling a person to do, or to refrain from doing, some act

Duress is another means to avoid a contract. Duress is wrongful pressure placed upon a person so as to deprive him or her of free will. For a duress action to be sustained, specific elements must be proven. The party alleging duress must show that the pressure or force asserted was extreme and that, had the pressure not been exerted, the party would not have entered into the transactions.

Coercion

Duress is difficult to prove, as it must go beyond a mere threat or overcoming of a party's free will. In a duress case, the pressure must be such that the conduct is extreme and not merely that the party was vulnerable. Coercion is a key element to a duress case.

Assume that you visit your dentist to have a tooth capped and you receive an injection of an anesthetic. You have an allergic reaction to the anesthetic, which later causes

dizziness and blotching on your skin. The doctor caps your tooth and you leave. You find out from a friend that other people have had similar reactions to and symptoms from such injections. Two months later, you bite into a candy bar and crack the dental work so that the cap falls out. You do not want to go back to the same dentist, but you cannot afford to go to another dentist. You contact the dentist and ask for a refund of the payment. The dentist refuses unless you sign a release of liability. Because you do not have the money and you want to go to another dentist, you sign the document. This may be a case of duress, if it can be shown that the doctor placed undue pressure on you to sign the release to get a refund and have the dental work repaired.

Four situations usually give rise to a duress case (Exhibit 5-5). First, when a party threatens another party with violence, duress exists. If you are a parent and someone holds a gun to your child's head and states, "Unless you sign this contract, I will shoot your child," duress exists. Secondly, threats of imprisonment can create inordinate pressure on someone, destroying free will. For example, your spouse threatens that if you do not sign this decree of divorce giving up custody of the children, assault charges will be filed. This form of coercion may create duress. Thirdly, a claim for duress arises when a party threatens to take or keep another person's property. Here one party wrongfully asserts a claim against a person's property to extract a contractual advantage.

EXHIBIT 5-5 Elements of duress

Duress
1. Threat of violence
2. Threat of physical imprisonment
3. Threat to take/keep personal property
4. Threat to breach contract

Finally, duress can be alleged when a party threatens to breach a contract. This may occur when a party is dissatisfied with a contract and attempts to use leverage to modify or change the contract terms by threatening a breach. A California case illustrates this issue. One of the stars of the movie *Problem Child II* demanded, during shooting, that his salary for starring in the role be raised from $80,000 to $500,000. The actor threatened to walk off the set and stop production if the contract price was not raised. The studio agreed, but later sued alleging duress. The studio won. The jury returned a verdict of duress; the studio only had to pay the original contract terms, and the young actor had to repay the excess amount.

A new form of duress, known as *economic duress* has developed, but it is *very* difficult to prove. Economic duress occurs when:

1. wrongful or unlawful conduct exists;
2. causing financial hardship;

3. when an injured party acts against his or her free will;
4. causing economic detriment to himself or herself; and
5. no immediate legal remedy exists.

Courts find economic duress in limited situations. This defense should be used sparingly. See if you agree with the court's decision as to whether economic duress existed in *VKK Corporation v. National Football League.*, 244 F. 3d 114 (2nd Cir. 2001).

Line of Reasoning

For all you football fans, this case is for you! Back in 1988, VKK Corporation bought the New England Patriots football team. As part of the purchase, VKK agreed to abide by the constitution and rules and regulations of the National Football League and agreed to obtain advance approval from the NFL of any transfer to another city or another entity. The Patriots were not doing well financially. As a result, VKK sought other cities to which to move the Patriots. Under the leadership of then Commissioner Pete Rozelle, the NFL agreed that if the Patriots could not secure a new stadium, then a move would be approved. One year later, Paul Tagliabue assumed the position of Commissioner and changed the NFL's position on transfers. Now, three quarters of the league's owners would have to approve a sale. In 1991, VKK began negotiating with a group from Jacksonville, Florida to bring the Patriots there. The Jacksonville group, Touchdown Jacksonville, Inc. (TJI) notified the NFL of their negotiations. The NFL told TJI that they did not favor a move and if they wanted a team they needed to cease negotiations with VKK, which they did. Finances became quite tight for VKK and the Patriots. The team was not profitable and could not maintain its financial obligations. A few months later, Jacksonville acquired an expansion team—the Jacksonville Jaguars. VKK's principal, Victor Kiam, approached the NFL and indicated that he had to move the Patriots to a more profitable city. Tagliabue opposed the move. The only way Kiam could sell the team was if it remained in New England. Kiam claims that this not only limited prospective buyers, but substantially lowered the value of the team. Eventually, James Orthwein bought the team, but only after he signed an agreement not to move the team. Two weeks before the scheduled closing, the NFL informed Kiam that he had to sign a release or the sale would not be approved. The document released the NFL of all claims, including antitrust claims. Two and one half years later, Kiam filed a lawsuit based upon antitrust violations and economic duress. A newspaper article outlined the "conspiracy" that had occurred among NFL owners during the various negotiations to block the Patriots' move to Jacksonville. One of the main issues that the appeals court focused on was the requirements of economic duress and whether it was present in this case. Along with other issues, VKK and Kiam challenged the validity of the release based upon a theory of economic duress. Applying New York law, the court stated that economic duress arises "when one party has unjustly taken advantage of the economic necessities of another and thereby threatened to do an unlawful injury." A contract induced by duress is voidable. The court then goes on to state that in order for economic duress to be raised, a party must act "promptly" to repudiate the contract [or release] otherwise, the right will be waived and ratified. The court's next point is key to the analysis; it stressed that, once a party accepts benefits from a contract or remains silent or acquiesces to the contract after a period of time when it could have been avoided, economic duress is not available. In evaluating the law, the NFL challenged the action not so much on the facts, but on the time in which an action was filed. Cases showed that six months was a reasonable time in which to file a lawsuit

and seek recovery under economic duress, but 30 months was not considered prompt action, leading the court to find that VKK forfeited its right to challenge the release and contract. In continuing its analysis, the court observed that economic duress usually is applied when there is a disparity of bargaining powers or because of economic circumstances or a combination of the two. Economic duress must be extreme and is only found in extraordinary cases. Kiam argued that, because he and VKK did not become aware of the conspiracy, such as in a fraud case, they should not be held to the "prompt standard," but only when they reasonably should have uncovered the fraud or conspiracy. However, the court concluded that Kiam knew about the conspiracy as early as one year before he filed a lawsuit and arguably was aware of the "situation" when he signed the release. Because of these facts, the court held that if Kiam was to challenge the release, he had to do it promptly after the execution of the release or not all.

Questions for Analysis

Review *VKK v. NFL*. Had VKK not seen the newspaper article, would there still have been a basis to bring a case of economic duress? What facts would have changed the court's result? Did VKK and Kiam have a case for fraud, misrepresentation, or undue influence? Does economic duress apply when one party simply drives a hard bargain? Explain your answers.

State Your Case

Prior to the commencement of World War II, many of the prominent citizens in Germany feared looting of personal items by the Nazis. One such citizen, Hanz Weiss, had a very valuable art collection which included many of the European masters. Given the threats of war, an art dealer in Germany approached him to buy one of his Van Gogh paintings. The art dealer reminded him that it was him or the Nazis, and thus, he relented for the sake of his family. He paid him a fraction of its value at the time. Nearly 50 years later, Berta, Hanz's daughter, received a telephone call from a prominent art dealer in New York stating that he had a Van Gogh for sale and was wondering whether she would be interested in purchasing it since she had expressed interest in the past. Berta said "yes." When she saw the painting, she immediately recognized it as the painting her father begrudgingly sold to the art dealer in Germany. Berta did not want to buy the painting since she believed it was already hers. Berta contacts her attorney, and she files a lawsuit for recovery of the painting. Does Berta have a case? Explain your response.

Undue Influence

undue influence Inappropriate pressure exerted on a person for the purpose of causing a person to substitute his or her will for the will or wishes of another

Undue Influence is yet another method of destroying mutual assent. Closely related to duress, the significant difference is that undue influence arises out of a confidential relationship. Undue influence occurs when a party who is in a position of trust unduly uses that position to gain advantages over a person who is in a weakened position. Undue influence can be a common problem with the sick and elderly. Quite often, caretakers

unduly influence weakened persons and extract monetary advantages from them. This can also occur within family relationships, as when one sibling influences a parent to disinherit another sibling in an attempt to extract inordinate monetary gain in the parent's will. When undue influence is alleged, courts look very closely at the method used by the dominant person and the circumstances surrounding the contract. How weakened or susceptible was the person? What is the relationship between the parties?

Another area in which undue influence cases are common is *fiduciary relationships.* As with a misrepresentation case, this often occurs between a trustee and beneficiaries, partners in a partnership, officers and shareholders in a corporation, and even in the legal profession between lawyers and clients. When these types of legal relationships are created, courts pay close attention to the acts of the fiduciary. What the court normally looks for is an unnatural disposition by a beneficiary to a trustee or to a person who is in a clearly controlling position, like an attorney; or by a sickly person. When an individual can show that undue influence occurred, the court can set aside the contract and void it.

Unconscionability

All contracts impose upon each party the duty to act in good faith and to deal fairly. When contracts are grossly unfair as to the performance or enforcement of one party, the issue of unconscionability may arise. An *unconscionable contract* is one that shocks public sensibilities and is unreasonably oppressive. Basically, such a contract results when the parties' bargaining positions are so unequal that the public is best protected by invalidating the contract, due to the oppressive and shocking nature of the bargain.

Although the doctrine of unconscionability dates back hundreds of years, the defense of unconscionability gained new momentum in the 1970s as a movement to protect consumers grew. The key element to proving that a contract is unconscionable is the showing of a lack of meaningful assent to the contract by a party claiming the defense and showing that the party affected truly did not understand the terms and conditions of the contract or had no choice, destroying mutual assent.

Unconscionability has been segmented into two areas: **procedural unconscionability** and **substantive unconscionability**. Each type deals with the contract process.

procedural unconscionability Circumstance where one party to a contract lacks meaningful choice or assent to a contract

substantive unconscionability Circumstance where contract terms are overly harsh or oppressive against one party

boilerplate Language common to all legal documents of the same type; standardized language

Procedural Unconscionability

When there is no meaningful choice by one party who enters into a contract, procedural unconscionability may exist. The key is in the party's assent to the contract. In forming the contract, the party is forced to enter into the contract without the ability to change, alter, or modify its terms. Nonnegotiable clauses, often referred to as **boilerplate** provisions, are tucked away in the contract, and the contracting party is in a "take it or leave it" position. Sometimes procedural unconscionability can occur when a high-pressure salesperson misleads consumers.

Restatement Second § 208 gives some guidance in determining procedural unconscionability. The *Restatement* suggests that unconscionability can be found if there is:

1. A belief by the stronger party that there is no reasonable probability that the weaker party will fully perform;

2. Knowledge of the stronger party that the weaker will be unable to receive substantial benefits from the contract;
3. Knowledge of the stronger party that the weaker party is unable reasonably to protect his or her interest by reason of physical or mental infirmities, ignorance, illiteracy, or inability to understand the language of the agreement.

As with most reasons for destroying mutual assent, a judge or jury will have to determine whether procedural unconscionability exists. Courts will look at the effect of the contract on the party who was restricted in contributing to the bargaining process.

Adhesion Contracts

adhesion contract A contract prepared by the dominant party (usually a form contract) and presented on a take-it-or-leave-it basis to the weaker party, who has no real opportunity to bargain about its terms

overreaching Taking unfair advantage in bargaining

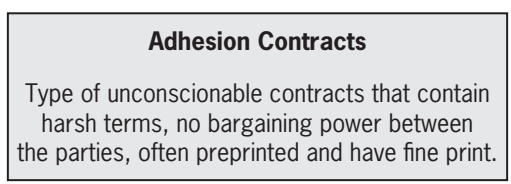
Some courts have termed unconscionable contracts to be contracts of adhesion. **Adhesion contracts** are ones where one party to the contract is able to impose its will on another party, leaving no mutuality of assent between parties. Some have considered this as **overreaching.** These kinds of contracts violate public policy and are usually set aside to protect the public good. What is key to understanding adhesion contracts is that these types of contracts are not open to negotiation. The offeree must take the terms as they are or forgo entering into the contract. This clearly puts the offeror at an unfair advantage and basically takes all aspects of mutual assent away from the contract.

Often, adhesion contracts are standardized. They are reprinted, nonnegotiated contracts in which terms are set in stone except for the parties, price, quantity, and length of payment. Otherwise, each term is set. Characteristics found in some adhesion contracts are *very* small type (the "fine print"), unclear or ambiguous terminology, or overly complex language that clearly favors the drafter.

Not all adhesion contracts are unconscionable, however, the court will review the totality of the circumstances surrounding the contract. Was there a gross disparity of bargaining powers? Did the party claiming an adhesion contract make any contribution to the bargaining process? Was there really mutual assent? If courts respond negatively to such questions, a contract of adhesion may be found.

The common thread winding through adhesion and unconscionability in contracts is the courts' attempt to protect the public welfare. Public policy is served by not allowing one party to unfairly benefit from a contract when the other party should not really participate in the contracting process. (See Exhibit 5-6.)

EXHIBIT 5-6 Characteristics of adhesion contracts



Substantive Unconscionability

Oppressive or overly harsh contracts are *substantively unconscionable.* This type of unconscionability often occurs with excessive price terms or unfair alterations in a party's remedies for breach of contract.

installment contract
A contract that requires or authorizes the delivery of goods in separate lots

Substantive unconscionability is prevalent in **installment contracts.** Here a party pays, over a period of time, a purchase price with accrued interest and charges on an item bought. Often the interest charges and fees are three to four times the actual price paid or the actual value of the items purchased. Courts have held that this is unconscionable and a basis for voiding the contract.

The other area where substantive unconscionability becomes a factor is in the remedies afforded a purchaser upon default under a contract. Here the individual or entity controlling contract terms expands its rights while diminishing the other party's rights. Courts have deemed this unfair and often refuse to enforce such contracts. Courts also have the option of excising the unconscionable clause to balance the contract's effect on the parties. The focus of the court's actions is always principles of fairness. Exhibit 5-7 illustrates the distinction between procedural and substantive unconscionability.

EXHIBIT 5-7 Illustration of distinction between procedural and substantive unconscionablility

Unconscionability in Contracts	
Procedural Unconscionability: Occurs when party does not understand contract, its terms and conditions, or has lack of knowledge, such as illiteracy, infirmity, language.	*Substantive Unconscionability*: Contract where some of its terms are highly oppressive or overly harsh.

5.3 PRACTICAL APPLICATION

Indications of fraud and misrepresentation do not often jump off the pages of a contract, crying for investigation. Rather, facts develop that suggest that parties have not been honest in their dealings. As a paralegal, you may be asked to investigate circumstances in which fraud or misrepresentation may have occurred. Similarly, in a duress or undue influence case, the issues do not jump out at you—they require analysis and examination. Along with your attorney, always ask questions and probe into the minds of the parties to the contract to determine if the mutual assent has been destroyed. Often, it is a slow, deliberate process.

Mistake is a bit different. Mistake often appears on the face of the contract, such as in the price or quantity term; these are usually clerical errors. To avoid this problem, thoroughly check contracts for mathematical, typographical, and spelling errors. If it is your job to check figures and proofread, do so carefully. Any legal professional's nightmare is missing a critical word (like omitting the "not" from "shall not") and thus changing the entire meaning of the contract.

The paralegal should pay special attention to provisions that appear too one-sided and thus might be unconscionable. Provisions that should be closely watched are default, remedy, and interest provisions. Courts scrutinize these provisions closely, and they are often litigated. This section gives some examples of provisions that have been determined ineffective by some courts. The key in evaluating a provision is whether its effect is a punishment and whether the parties had freedom in the negotiating process.

Default Provisions

When a party does not perform its obligations under a contract, that party is in default. Virtually all contracts have default provisions. To analyze the validity of a default provision, determine what effect the provision has on the defaulting party. Is the provision harsh and offensive and therefore unconscionable?

Examine the following default provisions.

1. In the event of a default of any kind, I hereby agree that the entire lease shall be accelerated and I shall be liable thereon for all past due principal payments, all accelerated payments, interest thereon at the rate of 15% per annum, costs, and all other related charges, together with attorney's fees in the amount of one-third of the total accelerated amount under the lease.
2. Upon the occurrence of an event of default and at any time thereafter, Lessor, in addition to any other rights and remedies he may have, shall have the right to take possession of the equipment, whereupon Lessee's right to use the same under and subject to the terms and provisions of this Lease, and any other right or interest of Lessee to or in the equipment, shall absolutely cease but such taking by Lessor shall not relieve Lessee of its obligations and liabilities hereunder.

The effect is that a default, no matter how minor, will have an unconscionable result. Courts have held that such default provisions are invalid. When drafting, pay close attention to the cumulative effects of default provisions.

Also, review provisions for excessive fees and charges. Again, courts will look to the cumulative effect of the clause: if it is clearly oppressive and if accumulated could surpass the amount of the money borrowed and interest charged, the clause would probably be rendered unconscionable.

Interest Provisions

Provisions charging interest are very standard in contracts. The interest charged, or the cumulative effect of an interest charge must be analyzed closely to determine if the interest charged is too high. Laws set limits on interest, and excessive rates are usurious and unenforceable. Review interest provisions carefully and look at their total effect. For a more in-depth discussion on interest, see Chapter 7.

Remedy Provisions

When one party's remedies are too limited, courts often hold the limiting provisions unconscionable. In such cases, one party excludes all possible remedies for another party

that has been unable to perform its contractual obligations, rendering the contract too one-sided and invalid. Examine the following provisions:

1. The buyer's limit for breach of performance by the seller shall be limited to the difference between the contract price and the fair market value at the time of the breach, and in no event is the buyer entitled to lost profits, consequential or punitive damages of any kind.
2. In the event of a breach of performance, the party shall only be entitled to the purchase price of the product purchased. This shall be the buyer's sole remedy and shall be in lieu of any other clams for incidental or consequential damages.
3. In no event shall the harmed party be entitled to recover for incidental or consequential damages, including but not limited to loss of profits, inconvenience, replacement of the product, or other loss thereof.

Most of these provisions limit the possible recovery for one party in a contract and could be held unconscionable by a court. When provisions are too oppressive, the party preparing the contract will suffer the consequence, which is often rescission.

This section presents a small sampling of provisions that might be deemed unconscionable. As a paralegal, your job will be to assist your attorney in making sure that the contract provisions drafted are enforceable by a court if challenged, and that the contract is not unfair or overly harsh.

SUMMARY

5.1 Mutual assent is a necessary element of a contract. It is found when the parties have the same understanding of the terms and conditions of the contract. Mutual assent can be destroyed by fraud, misrepresentation, mistake, duress, undue influence, and unconscionability.

5.2 One of the ways to destroy mutual assent is fraud. The main elements needed to prove a fraud case is that one party made a (1) misstatement of fact; (2) the fact was material to the contract; (3) the party had knowledge of the statement's falsity; (4) the party intended to deceive; (5) the other party relied on the misstatement of fact; and (6) the misstatement caused damage.

Closely related to fraud is misrepresentation, which is an innocent misstatement of fact not intended to deceive. Under misrepresentation cases, there may be a duty to disclose.

Mistake is another method to destroy mutual assent. There are two types of mistake: mutual and unilateral. Contracts can also be set aside based upon duress and undue influence. In either situation, a party is not acting freely when entering into the contract. Finally, unconscionable contracts, in which the terms are unfair and oppressive, may be set aside based upon public policy arguments. There are two types of unconscionability: procedural and substantive. Adhesion contracts are types of unconscionable contracts.

KEY TERMS

mutual assent
rescission
unconscionable
fraud
misrepresentation
fiduciary relationship
plaintiff
defendant
mistake
mutual mistake
unilateral mistake
duress
undue influence
procedural unconscionability
substantive unconscionability
boilerplate
adhesion contract
overreaching
installment contract

REVIEW QUESTIONS

1. Define mutual assent.
2. How is mutual assent destroyed?
3. What is the definition of fraud?
4. What are the critical elements in proving a fraud case?
5. What is the distinguishing characteristic between fraud and misrepresentation?
6. Upon whom is the duty to disclose imposed?
7. List the different types of mistakes and their definitions.
8. What must be proven to avoid a contract in a duress case?
9. Identify the types of relationships that are scrutinized when the defense of undue influence is raised.
10. What are some of the instances in which a court will set aside a contract based upon unconscionability? List the types of unconscionability and define each.

EXERCISES

1. Locate a retail installment or credit card contract and review its contents to determine if all the provisions are fair. Write down any provisions that might be deemed unconscionable. After you have reviewed the agreement you have chosen, determine whether the statutory or case law in your state prohibits any of the provisions you have identified. (The results may surprise you.)

2. Dennis Greenway and his wife Kelley really want to start a family. Unfortunately, Dennis was tested by a doctor, and it was determined that he was sterile. Kelley was upset and did not know what to do. Dennis enlisted his friend, Wesley, to impregnate Kelley. Wesley already had two kids with his wife and better yet, Wesley resembled Dennis in many ways. Dennis agreed to pay Wesley $5,000 to be with his wife twice a week. Wesley tried a number of times, but Kelley never became pregnant. Finally, Wesley's wife, Heidi objected, but he reminded her that he was only doing it for the money and to be patient. After four months of trying, Dennis insisted that Wesley get tested, which he did. To everyone's surprise, except Wesley's wife, he was sterile. Heidi had to confess that the two kids were not biologically Wesley's. Dennis wants to sue Wesley. Wesley believes he did everything he was asked. He never guaranteed conception only that he would try his best! What issues can Dennis raise against Wesley in a contract action?

3. Lenny lives in Dallas and owns a 1995 Porsche 911. Lenny just got word that he is being transferred to New York City in two weeks. As everyone knows, owning a car in Manhattan is simply unbearable. With this in mind, Lenny places the following advertisement in the newspaper:

   Must Sell Immediately—1995 Red Porsche 911
   Asking around $2,000.
   Please call at 974-5060 or stop
   by at 90125 Preston Road.

   The following day, George, an auto mechanic, goes to Lenny's house with $2,000 cash. Upon arrival, George says, before Lenny has a chance to say anything, "Here's $2,000 cash; give me the keys to the car."

   Lenny courteously replies, "I apologize for misleading you, but I inadvertently looked up the wrong price for my Porsche. What I accidently did was put the 1985 Blue Book price in my advertisement instead of the 1995 price. It was quite careless of me." Lenny continues, "The 1995 Blue Book price for a Porsche is $10,000, but since you came all the way down here and seem interested in the car, I will offer it to you for only $8,000."

   George then grumbles defiantly, "No way, you said $2,000 in your advertisement and that is what I got right here. You are legally obligated to sell me that car for $2,000." Lenny declines to take the $2,000. Disgusted, George drives straight to his attorney's office seeking legal advice. It just so happens that George's attorney is also a senior partner in the firm in which you are a paralegal. Write a memorandum analyzing the legal issues in this case.

4. Using the facts from "State Your Case" regarding Berta Weiss and the reclaiming of the Van Gogh painting, prepare a Complaint based on those facts. In preparing your complaint, research the necessary elements for your causes of action based upon your federal and state jurisdictions.

5. Steven Smith applied for a job at PharmaCare Alliance, a start-up pharmaceutical company. He interviewed with the head of Human Resources and was offered a job with the company. Having to give one month's notice to his present employer, Steve said he could start on February 15. Of course, Steven knew that his references had to be checked, but he was not too worried. PharmaCare contacted his present employer, Lilly Pharmaceuticals, a large company with offices in four countries. When the Human Resources Director contacted Lilly, he asked for a reference for Steve. The Lilly Human Resources Director had stated that all she could do was confirm his employment, but stated off the record that Steve had a very short temper, which was a comment one of his supervisors made in a recent evaluation. PharmaCare immediately rescinded the offer. Steve was baffled. He had already given his notice to Lilly and was hoping he could take it back. Steve continued to work at Lilly, but still was upset with PharmaCare's action. He went to Lilly's Director of Human Resources and asked to review his file. The Human Resources receptionist handed him a file, but it was not his. The file was for Stephen F. Smythe. He inquired with the receptionist as to why she gave him the

wrong file and apologized. Realizing what happened, Steve contacted PharmaCare to tell them of the mistake, but told him they had already filled the position. Steve wants to sue both PharmaCare and Lilly for the lost of his job with PharmaCare. What options are available to Steve? Was a contract created between the parties? Discuss all issues.

6. Marvin Bishop was a high roller. He loved Las Vegas. Believing his luck was changing, he hopped a plane to Vegas. With $5000 of cash in hand, he decided to try his luck at the black jack tables. Tiny Hart had heard Marvin was back in town and wanted him to pay him the money he owed on the lease he skipped out on months earlier. Tiny did not have a written contract, but he knew better this time. While Marvin was at the tables, Tiny tapped on his shoulder. Surprised, Marvin asked Tiny to wait until he finished his hand. Patiently waiting, Tiny told Marvin that the two needed to talk. The conversation is as follows:

   Marvin: Good to see you, Tiny.

   Tiny: Really. I'd guess you wouldn't be that glad to see me since you owe me so much money. Ya think I'd forget?

   Marvin: Oh, that. Well, man, that's why I'm here. I'm gonna pay you back, really man.

   Tiny: You're gonna pay be back and more. Here's how it's gonna work. You sign this contract here saying you owe me $50,000 and we'll be square.

   Marvin: $50,000. You are crazy. I only owe you $15,000 grand.

   Tiny: Funny how things go up when you don't pay. So, you either sign or else.

   Marvin: Or else, what?

   Tiny: You really want the details?

   Marvin: No man. Give me the paper, and I will sign. I want to get back to the tables.

   Tiny: Sign here, Marv. Good man.

   Marvin never pays Tiny. So, Tiny decides that he will sue Marvin. What is the basis of Tiny's lawsuit? Does Marvin have any defense to Tiny's contract? Address all issues.

7. Buck Campbell is a cowboy living in Wyoming. He sells hay to ranches around the area. Dirk Dickinson, an investment banker, has had enough of the good life on Wall Street. His dream has always been to own a ranch and raise cattle in Wyoming. Dirk quits his job and buys a ranch near Jackson Hole. Now, this is the life. Dirk needs some hay for his cows and is told that Buck is the guy to go to. He buys 10 bales and has them delivered to his ranch. Within three days of the delivery, the cows start getting sick. Dirk cannot understand it. He has the vet come out to check on his herd. The vet asks him what kind of hay has he been giving his cows. Dirk looked at him funny. The vet asked him, "Hey, didn't you know there were different types of hay for different types of purposes. This was not hay for cows to eat." Dirk was angry because he figured that Buck was the expert and knew what kind of hay to sell him. Dirk goes back to Buck and tells him what happened, insisting that he owes him for the dead cows. Buck tells Dirk he is crazy. Dirk comes to your law firm and wants to sue Buck. Does Dirk

have a case against Buck? What are the issues that both parties can raise in a potential legal action?

8. Buddy Burlington has been married to his wife for 40 years. Buddy had to go out of town on business. When he returned, he found his wife lying on the floor in a pool of blood. Distraught over his wife's violent death, Buddy went into a deep depression. Buddy was not a worldly person; he was from a small village in New Guinea. His reading and speaking skills in English were extremely limited. He had worked hard all his life and was devoted to and dependent on his wife. A week after his wife's death, his neighbor, Horace Evans came to his home and told him that the police suspecting him of killing his wife. That the neighbors were going to kill him if he did not leave town immediately. Having five acres of land in the country in upstate New York, Horace offered Buddy $10,000 for the house and the land. This represented one tenth of the value of the property. Horace told Buddy that if he executed the deed to the property by tomorrow, he could leave quietly with the $10,000. Frightened, Buddy executed the deed and left to live with his son in Ohio. After his son heard what had happened, he contacted a lawyer to see if the transaction could be set aside. Your attorney requests that you research whether there is a basis to have the deed set aside. Prepare the memorandum to your attorney.

9. Dora and Miguel Cortez were excited to be buying their first home. They found a home that they liked and could afford outside the Philadelphia area in Collingswood, New Jersey. The real estate broker just raved about the home stating, "It was the perfect place to raise a family." Since the house was a bit of "fixer-upper," Miguel asked the broker if there were any inherent problems with the house. The broker responded, "The house was perfect. If there were any issues, he was sure that they were addressed by the present owners." On February 28, 2010, the Cortez' became the proud owners of their new home. Two months later in April, Dora noticed some water in the basement. She brought it to Miguel's attention. Miguel called a contractor. The water kept piling up. When the contractor finally made it to the Cortex home, the basement was flooded. The contractor stated to Miguel, "Hey, didn't you know that this place had water problems. Why do you think it was sold as such a low price? Everyone in the neighborhood knew of the problems. Didn't the broker tell you?" The cost to fix the problem was $35,000. Miguel contacted the broker who stated that he did not know anything about it. Miguel did not believe him. Dora and Miguel decided to pursue the matter legally. Does the Cortex family have an action against the broker who sold the house for misrepresentation and fraud? The former owners? Explain your response.

10. Anna Freitag was the matriarch of an old Virginia family. She is presently 90 years young and loves to spend time with her niece and nephews. She is a bit hard of hearing and sometimes forgets where she is, but is in relatively good health. Anna was a bit lonely so she called her niece Aria to come visit her. Aria was 30 years old and unemployed. She had just lost her job at a financial investment firm in New York. Having nothing better to do, Aria decided to take the train down to Norfolk and stay with her Aunt for awhile. One afternoon, Anna took out a box containing all her jewelry she had acquired over the years. Aria reveled in beauty of the pieces. Their value was well into the millions of dollars.

Aria sensing an opportunity offered to stay with her aunt if she gave her all the jewelry. Anna had a will set up with all her worldly possessions going to the University of Virginia. Aria knew this, but given her present financial condition she did not care. Aunt Anna wanted the company, so she agreed to give her all her jewelry. Aria stayed for three days and left. When Aria's brothers heard what she had done, they filed a lawsuit against their sister for the return of the jewelry. Answer the following questions:

a. Is Aria entitled to the jewelry?
b. What is the basis of Aria's brothers' lawsuit?
c. The University heard about the lawsuit and filed one of their own. What is the basis, if any, of the University suing Aria for the return of the jewelry? (Limit all responses to the information discussed within this chapter.)

CASE ASSIGNMENTS

1. In a voice mail message, your supervising attorney, Justin Lakewood, receives the following message from a prosecutor in one of the criminal cases he is defending: Prosecutor: "I have thought about our case and will offer your client involuntary manslaughter with your client serving seven years in prison with four of those years suspended."

   Considering that Justin's client is charged with second-degree murder, that is a great deal for his client. Justin immediately calls the prosecutor and accepts the plea agreement. However, when Justin tries to accept the plea, the prosecutor states that he misspoke and really meant voluntary manslaughter, and he would serve five years in prison with only two suspended. Justin is not happy and records the voice mail message and presents it to the judge three days later. Justin argues that the prosecutor made an offer, which he accepted and more importantly, his client relied on that offer to his detriment. Justin had contacted the newspapers and told them of the situation. Now his client could be prejudiced if the case went to trial. The prosecutor is furious. He never intended to make an offer of involuntary manslaughter given that fact that this case was a high-profile murder. The court has asked both attorneys to present briefs to the court in whether there is a binding plea agreement.

   (a) Representing the prosecutor's side, prepare a memorandum to the court supporting the prosecutor's arguments that there is not contractual agreement.
   (b) Prepare the memorandum to the court supporting the arguments of the defense attorney Justin Lakewood.

2. Jillian Doran has excellent credit. Most of her credit cards have an interest rate of 10%. On January 25, 2010, she received a letter from one of her credit card companies informing her that her rate was going up to 27.99% annually. She is furious and wants to fight the increase. In your jurisdiction, would the new interest rate be enforceable or considered unconscionable? Are there any notice procedures that must be followed in your jurisdiction before the new interest rate can go into effect? Are there any federal laws that would affect the actions of Jillian's credit card company? If so, what are Jillian's available options? Prepare a memorandum to your supervising attorney detailing your results.

Chapter 6

Capacity: The Ability to Contract

Outline

Sandy and her best friend, Tatiana, decide that they need a "girls weekend" to get Sandy back into the swing of things. She just broke up with her boyfriend and she needs to "let go." Off to Las Vegas for a long weekend, Tatiana decides that meeting men is the number one priority. After checking into their hotel on the strip, the ladies decide to hit one of the bars. Almost immediately, two drinks are brought to their table compliments of two men sitting at the bar. Sandy thinks that they look like fun and invites them over to talk. One of the guys, Jared is kind of cute, but the other one, Malcolm, really seems interested in Sandy. They all decide to go to the Hotel with the beautiful water show outside, but not after they have had one more drink. That makes it three for Sandy. While watching the water show, Tatiana decides that she has had enough and decides to go back to the hotel for some sleep. She begs Sandy to go with her, but she is having too much fun with Malcolm. The next day, Sandy wakes up in Malcolm's room and notices a gold ring on her finger. She quickly wakes Malcolm up and asks where the gold ring came from. He looks at her and says, "Don't you remember, honey. We fell in love last night and decided to tie the knot. We're married." Sandy almost falls out of the bed. She can't be married. She doesn't remember a thing. All she remembers is the water show. Sandy thinks, "This is not good." She's got to get out of this situation—now. Malcolm is hurt. He doesn't understand. Sandy immediately calls her friend, Silva, to help her out. Silva will be on the next flight! Is she really married?

6.1 DEFINING LEGAL CAPACITY

capacity
Competency in law

In contract law, agreeing or understanding the terms and conditions of a contract is not sufficient to bind the parties. An additional element must be present: capacity. **Capacity** is the legal ability to enter into a contract. This concept is easily defined as being over the legal age (which means mentally competent).

Most individuals who enter into a contract have capacity, and it does not become an issue, but the occasion does arise when the parties to a contract lack the legal capacity to bind themselves to the contract. Persons who fall into this category are minors, mentally handicapped, legally insane, intoxicated, and drugged persons. Sandy, from our fact pattern, appears to fall into one of these categories.

In some instances, aliens and convicted felons also lack capacity. Depending upon how the law views the person, those who lack capacity create either void or voidable contracts. (Remember from Chapter 2 that a void contract is never valid; a voidable contract is one that may be avoided by the person with the disability, but it may become valid.) Capacity is essential to the validity of a contract. But as will be noted throughout this chapter, capacity is judged under an objective standard similar to the standard discussed in Chapter 3. Therefore, if it appears one person to the contract is incapable of understanding the terms and conditions because of some type of "incapacity" then a contractual relationship will not be formed. Courts take differing views on the issue and focus on the type and level of incapacity. This chapter focuses on parties whose capacity may be challenged (see Exhibit 6-1).

EXHIBIT 6-1

Persons with legal capacity

Capacity	
1. Adult by law	4. Legal resident
2. Legally sane and mentally healthy	5. Not a felon
3. Sober/not addicted to drugs	

6.2 A MINOR'S CONTRACTUAL CAPACITY

State statutes determine when a person legally becomes an adult. Usually majority is defined as somewhere between 18 and 21 years of age. Prior to reaching the age of majority, **minors**, or *infants* as the law sometimes refers to them, lack the capacity to create binding contracts. *Restatements (Second) of Contracts* § 14 states the following as to minors:

minor
A person who has not yet attained his or her majority

> Unless a state provides otherwise, a natural person has the capacity to incur only voidable contractual duties until the beginning of the day before that person's eighteenth birthday. Not only must a person be of legal age, but [he or she] must also be competent mentally. Persons who are mentally disabled or incapacitated generally do not have the full legal ability to contract.

disaffirmance
The refusal to fulfill a voidable contract; disavowal; renunciation

Under the law, minors create voidable contracts in that they generally are not held responsible for the contracts they create. Minors who contract with adults can avoid contracts they enter into by disaffirming those contracts. **Disaffirmance** is a method of rejecting a contract through cancellation. Basically, a minor can disaffirm a contract prior to reaching majority and for a reasonable time after reaching majority. Courts differ, though, as to what is considered a reasonable time to disaffirm a contract. Consequently, courts look to the subject matter, the parties, and when the disaffirmance took place to determine if it is reasonable. However, the adult who contracts with a minor does not have the same luxury. When an adult contracts with a minor, the contract is binding unless the minor disaffirms or the minor lets the adult out of the contract. The law clearly protects the minor.

A method of holding a minor to a contract is to insist that an adult co-sign the contract. This effectively eliminates the minor's ability to disaffirm the contract, as the adult will remain responsible for the contract. In addition, if a minor's **guardian** enters into a contract on the minor's behalf, that contract will generally be valid as well. Contracts made by a guardian often have a court's approval, negating the minor's right of disaffirmance and thus making them enforceable.

guardian
A person empowered by the law to care for another who, by virtue of mental capacity, is legally unable to care for himself or herself

Necessities

necessities
Things reasonably necessary for maintaining a person in accordance with his or her position in life, i.e., shelter, food, clothing, and medical care

Exceptions exist to every rule. When minors contract for **necessities,** such as food, clothing, shelter, and medical services, they, along with their parents, will be responsible for the reasonable value of those services and charges. For example, if a physician provides medical services and the minor does not pay, the parents will be responsible for paying for the services. Note that the law states that the minor or parents will be responsible for the *reasonable value* of those services. If someone attempts to take advantage of a minor and charge an exorbitant fee for a service, a court will determine what the customary and standard charge is for the service rendered and impose only a fair charge. The courts will not allow people to take advantage of minors.

Further, the courts consider the ability to pay. Generally, courts look to parents to pay for contracts for necessities. If the parents cannot afford to pay, courts have held the children responsible for such contracts. The basis for this liability is often rooted in quasi contract. (See Chapter 2.)

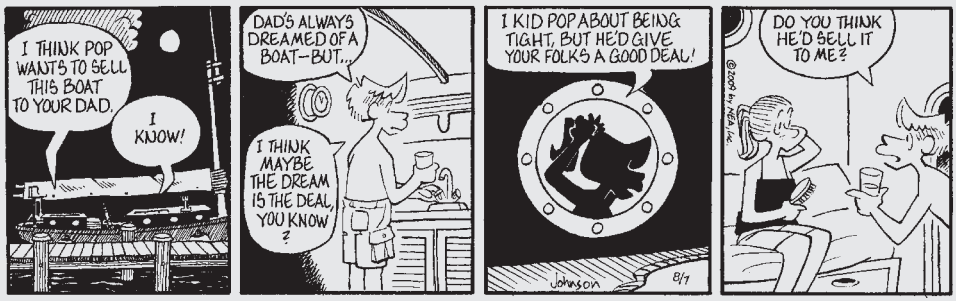
The more difficult question is: what is a *necessity?* How do courts define this word, which imposes liability on minors or their families? Courts look to a child's needs, social status, and economic ability. Determining exactly what a child needs is very difficult and is usually analyzed on a case-by-case basis. Is a car a necessity? A boat? An iPhone? Although a boat appears clearly not to be a necessity, assume that a minor lives on an island and needs a boat to get him back and forth to another island to go to school. Perhaps then a boat would be a necessity. Courts look closely at each situation. However, it should be noted that parents are normally responsible only for necessities; if the minor contracts for something other than a necessity, a parent will not be responsible, unless he or she is a co-signor. *Young v. Weaver,* 883 So. 2d 234 (Ala.Civ.App. 2003) presents the question as to what is considered a necessity for a minor.

Line of Reasoning

Why would a landlord contract with a minor and run the risk of nonpayment? That is the case in *Young v. Weaver*. Kim Young and a friend wanted to rent an apartment to gain some independence. They were both minors at the time. They signed a lease on September 20, 2001 without an adult's guarantee. Mr. Weaver was the landlord. The girls paid the security deposit of $300; the monthly rent was $550. The lease term was until July 31, 2002. Young paid the rent until November but moved out to live with her parents again. Young had a dog that damaged the floor and bathroom of the apartment. Weaver only sought the one-half of the rent that Young was responsible to pay—$275.00. Weaver then sued Young in small claims court for the damage to the apartment and back rent. He did rent the apartment in June of 2002 to other tenants. The lower courts awarded Weaver damages in the amount of $1,370 for three months rent and the damage the dog caused to the apartment. In the appeals court, the issue was whether the apartment was a necessity and if not, Young cannot be bound by the lease contract. Applying Alabama law, a minor is one who is 19 years old and not married. Following well-established common law, the court recognized that a minor is not liable for their contracts and may disaffirm them. Of course, the exception is when a person provides "necessaries" to that minor and in that case the reasonable value of the necessaries may be recovered. Thus, Young argues that since the apartment is not a necessary, Weaver cannot recover from her. The court agreed. Defining a necessary, the court found that the necessary must be something that is "necessary to the position and condition of the minor." This term has "relative" meanings and is normally decided by the facts of the case. Thus, to be a necessary the "things" must be obviously needed for the maintenance of the minor's existence. The court applied a two-step process: do the things that are to be supplied fall within the general class of necessaries and if so, is there sufficient evidence for a jury to find that they are necessary. If the answer to the first question is in the negative, the analysis ceases as the first test is one that is a legal determination. Although cases have clearly found that "shelter and lodging" are considered necessaries, the key question for the court is whether it is a necessary for Young. In this case, Young argues that the apartment was not a necessary as she was free to live with her parents; she still had her room there and could return any time. Because of these facts, the apartment was not a necessary. Borrowing authority from other states that had similar fact situations, the court analogized to a Nebraska case, which had virtually the same facts. The minors entered into a lease for an apartment, moved out and were sued by the landlord. The minors argued that they could not be responsible because of their status. The tenants, minor boys, also argued that they could return to their homes and live with their parents anytime they chose. The Nebraska court, essentially following the same analysis as the Alabama court, found that in those circumstances, an apartment was not a necessary. Thus, if a parent is willing and able to supply the minor with the item or things in question, then they are not considered a necessary. The court also distinguished cases that dealt with emancipated minors, of which Young was not. Therefore, the court found that the lease was not a necessary and found for Young reversing the lower court's decision.

Questions for Review

Review *Young v. Weaver*. What facts would have required the court to hold for Mr. Weaver? What analysis does a court use to determine whether a thing or item is a necessary for a minor? Suppose that Young had moved out because she was thrown out by his parents, would the court have deviated from his result? Why or why not?



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State Your Case

Melissa Cohen, 17 years old, was rushed to a nearby hospital due to injuries she suffered in a helicopter accident. Melissa's medical expenses after all the surgeries totaled $300,000. Melissa's parents were uninsured, but the hospital sued both Melissa and her parents for the services provided by the hospital. Can the hospital enforce a contract for the services performed against Melissa, her parents, both, or none of them?

Cybercises

Locate a case in your jurisdiction which defines what it considers a necessity for purposes of incurring liability for a minor. What factors does your jurisdiction consider in determining a necessity? What is the age of majority in your jurisdiction?

Misrepresenting Age

More than ever, minors look and act like adults. It is difficult to distinguish a 15-year-old from a 20-year-old—and with fake identification easy to acquire, misrepresenting one's true age is not difficult. Granted, adults should investigate a "suspected" minor, but that is not always possible. When a minor misleads another party into entering into a contract, both parties can often disaffirm the contract.

Ordinarily, an adult cannot disaffirm a contract made with a minor, but when allegations of misrepresentation are involved, the law will not hold the unsuspecting party to the contract. The rules vary from state to state, but one thing appears to be clear: minors cannot benefit from their own wrongdoing.

To even out the rules, although courts firmly maintain a minor's right to disaffirm a contract, they also require the minor to put the adult back in the same position the adult occupied prior to the contract and the misrepresentation. The courts attempt to prevent unjust enrichment and act in a fair and equitable manner. Consequently, when contracts are voided based upon misrepresentation, the law will force minors to return the property gained by their acts and not allow them to profit from their wrongdoing.

Although courts try to be fair, the tendency is still to lean heavily toward the side of the minor. If the minor cannot return the item, or the item is damaged, it is highly likely

that the minor will be afforded the opportunity to disaffirm the contract, with virtually no consequences. The reason behind this policy is that adults should know better! *Gillis v. Whitley's Discount Auto Sales, Inc.,* 319 S.E.2d 661 (N.C. Ct. App. 1984) illustrates the misrepresentation issue.

Line of Reasoning

William Wallace was a sixteen-year-old who purchased a car by misrepresenting his age as eighteen—the legal age in North Carolina. He gave Whitley's Discount Auto Sales, Inc. a $1200 down payment from his social security benefits and lied on a credit application. The result is that William received a loan for the remainder of the purchase price for a 1977 Datsun (now Nissan), which was $3080. William wrecked the car a number of times and returned the car back to Whitley's and demanded his money back. Of course, Whitley's did not return any of the money and Williams' guardian Mary Gillis sued Whitleys for the monies on the basis that he was a minor. The lower court entered judgment for William and his guardian. Whitley's appealed. The appeals court, following the black letter law that minors can disaffirm contracts which are not for necessities. The court then addressed the misrepresentation of age issue, also finding that William could disaffirm the contract as well. Thus, William can recover the down payment since he returned the damaged car. However, he cannot recover the loan amounts paid to the dealer. He is not entitled to a windfall—only to be made whole.

Questions for Analysis

Review *Gillis v. Whitley's Discount Auto Sales, Inc*. What actions could Whitley's (and the bank) have taken to guard against the misrepresentation of age issue? What facts would have changed the result in this case?

Ratification: Validating a Contract

ratification
Approval of a previous act; Actions or conduct indicating a person's express promise to be bound by a contract

When a minor accepts benefits from a contract, **ratification** occurs. The key to ratification is *when* it happens. For ratification to be effective, a minor must show some act of approval or benefit in some way from the contract after majority. Any other result would not protect the minor.

Ratification can elevate a once voidable contract to the status of a valid one. When a minor becomes an adult and shows a willingness to abide by the terms of a contract made as a minor, ratification may be found. Ratification can be found from a subtle act, such as continuing to make payments on a car upon reaching majority. This is known as *implied ratification.* Ratification may also occur from an express act, such as a written letter (but may be oral also). No matter what the form of ratification, attaining majority will affect the enforceability of the contract and erase any prior disability. Consequently, minors should pay close attention to their actions when the age of majority approaches.

State Your Case

While 17 years of age, Lee purchased a telescope to view the stars and planets. The telescope was $1500. He made monthly payments of $100. On October 24, 2010, Lee turned 18, which is the age of majority in his state. He continued to make the payments on the telescope until January, 2011 when he began college and had to quit his job. He had eight payments left on the telescope. The company from which he purchased the telescope sued him for the remaining payments. Lee countersued by stating that he was a minor at the time of the purchase. Does Lee have a successful defense to the case? Explain your answer.

Emancipated Minors: The Exception to the Rule

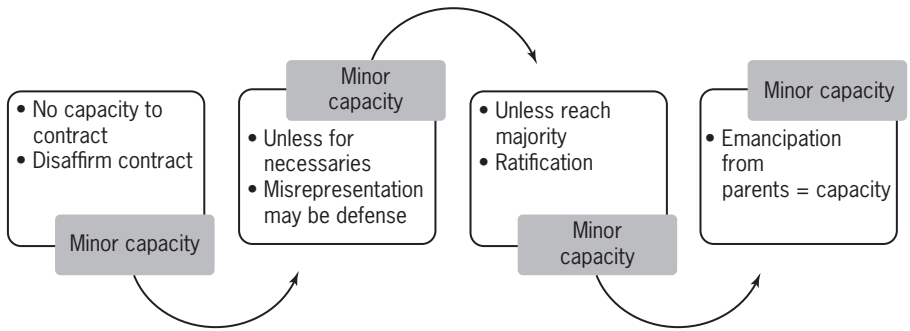
Cybercises

Determine the procedures in your state for emancipation and what requirements must a minor prove in order to be legally emancipated in your jurisdiction.

Some minors, either by their acts or through legal action, are treated as adults for contract purposes. When a child, who is legally a minor, becomes an emancipated minor, they live separately from their parents and are effectively responsible for their actions. Some minors seek court intervention by filing a complaint for emancipation from their parents. We often see these types of actions from "child stars" who want to manage their own personal and business affairs. A notable case is the actress Drew Barrymore, who petitioned the courts for emancipation from her mother. Macaulay Culkin, of *Home Alone* fame, successfully emancipated himself from his parents as well. As a general rule, unless a child is legally emancipated from its parents, he or she will not be responsible for contracts for which they may enter into with an adult.

However, minors may become emancipated by their acts, such as marriage or pregnancy. Whether a minor is emancipated by their own acts is determined by each state's statutory codes or case law. Exhibit 6-2 summarizes the issue of minors and the capacity to contract.

EXHIBIT 6-2 Summary of capacity for minors



6.3 THE CAPACITY OF INSANE AND MENTALLY ILL PERSONS

Much of the law deals with gray areas. The analysis and evaluation of a case depend on a particular set of facts and circumstances. This is particularly true when dealing with the issue of capacity and how it relates to a person's mental abilities. The *Restatement (Second) of Contract's* view of mental incapacity is found in § 15, which states:

(1) A person incurs only voidable contractual duties by entering into a transaction if, by reason of mental illness or defect:

(a) he is unable to understand in a reasonable manner the nature and consequences of the transaction; or

(b) he is unable to act in a reasonable manner in relation to the transaction and the other party has reason to know of his condition.

Persons who lack mental capacity generally create voidable contracts or void contracts. The law makes distinctions as to a person's capacity based on the degree of mental inability. Suppose that an individual's mental ability is impaired only temporarily. In that instance, the mentally infirm person may have moments of lucidity and thus can understand the terms of a contract. If it can be proven that the person understood the contract and was competent, the contract may be enforced; but if the party was not competent or was mentally insane *at the time the contract was created,* a voidable contract is formed. If the mental infirmity worsens, the party may disaffirm the contract just as a minor could.

Determining whether a contract by a mentally disabled person is voidable or enforceable is a very difficult task. Each situation has to be evaluated independently to determine whether the person truly understood the terms of the contract and the consequences of those acts in the contract. Review *Uckele v. Jewett,* 642 A.2d 119 (D.C. 1994) for a good example of a court's analysis of mental incapacity.

Line of Reasoning

This case is about what happens when family gets a bit greedy. In 1987, Harold Jewett, 89 years old (and a retired lawyer) executed a will where he divided his estate equally between his son, the appellee, and his grandson, the appellant. (The grandson was the son of appellee's sister.) However, Harold had transferred the bulk of his estate to a joint bank account with his son, Eugene Jewett. Eugene invested the monies with both he and his father as joint owners of the investment accounts. Then Harold transferred his home to his son by a deed. After Harold died in February, 1990, Bolten Uckele—the grandson—filed a lawsuit against his uncle claiming a fraudulent transfer of property. At trial, virtually everyone in the family, including Eugene's ex-wife, contested the transfer of the real and personal property. The family testified that after Harold suffered from an illness in 1985, he had memory loss and difficulty in recognizing some of his family. Apparently, Harold's house was in a general state of uncleanliness. There was testimony about Harold's questionable actions in his later years and that he did not have a close relationship with his son Eugene. However, there also was testimony from Harold's doctor that he responded appropriately to questions when his mental status was tested. There was testimony that Harold had handled all

directed verdict
A verdict in which the judge takes the decision out of the jury's hands; the judge decides the case rather than the jury based upon the evidence presented

his own personal affairs including his finances and medical appointments when he conveyed his property to his son. At trial, Eugene's lawyer requested a directed verdict, which was granted by the trial court judge. The reason behind the directed verdict was because the trial judge found that there was no evidence that Harold did not have the capacity to make the property transfers he made to his son. The grandson appealed the **directed verdict.** The appeals court observed that in evaluating a case for directed verdict, the court must look at the facts in a light most favorable to the party against whom the verdict is sought. The court then evaluated the legal standard for mental capacity. It stated that mental capacity revolves around whether the person in question had the sufficient mind to understand the nature and extent and effect of a particular transaction in which he is engaged. The presumption under the law is that an adult is competent to enter into contracts. The burden is on the party challenging the person's mental capacity to prove the deficiency or incompetency. What must be established is not simply that a person suffers some mental defect, such as a dementia, but that the person was rendered incompetent to execute *that particular* transaction under the legal standards set forth herein. The court observed that although there was evidence of the unhealthy living conditions and the difficulty Harold had in recognizing some family members, the record did not establish that Harold was incompetent at the time he executed the real property conveyance. In fact, the trial testimony established that Harold continued to take care of himself and manage all his affairs. Therefore, regarding the property conveyance, the appeals court did not find that Harold lacked the capacity to execute the deed and that he was of sufficient mind to understand the consequences of his actions. The trial court was correct in granting the directed verdict. Next the court evaluated the transfer of the bank funds to his son. The issue before the court was whether the funds were a gift and was the directed verdict proper regarding that transaction. Here, the burden of proof shifts to the party asserting a gift—the son. Here, the court held that the trial court improperly granted the directed verdict because it was clearly within the jury's purview to weigh the credibility of the witnesses. This was proper for the fact finder—the jury—to determine, not the judge. Therefore, the court reversed the judge's directed verdict regarding the bank accounts but affirmed the transfer of the real property finding Harold competent.

Questions for Analysis

Locate a copy of *Uckele v. Jewett* and review the case. What facts would have changed the result regarding the transfer of the real property? If Harold Jewett had been diagnosed with Alzheimer's disease prior to making the conveyance of real property, would the court's result have changed?

An easier issue arises when a person has been legally declared by a court to be insane or *non compos mentis*. Those who are declared by a court to be insane are denied the right to contract, and thus any contract they create is void. The court appoints a guardian to act on the person's behalf, and the guardian's acts must always be with court approval. The only person who can enter into contracts for the declared incompetent person is the guardian. There are no exceptions to this rule, as courts will protect insane persons from themselves and society. Recall singer Britney Spears' unusual behavior around 2007. Her family believed that she was not mentally competent and

petitioned the court to take control over her person and property. The court appointed Ms. Spears' father as her guardian and virtually all her personal and business affairs had to be approved by her father. Ms. Spears legally did not have the capacity to contract on her behalf. When Ms. Spears regained her capacity, then she could petition the court to dismiss the action restoring her ability to contract and manage her own affairs.

As with minors, society is also protected when necessities are provided to mentally incapacitated persons. A mentally incapacitated person is liable for contracts created for necessities under the theory of quasi contract. Only the reasonable value of the services will be allowed, however, as with minors, courts do not allow the mentally incapacitated to be taken advantage of.

State Your Case

Janeice Brown was tired most of the time. She was not sure why she was tired, she just was. She was having problems focusing at work and at home, especially helping her kids with their homework. One day, she received a telephone call from a telemarketer who was offering time shares in the Florida. For $400 a month, she could be the proud owner of a beautiful time share anywhere in Florida. She didn't even have to sign anything. All she had to do was pay the monthly fee. Just to get him off the telephone, she agreed. Not thinking much about it, Janeice noticed mail from some company called Vacationland Properties. She never opened any of the mail, because she knew she couldn't afford a vacation. Out of the blue, she was served with a lawsuit from Vacationland Properties stating that she failed to pay for the time share she had purchased. Can Janeice defend the lawsuit based upon lack of capacity? What other issues could Janeice raise to set aside the contract?

6.4 OTHER PERSONS LACKING CAPACITY

There are other situations in which persons are legally incapable to contract. This incapacity occurs when a person is intoxicated or drugged, is an alien, or is a convicted felon.

Intoxicated or Drugged Persons

Persons who are under the influence of alcohol or drugs often lack the capacity to contract. Capacity is determined by the degree of intoxication. If the intoxication is to such a degree that the party has no ability to understand the nature of the contract, the court *may* not enforce the contract. The contract created is voidable.

As with mentally incapacitated persons, courts have to evaluate these situations on a case-by-case basis. Unless the facts are clear, courts generally do not like to avoid contracts based upon intoxication by alcohol or drugs.

Persons who are intoxicated may disaffirm or ratify a contract when sobriety returns. If disaffirmance is desired, it must be total and complete, that is, the party must return all consideration. Unless disaffirmance occurs soon after the disability is removed (i.e., upon sobriety), the assumption will be that the party has ratified the contract and thus it will be enforced.

Now let's examine our couple, Sandy and Malcolm, from our fact pattern in the beginning of the chapter. Sandy woke up married to Malcolm. Did she have the capacity to enter into a "contract of marriage" with Malcolm? Our facts tell us that Sandy had at least three drinks. That may or may not be a lot for Sandy, but in most situations a court probably would not determine that three drinks were sufficient to create an incapacity. She did call an attorney when she awoke, so that may be considered an act of disaffirmance. This is a situation where Sandy may be stuck unless Sandy truly was intoxicated and did not know what she was doing. Like it or not, Sandy may be married to Malcolm. It looks like they may be headed to divorce court!

How does the capacity issue affect contracts on the Internet? That is a challenging question because there have not been any cases directly dealing with the capacity issue and contracting on the Internet yet. The checks and balances for contracting usually involve a cybercontract with seemingly unknown parties. Where the capacity issue has seen quite a bit of attention is in the area of underage teens and seemingly adult predators. Too often we hear of teens misrepresenting their age either in chat rooms, adult websites, or social networks. Usually these situations involve criminal implications. But, the courts have not been faced with determining the enforceability of contracts made on the Internet by minors. Based upon the general trends of the courts thus far, it appears that courts will apply strict common law principles to cyber issues, even those involving teens. There is no doubt that these issues will, sooner or later, be decided by a court. If faced with a case involving capacity issues over the Internet, the best approach would be to follow past precedents under the common law, unless there are statutes that govern the particular facts or transaction with which you are faced.

Aliens

alien
Any person present within the borders of the United States who is not a U.S. citizen

Persons who are not citizens of the United States are known as **aliens.** As a general rule, aliens have the capacity to contract and have very few restrictions on that ability to contract. Exceptions include contracting with an alien whose country is at war with the United States. While hostilities are continuing, such aliens lack the capacity to contract and may create a voidable contract. This situation does not occur that often.

Cybercises

Under your jurisdiction's laws, what classes of individuals do not have the capacity to contract?

Convicted Felons

Upon imprisonment, many prisoners have restrictions placed not only on their freedom, but also on their ability to contract. Consequently, contracts created by incarcerated persons are unenforceable and void. However, once prisoners are freed, their contractual rights are restored, and they enjoy virtually the same rights they had prior to imprisonment.

Exhibit 6-3 sets forth the types of contracts minors, insane persons, intoxicated persons, aliens, and convicts can create.

EXHIBIT 6-3

Status of contract by person with questionable capacity

Classification	Status of Contract
Minors	Voidable
Mentally incapacitated	
a. Lucid moment	Valid, unless can prove that not lucid at time
b. Incompetent but not judicially declared by court	Voidable
c. Declared incompetent by court	Void
Intoxicated persons (alcohol or drugs)	Voidable
Aliens	Voidable
Convicts	
a. Imprisonment	Void
b. Release from imprisonment	Valid

Strictly Speaking: Ethics and the Legal Professional

Lawyers are required to be competent in the practice of law. This standard is not relaxed for new attorneys or attorneys who are practicing out of their areas of comfort. Like attorneys, paralegals need to be competent in the duties that they perform. Of course, there is always a learning curve and you will know more as the job progresses. But, one mistake many legal professionals make, including attorneys, is not recognizing their limitations and taking on cases that are beyond their level of expertise. The secret of a smart lawyer and paralegal is knowing your limitations, which may require an acknowledgment of those limitations. As a paralegal, you may not have a say in what cases your firm takes or the projects on which you work. However, you can make use of your "gut instincts" and know when you are beyond your expertise or comfort level. This may mean asking for assistance or simply letting your supervising attorney know that you need clarification or do not understand the assignment or area of law with which you are dealing. Where the problems begin is holding yourself out to clients, peers, and attorneys to know an area when the opposite is the case. It is not shameful to admit to the lack of knowledge and ask for guidance. That makes you competent. Not asking the questions is a completely different story.

affidavit
Any voluntary statement reduced to writing and sworn to or affirmed before a person legally authorized to administer an oath or affirmation; a sworn statement

pleadings
Formal statements contained within a legal document by the parties to an action setting forth their claims or defenses

complaint
The initial pleading in a civil action, in which the plaintiff alleges a cause of action and asks that the wrong done be remedied by the court

motion
An application made to a court for the purpose of obtaining an order or rule directing something to be done in favor of the applicant. Motions may be written or oral, depending on the type of relief sought on the court in which they are made

affiant
Person attesting to affidavit

6.5 PRACTICAL APPLICATION

As with mutual assent, issues of capacity do not often jump off the pages of a contract. In many circumstances, investigation will determine if a legally incapacitated person's rights were violated. But one area where capacity is a clear issue involves the preparation of **affidavits.** Many paralegals are asked to draft affidavits for a variety of reasons. For example, an affidavit may accompany a **pleading,** such as a **complaint,** or a **motion,** such as a motion for summary judgment. Most affidavits begin with a paragraph that specifically deals with the capacity issue. A sample introductory paragraph might read:

> My name is Joseph Simms. I am over the age of eighteen and of sound mind. I have never been convicted of a felony nor a crime involving moral turpitude. I have personal knowledge of the facts herein and know the purposes for which this affidavit is being made.

There are variations on such paragraphs such as:

> My name is Joseph Simms. I am competent to make this affidavit and have personal knowledge of the facts herein.

Notice that such paragraphs focus on the issue of capacity by stating that the **affiant** has reached majority, is not insane, and has not been convicted of a crime. These representations are critical to the validity of an affidavit and should not be overlooked in drafting. They are legal requirements.

A paralegal may also encounter the capacity issue when a party disaffirms or ratifies a contract. Ordinarily, your task will be to assist in drafting a letter to a service provider or merchant, such as a car dealership, an electronics store, or even a hospital. Exhibit 6-4 shows a letter disaffirming a contract. The letter could be revised so that Cheryl Hargrove, the minor, could sign the letter.

EXHIBIT 6-4

Letter disaffirming contract

March 31, 2011

Mr. Edward Simon
ABC Cars
2154 Chestnut Street
New City, U.S.A. 81176

Re: Disaffirmance of Car Purchase

Dear Mr. Simon:

On March 11, 2011, my daughter, Cheryl Hargrove, purchased a car from your establishment. She was 17 years old at the time of the transaction, a minor.

At the time of the transaction, she tendered Five Hundred Dollars and No Cents ($500.00) as a down payment when she signed the contract. I demand the return of the $500.00 prior to returning the car.

I will have her return the car and keys on April 14, 2011, if the check is sent to us by April 7, 2011.

Thank you for your cooperation.

Sincerely,

Sally Hargrove

The minor, upon reaching the age of legal adulthood, may also reaffirm the once-voidable contract (see ratification letter in Exhibit 6-5).

EXHIBIT 6-5 Letter ratifying contract

September 7, 2011

Mr. Edward Simon
ABC Cars
2154 Chestnut Street
New City, U.S.A. 81176

Re: 2009 Toyota Corolla

Dear Mr. Simon:

On March 11, 2011, I purchased a 2009 Toyota Corolla. At the time I signed the contract I was seventeen (17) years old. I turned eighteen (18) years old on July 31,2011, and want to continue my obligations under the contract. I therefore affirm my obligations under the contract.

Sincerely,

Cheryl Hargrove

SUMMARY

6.1 Parties must have capacity to enter into contracts. To have capacity, a party must be over the legal age and of sound mind. Persons who lack capacity create void or voidable contracts.

6.2 Minors lack the capacity to contract. Depending upon the timing of the transaction, a minor can either disaffirm or ratify a contract. When minors contract for necessities, their parents will be held responsible for the reasonable value of the necessities provided. In addition, if a minor misrepresents his or her age, the adult will not be held to the contract.

6.3 Persons who are mentally incapacitated create either void or voidable contracts. Whether the contract is void or voidable depends upon whether the court has declared a person incompetent. Mentally incompetent parties are responsible for paying for necessities.

6.4 Individuals who are intoxicated or drugged may lack mental capacity. The contracts they create are voidable. Generally, aliens have the capacity to contract and convicted felons lack capacity to contract while imprisoned.

KEY TERMS

capacity
minor
disaffirmance
guardian
necessities
ratification
directed verdict
alien
affidavit
pleadings
complaint
motion
affiant

REVIEW QUESTIONS

1. How is *capacity* defined?
2. How can a minor legally reject a contract?
3. What is one method of holding a minor responsible for a contract?
4. How is *necessity* defined?
5. Who is responsible for a minor's contract when it involves a necessity?
6. Are minors responsible for their contracts when they misrepresent their age? Why or why not?
7. Define *ratification* and when it applies.
8. What types of contracts do the mentally incapacitated create?
9. Can intoxicated persons create a valid contract? Why or why not?
10. When can a convicted felon create a valid contract?

EXERCISES

1. Draft an introductory paragraph for an affidavit which complies with your state statutes.
2. A minor, Jennifer Owens, has purchased a 2000 Mustang convertible from the local used car dealership, ABC Motors, Inc. Prepare a letter disaffirming the purchase of the car.
3. Sarah Malone has terminal cancer. She takes a morphine tablet every four to six hours. Today she is feeling better and decides not to take the medicine. In fact, she is feeling so good, she asks her husband, Kevin, to take her to the mall for a walk. She walks past the computer store and decides that she wants a new netbook computer. A few minutes before she goes into the store, Sarah starts to feel ill. But, she wants that new computer. She takes one of her pills and enters the store. Quickly seeing the computer she wants, the sales person tells her about the installment plan that would allow her to pay off her computer in two years. Sarah really does not hear much of the conversation and just signs where the sales associate tells her. After completing the transaction, she walks out of the store and sees her husband. She asks him to take her home immediately to rest. Sarah dies two weeks later. Kevin begins receiving bills from the computer company for $50.00 a month. He does not understand as Sarah did not have a netbook computer. He calls the company who informs him that Sarah did sign an installment contract for a netbook computer. Kevin wants to void the contract. What are Kevin's arguments for voiding the contract? What are the computer company's arguments for enforcing the contract?
4. Evanston Ellis is a famous actor who lives in Hollywood Hills. One afternoon, the police receive a telephone call from the Ellis residence. It was from one of the housekeepers, Ria, calling 911. She was worried about her boss, Evanston. He was acting funny and was drinking heavily. He kept telling her that he had enough of the vultures around him and did not want to live anymore. He just kept drinking. When the police arrived, Evanston was on a rant. The police contacted the nearby hospital, which sent over an ambulance to pick up Evanston to have him involuntarily admitted to the psychiatric ward. Answer the following questions based upon the additional facts.
    a. One day prior to being admitted to the hospital, Evanston signed a contract to be a representative of a new chain of fast food restaurants. He was to be paid $500,000 a year. Before Evanston was admitted to the hospital, he contacted the representative of the fast food chain and told him the deal was off. Fast food was beneath him. Can the fast food chain enforce the contract against Evanston? Discuss all issues.
    b. The fast food chain hears that Evanston is in the psychiatric ward. They are worried about their image, but still think Evanston would be a good representative. Evanston received a telephone call on his cell phone from the fast food chain telling him that he was more risk than they bargained for so they wanted him to sign a new contract for $200,000 rather than $500,000. Evanston signs the new contract. After Evanston gets out of the hospital,

he finds the new contract and the lower amount. He contacts the fast food chain and tells them that it is $500,000, or they can forget it. Can Evanston challenge the new contract at $200,000? Discuss all issues.

c. If the $200,000 contract is voided, can Evanston have the initial contract enforced against the fast food chain? Discuss the capacity issues only.

5. Alicia Torres is 16 years old and lives with her mom. Times are difficult and Alicia has to find work to help with the family bills. Alicia lives in the Bronx, New York, but finds work in Ft. Lee, New Jersey. Looking mature for her age, Alicia decides that she is better off living closer to work than commuting back and forth from the Bronx. Her mom is not happy about her moving, but they have no choice. Alicia signs a lease for an apartment for $400.00 per month. The landlord, Mr. Hardy does not check Alicia's background. He just wants the rent money each month. She signs the lease beginning on April 1 for six months. In July, Alicia loses her job and has to move back with her mom. There are still two months left on the lease. Mr. Hardy sues Alicia. Will Mr. Hardy be successful in his lawsuit against Alicia?

6. Big Joe Fenton was convicted for armed burglary and was sentenced to 10 years in prison. He received a letter from one of his "friends" in the mail asking him whether he wanted to participate in a "club" that loaned money to people in need. Big Joe thought that was a great way to make some money in his situation. His friend, Mo Shine hand wrote an agreement, which stated that they would charge 30% for any money they loaned. Big Joe's friend, Raz Robbins, heard that Mo was holding out on some of the money from their business. Mo was not giving Big Joe his fair share. Big Joe was owed about $100,000, and he was not happy. He decided to make Mo pay, but this time he was going to do it "the right way," hire a lawyer and sue Mo. Mo was surprised when he was served with a lawsuit. Mo responded. (1) What is the basis of Mo's response to Big Joe's lawsuit? (2) Assume all the above facts, but now Big Joe is out of prison. Can Big Joe enforce the contract with Mo and make him pay the money he is owed? Discuss all capacity issues.

7. Michael Anders—aka Little Mikey—really wants to purchase a Mazda 626. Mikey is six foot three inches and plays basketball for Central High School in St. Croix, Virgin Islands. (Obviously, Mikey's name is nickname. His dad's name is Big Mikey!) Mike is 17 years old and heads to Island Used Motor Cars to see if he can find a used Mazda. He sees a Nissan, which will do just fine. The car is $3500. He gives the sales person, Mr. Samuel, a down payment of $500 with the remaining payments to be in installments of $200 per month. When Mike drives up in the car, his mother rushes out screaming at him to take back the car. He's not spending money on some luxury, when he has college to pay for next year. Mikey decides to keep the car for the weekend before he returns it. His mom does not object. Besides, Island Cars is closed until Monday. Saturday night, Mike picks up his girlfriend, Nikkee. On the way to their friend's house, Mikey is rear ended by a lady on her way to a dinner party. The car is totaled. Monday morning, Mike delivers the car to Island Cars. Mr. Samuel looks at Mikey like he is crazy. Mikey tells him that his mom won't let him keep the car. Mr. Samuel sues Mikey for the balance of the car. Mikey countersues for the deposit. What is the result?

8. Jimmy Jarvis is a new recording artist for Jammin' Records. He signed his recording contract when he was only 17 years old. Jimmy claims that he did not have a guardian to sign on his behalf. Jammin' signed him anyway. Jimmy's first CD did not do well, in fact, it only sold 200,000 copies. Jimmy wanted out as he thought Jammin' was not representing him as vigorously as they could. Jimmy used Jammin's studios continuously (and finally turned 21 years old). Jimmy sends Jammin' a letter stating that his contract was void. He was not going to record for Jammin' any longer and was definitely not doing another CD with them. Jammin's president, Michael Harken, asked Jimmy whether he had been recording some demo tapes in the last few weeks. Jimmy answered in the affirmative. Does Jammin' have a basis to enforce the contract?

9. Peter has just been diagnosed with Hodgkin's lymphoma, a type of cancer. He lives in Portland, Oregon. He goes for his radiation treatment every other day for six weeks. The pain is unbearable, so Peter's doctor prescribes marijuana to ease the pain. He is supposed to take the marijuana as needed. One afternoon, Peter decided he wanted a new telephone and went to one of his local carriers. The salesman talked Peter into buying a plan that cost $100 per month, which included Internet and unlimited texting. The telephone was free if Peter signed a two year contract, which he did. When Peter gets home, he puts the telephone in a drawer—he never talks on the phone and doesn't know how to text. It just felt good to feel alive again. Peter receives the bills monthly, but never sends payment. The telephone company sues Peter for the unpaid invoices and wants the return of the telephone. Does the telephone company have a legal action against Peter? Why or why not? What issues will each party attempt to raise? Explain your response.

10. Barrett Leighton is a self-made millionaire who made it big during the technology boom of the 1990s. He is single and pushing 70 years old. After a boating accident where he broke his leg, he was constantly taking pain killers to dull the aches and pains from the accident. His personal physician prescribes Vicodin, but that was not enough. Barrett was able to find another physician to prescribe some Tylenol 3. Barrett does like his prescription drugs and usually chases them down with a dirty martini—every night all night. Barrett has a devoted staff, but none more devoted than Charles, his personal valet and assistant. One night Barrett was feeling particularly generous and signs a deed to his Hampton estate to Charles, giving full ownership. Charles was overwhelmed and very appreciative. Charles tucked the deed away in his safe deposit. Two months later, Barrett unexpectedly dies. He just never woke up one morning. Barrett's only child Margot attends the funeral and asks Charles to make a room up for her. Charles "respectfully" tells Margot that he would do no such thing as Margot never acknowledged her father in his life and besides that Charles was the new owner of the estate. Margot was flabbergasted to say the least. She told Charles that she would see him in court as he knew what a drunk her late father was. He never would have given Charles the Hampton estate. Does Margot have a basis to void the deed that her father signed to Charles?

CASE ASSIGNMENTS

1. Based upon the facts in Exercise 7 above, prepare an affidavit and letter disaffirming the transaction between Mikey and Island Used Motor Cars.
2. Winston and Francine are in love. Winston is 21 years old and Francine is 17. They secretly get married. Using your state's case and statutory law, can Winston legally marry Francine in your jurisdiction? What are the legal requirements in your jurisdiction for a minor to marry?
    a. Suppose Francine is pregnant, would your response change?
    b. If Francine goes to the hospital to have her child and cannot pay, would she be held responsible for the bills if she was a minor? What about Winston?

Chapter 7

Legality in Contracts

Just Suppose . . .

You have just found out that your best friend Becca's parents have recently passed away. You knew her mom was sick, but her dad was fine other than he was getting older; he was 82 years old. She is upset because she was prepared to lose her mom, but her dad, too—it was too much. Oddly enough, her parents died together at what Becca thought was a spa in northern California near the Oregon border. It turns out that the place was not a spa but a place where people were assisted in committing suicide. You had heard about some of these places in Europe, but not in the United States. Unbeknownst to Becca, her parents wanted to die together. They went to the Eutopian Clinic two months ago where they contracted with the clinic to provide services for a "peaceful passing," which is how they termed it. Becca was incensed. How could that kind of arrangement be legal? She knew that new laws had passed in Oregon and Washington where people could legally commit suicide, but only in certain circumstances. What bothers her the most was that her dad was not sick, just getting on in years and, of course, heartbroken about her mother's illness. Becca is not aware that assisted suicide was legal in California. She wants answers, but the clinic refuses to answer any of her telephone calls other than to say that her parents knew what they were doing and to respect their wishes. Becca can't. Becca wants to take legal action against the clinic and the doctor who helped kill her parents. She has asked your law firm to represent her. At the very least, Becca believes that the clinic acted illegally by entering into a contract with her parents for assisted suicide.

Outline

Your supervising attorney, Andie, needs more information and sets up an appointment to meet with Becca and hear her story. She believes that Becca has a case against the clinic. Contracts like this are not only illegal but also against public policy, but there is no case law in the state of California addressing these issues. Becca's case opens up many questions on both the legal and legislative fronts.

Hearing about Becca's efforts, your office receives a telephone call from an action group calling itself "Dying with Dignity and Compassion." They want to talk to your supervising attorney about the repercussions of pursuing this matter. A meeting is scheduled for tomorrow in the late afternoon. The issue is whether the contract for assisted suicide is legal—the subject of this chapter.

7.1 LEGALITY: A NECESSITY FOR ENFORCEABILITY

legality
The condition of conformity with the law; lawfulness

Even after competent parties have accepted an offer, provided the consideration, and understood the terms for mutual assent, one more element must be present for a contract to be enforceable. This final necessary element is **legality**. The contract must have a legal purpose and legal subject matter to be enforceable between the parties. If a contract is deemed illegal, it is void.

Sometimes contracts that appear to be legal are later deemed by a court to be illegal. This causes concern for those creating contracts. Parties may not know that the contract they created was illegal and therefore unenforceable. The illegality may be the result of a court challenge during which the decision strikes down the contract. Consequently, the parties may not have been able to predict the outcome of their contractual agreement. Legality can be difficult to identify when no clear legal guidance exists.

In addition, an illegal contract can be formed when a party violates a statute or public policy. These very common occurrences will void a contract. The *Restatement (Second) of Contracts* § 178 discusses legality as follows:

> A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

When such violations occur, the contract will be deemed illegal. Consequently, contracts may be illegal if they violate statutes or public policy.

7.2 CONTRACTS VIOLATING A STATUTE

A common type of illegal contract occurs when the parties' agreement or conduct is prohibited by law. The most obvious situation that violates a statute is a contract for hire (an agreement to kill someone for money). Common sense tells us that if you hire someone to kill your parents, promise the killer the proceeds of a life insurance policy as payment, and then renege on the agreement, no court in this country will

enforce the contract. That kind of activity is criminal, and an agreement to engage in unlawful activity is void and unenforceable. So are agreements to engage in tortuous activity, such as a deliberate scheme to defraud unsuspecting investors. These acts would be regarded as illegal, and a contract involving such acts would be illegal and unenforceable.

Illegal agreements go beyond a person's activities. Illegal agreements are also found in contractual terminology that violates laws on usury, wagering, and unlicensed persons. Each has a common measure, in that they violate specific state statutory provisions.

Usury Laws

usury
Charging a rate of interest that exceeds the rate permitted by law

States regulate the amount of interest that individuals and business entities can charge in a loan or credit transaction. These statutes are known as **usury** laws. A usurious contract exists when money is loaned at a higher interest rate than a state statute permits. To protect the public from the greedy excesses of business, states put a ceiling on the amount of interest that may be charged by a lending institution. An example of a Texas usury statute is reprinted in Exhibit 7-1.

EXHIBIT 7-1 Sample usury statute (Texas)

Art. 5069–1.02. Maximum rates of interest

Except as otherwise fixed by law, the maximum rate of interest shall be ten percent per annum. A greater rate of interest than ten percent per annum unless otherwise authorized by law shall be deemed usurious. All contracts for usury are contrary to public policy and shall be subject to the appropriate penalties perscribed in Article 1.06 of this Subtitle.

Art. 5069–1.06. Penalties

(1) Any person who contracts for, charges or receives interest which is greater than the amount authorized by this Subtitle, shall forfeit to the obligor three times the amount of usurious interest contracted for, charged or received, such usurious interest being the amount the total interest contracted for, charged, or received exceeds the amount of interest allowed by law, and reasonable attorney fees fixed by the court except that in no event shall the amount forfeited by less than Two Thousand Dollars or twenty percent of the principal, whichever is the smaller sum; provided, that there shall be no penalty for any usurious interest which results from an accidental and bona fide error.

(2) Any person who contracts for, charges or receives interest which is in excess of double the amount of interest allowed by this Subtitle shall forfeit as an additional penalty, all principal as well as interest and all other charges and shall pay reasonable attorney fees set by the court; provided further that any such person violating the provisions of this section shall be guilty of a misdemeanor and upon conviction thereof shall be punished by fine of not more than One Thousand Dollars. Each contract or transaction in violation of this section shall constitute a separate offense punishable hereunder.

Interest rates may vary according to the risk involved in a transaction. Private lending companies and pawn shops, whose customers often have poor credit histories and represent a high risk, can charge a higher interest rate than a banking institution. Again, the interest rate is regulated by statute.

Another area in which interest rates are monitored closely is in retail installment contracts, such as for credit cards or the purchase of any consumer item like a computer, flat screen television, or refrigerator. The rates companies can charge are regulated by the states. Exhibit 7-2 examines provisions for charging interest in retail installment contracts. Note how specific the language in the contracts is and also how small the print is. Such agreements are used every day and are legally enforceable.

EXHIBIT 7-2 Sample retail installment contract

_____ CHARGE ACCOUNT AGREEMENT

I apply for credit with _____ (_____). The information on the back of this agreement is true. I authorize _____ to investigate my credit record including my references and statements, and to report my performance of this agreement to any consumer reporting agency or other credit grantor.

The monthly statement from _____ will show my account balance (the amount I owe) at the bill closing date by which payment must be made. If my account is not a 30 Day Account, the statement will also show a minimum payment due (the amount which must be paid by the next bill closing date), and finance charge, and the "average daily balance" on which it was calculated. The time between closing dates is referred to as a billing period. I understand that I will have either a 30 Day or an Option Account. I may also have an Extended Payment Account, but _____ may limit the types of goods and services which I may purchase under the Extended Payment Account.

30-DAY ACCOUNT: I agree to pay _____ the full amount of my new balance on or before my next bill closing date. If I do not pay the full amount of my account balance on or before my next bill closing date, I agree that _____ may, upon notice to me, convert my 30 Day Account to an Option Account.

OPTION ACCOUNT: Whenever I have an account balance, I agree to pay _____ on or before my next bill closing date whichever of the following is greater, (a) 20% of my account balance or (b) $10.

EXTENDED PAYMENT ACCOUNT: Whenever I have an account balance, I agree to pay _____ on or before my next bill closing date, whichever of the following is the greatest: (a) 5% of my highest account balance since the last time I had a zero balance; (b) $50; or (c) a monthly amount agreed to in writting by _____ and me.

I agree that _____ shall retain a security interest in each item purchased, until it is fully paid for; may repossess any merchandise for which _____ has not been paid in full; may dispose of the merchandise at public or private sale, and hold me responsible for any unpaid balance of my account and may exercise all other rights and remedies of a secured party under the _____ Uniform Commercial Code and any other applicable laws.

I may pay the full balance of my Option or Extended Payment Account at any time to avoid additional finance charge.

A finance charge will be applied to Option and Extended Payment Accounts. _____ figures the finance charge on my account by applying the periodic rate of 1½% per month (ANNUAL PERCENTAGE RATE OF 18%) to the "average daily balance" of my account (including current transactions). To get the "average daily balance" _____ takes the beginning balance of my account each day, adds any new purchases or miscellaneous debits, and subtracts any payments or credits. This gives _____ the daily balance. Then, _____ adds all the daily balances for the billing cycle and divides the total by the number of days in the billing cycle. This gives _____ the "average daily balance".

No finance charge will be assessed for a billing period in which there is no previous balance or during which payments and credits equal or exceed the previous balance. Earlier receipt of payments, during a billing period will lower the finance charge for that period. _____ may revise the terms of this agreement after notifying me, but the changes may not increase the payments required for previous purchases. Revisions in the calculation of finance charge or annual percentage rate may not exceed the legal limits.

I apply for 30 Day ❑ Option ❑ Extended Payment ❑

Payments are not considered made until received by _____. If I fail to make payments when due, all sums owed by me to _____ immediately become due. If I fail to pay the amount owed in full and you give my account to an attorney (who is not one of your salaried employees) for collection, I will pay you a reasonable amount to cover the attorney's fee and court costs.

I may be liable for the unauthorized use of my _____ charge indentification card. I will not be liable for unauthorized use that occurs after I notify _____ credit office where my account was opened, at the address shown on the back of my bill, of the loss, theft of possible unauthorized use. Notice may be oral or written. In any case my liability will not exceed $50.

NOTICE: SEE OTHER SIDE FOR INFORMATION ABOUT YOUR RIGHTS TO DISPUTE BILLING ERRORS.

NOTICE: ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

NOTICE TO THE BUYER: DO NOT SIGN THIS AGREEMENT BEFORE YOU READ IT OR IF IT CONTAINS BLANK SPACES, YOU ARE ENTITLED TO AN EXACT COPY OF THE AGREEMENT YOU SIGN.

I AGREE TO THE ABOVE TERMS AND ACKNOWLEDGE RECEIPT OF A COPY OF THIS AGREEMENT AND A COPY OF NOTICE OF RIGHTS TO DISPUTE BILLING ERRORS.

Applicant Signature _____ Joint Applicant or Co-Signature _____ Date _____

Address _____ Address _____

Cybercises

Determine your state's policy and laws on usury. Compare your state's usury laws with two other jurisdictions. List the differences in the state statutes.

When violation of a state's usury law is proved, the contract is void. The sanctions for violating usury laws range from denial of a lender's ability to collect the interest charged on the principal amount loaned, to the lender receiving no payment at all for either the principal or the interest charged.

Wagering Laws

Many states prohibit their citizens from gambling, betting, or participating in games of chance. Unless condoned by a state, any agreement or scheme that promises prizes or money is illegal.

There are exceptions. For example, Nevada and New Jersey allow casino gambling, and Louisiana allows betting on horse racing. Many states permit wagering in state-sponsored lotteries; many states now permit such wagering because it produces revenue and avoids higher taxes.

State Your Case

It is bingo night at the local recreational center. Each pot is worth $50.00, with the final "Bonus Bingo Pot" worth $500.00. Some conservative action groups have recently complained about bingo night and have been threatening to shut it down. The local residents are angry, as bingo is a tradition. Knowing that you are studying the law, your Aunt Marge has asked you to find out whether this group can shut down bingo night. Using your jurisdiction, determine whether bingo night is legal in your state. What statutory authority are you relying upon to support your response? Are there circumstances where bingo nights are legal even if your jurisdiction prohibits gambling? Would your response change if the prizes were items such as gift certificates to a local restaurant or store? Alternatively, if your state permits bingo nights, are there licensing requirements to legally conduct bingo night? Are there limitations to the prizes that can be offered?

Sunday Laws

Cybercises

Determine whether your state has restrictions on the sale of liquor on Sundays and whether your state still has restrictions on the sale of any or particular types of goods on Sundays.

Some states still prohibit the formation and performance of contracts on Sunday. These laws are known as *Sunday laws* or *blue laws.* (Note: The term "blue law" is derived from the fact that the first laws banning Sunday contracts were written on blue paper.) The logic behind Sunday laws is that persons should have a day of rest. Sunday laws have been repealed or eased in many states to allow the sale of merchandise and the making of contracts on Sunday. Many states still do prohibit certain transactions, such as the sale of alcoholic beverages on Sunday.

Undoubtedly, the trend is to relax Sunday laws. Issues of First Amendment rights have been raised by groups challenging such laws. Many states have left the option of observing Sunday laws to local governments. Consequently, one county may observe a Sunday law even though an adjoining county may not. Check state restrictions for Sunday law prohibitions.

Unlicensed Performance Laws

Many laws require that certain businesses and professionals be licensed. Licensing requirements stem from the need for public protection; professions such as law, medicine, accountancy, and architecture have such requirements to protect the public from persons who do not meet standard educational and testing criteria for licensing. Most of us realize that attorneys must have a minimum legal education and pass a state bar to become licensed to practice law. Practicing law without a license is illegal and violates most states' statutes. The purpose for the licenses is regulatory, not economical. A contract involving an unlicensed professional would probably be unenforceable.

However, other licensing requirements for businesses or professions exist for purely economic reasons. Licensing provides needed revenue for state and local governments. When persons fail to obtain the requisite revenue-based licenses, contracts made by them may still be enforceable. Courts examine these contracts closely, but when the legislative intent is economic, such contracts will usually be enforced. The approach to licensing as set out in *Restatement (Second)* § 181 has been adopted by many states:

> If a party is prohibited from doing an act because of his failure to comply with licensing, registration, or similar requirement, a promise in consideration of his doing that act or of his promise to do it is unenforceable on grounds of public policy if:
>
> a. The requirement has a regulatory purpose; and
> b. The interest in the enforcement of the promise is clearly outweighed by the public policy behind the requirement.

Licensing requirements should be reviewed before undertaking a commercial transaction with a professional who is regulated by state statute. Enforceability of the contract will depend on whether the professional licensing is for public protection or for revenue.

Strictly Speaking: Ethics and the Legal Professional

Now more than ever, regulating the licensing of attorneys is increasingly difficult. With e-commerce and e-transactions the norm, attorneys practicing in another jurisdiction is becoming more difficult to determine. If an attorney practices in a jurisdiction for which he or she has no license and charges a client for those services, can the attorney collect those fees if the client refuses to pay? Is the contract between the attorney and client legally enforceable? Generally, the answer is no, but the issue hinges on what is considered the "practice of law" within the jurisdiction. State bar associations govern the practice of law in their jurisdictions. When a client believes that an attorney has violated the licensing laws of that jurisdiction, then an avenue for recourse is the filing of a grievance with the bar association or the designated authority for that jurisdiction. All states have grievance procedures and can be located on the Internet. The question is not only the enforceability of the contractual relationship between the attorney and client but also what constitutes the unauthorized practice of law in that jurisdiction. Familiarizing yourself with your jurisdictions regulations is important to knowing what the parameters are and under what circumstances certain acts may cross the line.

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7.3 CONTRACTS VIOLATING PUBLIC POLICY

Courts have the discretion to void a contract if it is unfair, offends the public's moral sensibilities, or is oppressive. Unconscionable contracts fall into the category of oppressive and unfair transactions. An unconscionable contract can be avoided based upon lack of mutual assent, as we learned in Chapter 5, and also on the basis of legality. The focus for a court is the public good and public interest.

Today there are many instances where a contract's enforceability hinges on whether it violates public policy. Our fact pattern in the beginning of this chapter is an example of a type of contract that may violate public policy. Is it legal to contract to have someone assist in committing suicide? How is that kind of contract monitored? Recall in Michigan where the issue arose with Dr. Jack Kevorkian, who practiced physician-assisted suicide. He landed in prison for many years for his actions. What about a state, such as Washington, that has passed legislation allowing for physician-assisted suicides? Are all contracts for physician-assisted suicides legal in Washington? What about Maine or Florida? The public policy issue is a sticky one.

Surrogacy Contracts

surrogacy contract A situation where a woman who "hosts" the fertilized egg of another woman in her womb or who is artificially inseminated with the sperm of a man who is in a relationship with someone else agrees to assign her parental rights to the donors

Another type of contract that has received much public attention and court scrutiny are **surrogacy contracts**. A surrogacy contract involves the hiring of a woman to bear a child for another woman or couple for a fee. These contracts usually provide a substantial fee to the surrogate for the service, as well as the payment of medical expenses. Upon the birth of the child, the surrogate gives the child to the biological parents and terminates all rights to the child. Unfortunately, as they say: easier said than done. Cases have developed on this issue all over the country, with the one of the most notable and cited cases from New Jersey. It is the *In re Baby M,* 109 N.J. 396, 537 A.2d 1227 (1988).

Line of Reasoning

The *Baby M* case addresses the validity of a surrogacy contract in New Jersey. It also was the basis for other jurisdictions determining their validity as well and in many cases passing statutory laws regulating these types of contracts. In the *Baby M* case, a couple entered into a contract with a woman, Mary Beth Whitehead, who was artificially inseminated with William Stern's sperm (the biological father), because his wife was infertile. The contract provided for payment of medical expenses as well as termination of the surrogate's parental rights once the baby was born. When the child was born, Stern would pay Whitehead $10,000, and his wife would adopt the child and raise it as their own. On March 27, 1986, Baby M was born. After the child was born, Whitehead felt stricken and told the Sterns that she could not live without her baby. Whitehead stated to the Sterns that she only wanted the child for a week and would return it after she spent some time with her. The Sterns obliged because they were concerned that Whitehead was suicidal. Of course, at the end of the week, Whitehead refused to return the child. The Sterns filed a lawsuit to enforce the surrogacy contract and gain custody of the baby. The New Jersey Supreme Court evaluated the validity of the surrogacy contract in New Jersey. It stated that it was invalid due to public policy concerns and existing statutes. In expressing its reasoning, the court stated that such contracts are induced by money and are coercive by forcing the surrogate to irrevocably relinquish all rights to the child. Here, the fact that the relinquishment of rights occurs before the birth violates established New Jersey statutes and goes against regulations requiring counseling prior to the relinquishment of the child. Another issue that the court examined was the manner of termination. The mother's rights were terminated by contract, which is prohibited under New Jersey law. Because the termination was through a contract, the court stressed that this was not only contrary to established law, but against public policy. The court saw the contract as a form of coercion. But more importantly, the basic contract itself was against the legal principles and public policy that parental rights and custody are established by determining the best interest of the child. The surrogacy contract takes this determination away. Furthermore, the sole purpose of the surrogacy contract was to terminate the rights of the mother and place the child permanently and exclusively with the father. The mother's rights were not truly taken into account, especially given the law that any relinquishment must be voluntary and informed. The court stated that it was impossible for Whitehead to make a voluntary decision when she had the threat of a lawsuit over her head and the inducement of the $10,000. Seeing the transaction as "a sale" of a child or, at the very least, the sale of the mother's rights, the court could not see any positive result other than the "purchaser" was the biological father. Thus, the New Jersey court found the surrogacy contract—or the contract to sell a child—to be void.

Questions for Analysis

Review the *Baby M* case. Are there any facts that would have changed the New Jersey Supreme Court's result? If the Sterns had implanted all their genetic material, the egg and sperm, in the surrogate, would the New Jersey court's decision have been different? Explain your response.

Now, suppose you live in a state where neither statute nor case law prohibits a party from entering into a surrogacy contract. You prepare a surrogacy contract and then the surrogate refuses to perform. Is the contract legal or illegal? What are your rights? There is no answer until a court or legislature sets the standard. You could be entering into

Cybercises

What is your state's policy on surrogate contracts? Are there cases or statutes governing the practice? Identify the legal basis of your state's practice.

a contract that is seemingly legal but may be deemed illegal if challenged. The area of surrogacy contracts is still developing and may garner different results in every state.

Frozen Embryo and Sperm Donor Agreements

Science has advanced to such an extent that embryos and sperm can be frozen. Everything is fine until some unexpected event places the issue front and center. For example, a couple decides to freeze the wife's embryo for the future; the couple divorces before an embryo is implanted. The wife wants the embryo destroyed; the husband does not. Who owns the rights to the embryo? Are there child support issues? A case in Chapter 10 dealt with a sperm agreement but on very different issues. The sperm donor was a man who died. His parents wanted to implant the sperm in a surrogate. The contract provided that the sperm would be destroyed upon the death of the donor. That situation poses a real dilemma for the courts. The legality of these types of agreements have been challenged in some jurisdictions and usually turn on consent and public policy issues just like surrogacy contracts.

Prenuptial and Palimony Agreements

prenuptial agreement An agreement between two independent individuals prior to marriage that sets forth the terms and conditions of the division of property in the event of a divorce

A **prenuptial agreement** is an agreement between two individuals prior to marriage that sets forth the terms and conditions in the event the couple divorces. A prenuptial agreement usually determines the amount of monetary compensation one spouse may receive or how real or personal property is divided. The key to enforceability is whether the agreement is fair and reasonable and whether there has been full disclosure of the assets involved. If an agreement is found to be unfair or unreasonable, a court may deem the agreement unenforceable on grounds of illegality or, as discussed in the chapter on mutual assent, fraud or misrepresentation.

Palimony agreements present a different side of the issue. Palimony agreements grew out of the infamous *Marvin v. Marvin,* 557 P. 2d 106 (Cal. 1976) case, where actor Lee Marvin's longtime live-in companion sued him for support. The two were not married, but Mr. Marvin's companion claimed that the two would hold themselves out as husband and wife (even though Mr. Marvin was married to someone else) and that they would share equally in property accumulated as a result of their joint efforts. Therefore, she was entitled to certain assets and support during their longtime relationship in the amount of $1 million. (Remember, this was 1976!) From that case, the palimony agreement emerged. Prior to that time, no case had addressed the issue or the possible contractual relationship between two persons who cohabitated but were not married. In that case, the California Supreme Court found that this type of agreement could be implied through contract and remanded the case back to the trial court for further evaluation. Even though Michelle Marvin did not recover much from Mr. Marvin, this case was groundbreaking because no court had found an implied financial obligation between two unmarried people.

State Your Case

Carrington Toms is a well-known director of horror films. He had been living with Annabelle Hamilton for nearly 10 years. During their relationship, Carrington promised to give Ms. Hamilton a

Beverly Hills condominium worth over $4 million, a car of her choosing, and a monthly allowance of $10,000 so long as they were together. The agreement was reduced to writing. The two broke up. Annabelle claims that Carrington promised to support for the rest of her life and now she could not afford the style of life to which she had become accustomed. Annabelle claims the agreement is illegal and wants it set aside—effectively cancelling it. Is the agreement between Toms and Hamilton enforceable? State the basis of your conclusions.

Agreements for the Donation of Human Organs or Bone Marrow

Another area that has raised a public debate involves donations of human organs or bone marrow. Is it legal for a person to contract to sell a kidney or liver, for example? The key to these issues revolve around the term "sale" as opposed to donation. It is perfectly legal to donate organs and tissue to a person in need. In fact, this is a practice that is encouraged. Where the issue becomes problematic is when organs are purchased and sold for high sums of money. This has reached public proportions in recent times where an international organ for purchase ring had been discovered in the New Jersey/New York area. Here, organs were "donated" (actually purchased) from foreigners to be used for persons within the United States for tens of thousands of dollars. Usually these types of cases have criminal ramifications but also have public policy and legality implications.

Cybercises

Locate your state laws or policies on organ donation. Are organ donation contracts legal in your jurisdiction? Are there any federal statutes that govern this area of the law? Are contracts for selling human organs legal in your jurisdiction? What terms are required, if any, to support their legality?

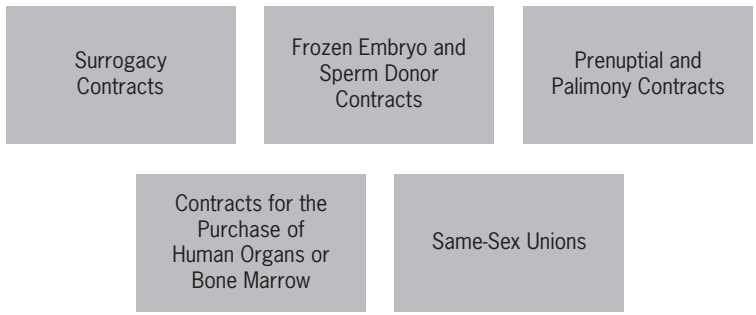
Same-Sex Unions

A new area of significance and attention is the national debate on same-sex unions. The debate not only touches on the legality of the union but also on the public policy issues that it raises. In California, where the debate rages on, initially the city of San Francisco permitted same-sex unions. A legislative proposition was brought before the voters, which would allow same-sex unions in the state. It was voted down. Many civil unions had been performed prior to the legislative vote. The question was how that affected the unions that were entered into previously. Were the unions legal and recognizable? This is an important question as it affects benefits and inheritance rights. The issue is unresolved. But in the wake of the California mandates, many states have either recognized the legality of civil same-sex unions either by legislation or by court decision. That means that persons within the states that have recognized same-sex unions have a legal relationship, and to undo the relationship, a divorce action would have to follow. For states that have not passed legislation or do not have case law addressing the subject, it is likely that same-sex unions would be illegal in those jurisdictions. See Exhibit 7-3 for an illustration of contracts which may be considered illegal on public policy grounds.

Cybercises

Determine the states that have recognized same-sex unions either by legislation or case law?

EXHIBIT 7-3 Illustration of contracts which may violate public policy



Covenants Not to Compete

In many circumstances, parties will agree not to engage in competition for a period of time and within a specific geographical area. These are known as **covenants not to compete.** Such provisions are frequently included in contracts for the sale of a business or employment. Because we live in a free market economy where competition is encouraged, restricting competition raises questions of unfairness. The *Restatement (Second)* § 187 states:

> A promise to refrain from competition that imposes a restraint that is not ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade.

Often in business relationships, contract provisions restrict the right to compete. These provisions protect one party when there is a high likelihood that the other party's competition could substantially and negatively affect its business. These provisions are known as **restrictive covenants** or **covenants not to compete**. Restrictive covenants can be categorized into covenants incident to the sale of a business and covenants incident to an employment relationship. Each restricts the ability to compete under very specific circumstances.

covenant not to compete (restrictive covenant)
A provision in a contract that restricts a party's ability to compete. Arise in employment or business contracts

Restatement (Second) § 188 has been adopted by many states as a basis for analyzing the validity of a noncompetition provision. The provision provides:

(1) A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if:
   (a) the restraint is greater than is needed to protect the promisee's legitimate interest, or
   (b) the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.

(2) Promises imposing restraints that are ancillary to a valid transaction or relationship include the following:
   (a) promise by the seller of a business not to compete with the buyer in such a way as to injure the value of the business sold;

(b) promise by an employee or other agent not to compete with his employer or other principal;
(c) promise by a partner not to compete with partnership.

Courts have used the *Restatement* definitions in determining the enforceability of noncompetition agreements.

Covenants Incident to Sale of a Business

It is common, as part of the conditions for the sale of a business, to restrict or limit the seller's ability to compete in the same field for a specified period of time within a specified geographical area. This contractual provision is important because it effectively prohibits a seller from going into the same business, using the same contacts and suppliers, and, in effect, selling the prospective buyer nothing. Laws allow for reasonable restrictions and reasonable restraints on competition when the provision is incident to the sale of a business. Whether a covenant not to compete is enforceable depends on the scope of the covenant.

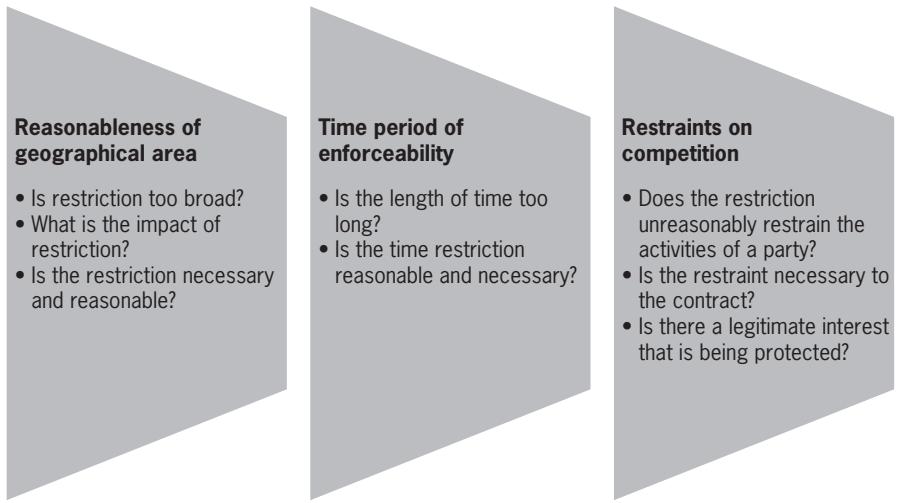
Most courts set restrictions as to the geographical area and time period in which a covenant may be enforced. The court will look at the type of business involved, the general geographical area in which the business operates, and the overall impact of the restriction on a person's right to engage in business. If the covenant goes beyond what is reasonable and necessary, the court may either excise the provision and enforce the contract without the noncompetition provision, or reform the provision to limit the geographical area and make it reasonable. For example, suppose that you are in the market to sell a business in the state of New Jersey. Your business involves the sale of seashell art. Your business is limited to the counties of Atlantic and Ocean in the southern portion of New Jersey. However, the covenant as drafted provides that the seller is restricted from selling seashell art in the entire state of New Jersey for a period of seven years. This would likely be considered an unreasonable restraint of trade and competition. The provision would probably be declared void, because it extends for too long a time and covers a larger geographical area than is reasonable and necessary. Critical to the analysis of a noncompetition clause is its reasonableness.

Many states have statutes regulating the reasonableness of covenants not to compete, but the statutes have strict requirements. Courts do not look kindly upon contracts that restrict trade, and will do whatever is necessary to allow free competition in a market economy.

Covenants Incident to Employment

Similarly, employers may restrict the right of employees to compete in the same business after their employment has terminated. The same standards of reasonableness apply as for covenants not to compete. The restrictions may include geographical and time constraints. Covenants in employment contracts are very common, especially in industries such as computers, technology, and manufacturing. Employers attempt to protect the investment they have in their employees, especially when employees are exposed to confidential, proprietary information and trade secrets. As a method of protection for employers, courts have enforced restrictions in employment contracts. Again, what courts look for is the extent of the provision and its effect on the employee. Exhibit 7-4 sets forth some characteristics a court will examine when determining the enforceability of a covenant not to compete.

EXHIBIT 7-4 Characteristics a court will consider in covenants not to compete



TECH CHECK

The Non-compete agreement and the Internet

Global e-commerce and technology present new and interesting crinkles to the area of noncompetition clauses. Suppose an Internet business is sold, and the new buyer wants a noncompetition clause in the contract of sale. In this instance, what is considered a reasonable and fair noncompetition clause? More importantly, how do you monitor the behavior on the Internet? These are questions that presently have not been analyzed by a court, but are real issues in today's world. Usually a court will not enforce a noncompete agreement that is overly broad, designed not to protect a legitimate business interest and not confined to a specific time period and geographical location. However, in a recent challenge to a noncompete clause, which was in effect nationwide, the North Carolina court in *Phillips Electronics North America Corp., v. Hope,* 631 F. Supp. 2d 705 (M.D. N.C. 2009) upheld the noncompetition clause. The question is, "how do you limit geographical location on the Internet?" Perhaps cases like *Phillips Electronics* will be a guide. As the Internet evolves and the issues make their way through the courts, you may be faced with novel legal issues that presently have no concrete answer.

Exculpatory Clauses

exculpatory clause A clause in a contract or other legal document excusing a party from liability for a wrongful act

Clauses that limit one's liability are known as **exculpatory clauses.** Exculpatory clauses are closely monitored by the courts and undergo basically the same analysis as unconscionable and adhesion contracts. Courts will determine (1) whether the bargaining powers of the parties were equal and (2) whether the parties had any bargaining powers at all.

Many of us see exculpatory clauses daily. For example, when you park your car in a parking lot, a limitation of liability is often printed on the claim ticket. Usually the claim ticket states that management will not be held responsible for any items stolen or for damage to the car while it is in the possession of the garage. Lift tickets for ski resorts also have printed exculpatory clauses that attempt to absolve the ski resorts from any liability for their negligence. The list can go on and on, but whether the exculpatory clause is valid is determined by comparing the bargaining powers of the parties and analyzing how offensive and oppressive the contract is. Review *Harris v. Walker,* 119 Ill. 2d 542, 519 N.E.2d 917 (1988), where the main focus is the validity of an exculpatory clause.

Line of Reasoning

This case involves a horseback riding accident. Ronald Harris fell off a horse and injured himself at the Ky-Wa Acres riding stables, which was owned by Al Walker. Ronald claimed to know how to ride and fully accepted the risks associated with riding. On the sign-in sheet, Walker read an exculpatory clause that stated the following:

> Your signature below indicates that you have read the posted rules will abide by them. Also, your signature shall release Ky-Wa Acres and employees of any liability you may incur while on the premises or for any injury which may result from horseback riding. If your signature is not reliable, please do not sign or ride.

Additionally, there were signs that the patrons rode at their own risk. Ronald claimed to understand the risks associated with riding. Apparently, he was thrown when his horse was startled. In analyzing the public policy concerns, the court examined the language of the exculpatory clause. The court pointed to the obvious risks associated with riding, even to the experienced rider. After a review of the jurisdiction's public policies, the court did not find any reason to set aside the release of the liability clause. Another basis for the enforcement of the clause is that ordinarily these types of clauses will not be enforced where the parties have unequal bargaining powers. Here, Ronald could have walked away and chosen not to ride. He had choice; he had an option. His actions were voluntary, and he agreed to accept the risks associated with riding. Therefore, the exculpatory clause was valid and enforceable. Ronald could not recover anything for his injuries.

Questions for Analysis

Review *Harris v. Walker*. Had Ronald indicated that he had not ridden in years to Walker and still signed the agreement, would the court have enforced the exculpatory clause? Would the court have enforced the contract against a rider who was just a beginner? Explain your response.

7.4 SAVING AN ILLEGAL CONTRACT: WHAT ARE THE REMEDIES?

Depending on the type of contract at issue, a contract may be void or voidable. And, in some instances, the offending provisions severed or removed from the contract. Results vary with each situation requiring review. What is safe to say is that a contract to commit

an illegal act, such as a crime, is void. Contracts that raise public policy questions may be voidable at the election of the party who is attempting to challenge enforceability. Often these contracts not only present grey areas for the parties but are also uncharted territory for the courts. Do not try and second-guess these types of situations.

There is a limited exception to nonenforceability of illegal contracts. Courts may use the concept known as *in pari delicto* (equally at fault), which focuses on the illegal acts of the parties. A court will not reward one party for its illegal acts in order to prove a case against another illegal actor. If the court finds that the parties to the contract were not equally blameworthy of an illegal act or that one party was not guilty of moral turpitude, the court may enforce the contract against the person who is less guilty; in this instance, the parties are not in pari delicto. This situation is infrequent. An example of the in pari delicto doctrine is found in an early case, *Liebman v. Rosenthal,* 57 N.Y.S.2d 875 (1945).

Line of Reasoning

Liebman and his family wanted to escape the Nazis in World War II. While vacationing in France in May, 1941, Liebman met Rosenthal, who stated that he knew the Consul in Portugal and could provide him safe passage to that country. It would cost $30,000 to get the papers. Rather than cash, Liebman presented Rosenthal with diamond jewelry worth $28,000. They went to the Consul, but Rosenthal never made a formal application for a visa. Rosenthal absconded with the jewelry. Somehow, the two met up in New York City, where Liebman demanded the return of the jewelry. Liebman sued Rosenthal. Because the parties entered into an agreement to bribe an official and participated in an immoral act, Liebman could not recover because each was in pari delicto in that one could not recover when the purpose of the agreement was illegal. In its reasoning, the court stated that parties to an illegal contract that has been executed cannot recover the money paid, because they are in pari delicto—equally at fault. However, when one party wishes to rescind an executory contract, he may do so. The court further stated that it will not enforce a prohibited contract, but it will take notice of the circumstances and if justice and equity require, will give relief. In this case, the court found that the contract was executory. Here, Liebman wanted to recover his money from a man who obtained it under false representations and fraud. Moreover, given the circumstances surrounding the contract, that Liebman was trying to escape Hitler's Germany and get his family out, the court did not conclude that the parties were in pari delicto. Rosenthal had made representations upon which Liebman relied. As the court observed: "There is no question of the public policy involved in a case like this where a man is attempting to save himself from an enemy who has violated all the laws of civilization. Protection of one's self and one's family is among the first laws of nature and this court can appreciate that under similar conditions the most law-abiding man would enter into such an agreement as this plaintiff is alleged to have made." The court found for Liebman.

Questions for Analysis

Review *Liebman v. Rosenthal*. Under what circumstances would the court have found the parties in pari delicto and set aside the agreement? If a mother sold a child to a childless couple to save the child from marrying a stranger at age 14, would a court enforce that contract if the mother wanted the child back later?

Connected to the concept of in pari delicto is *locus poenitentia* (a time in which to repent). Here, a party can withdraw from a contemplated illegal act before liability results. Thus, courts will allow a party to an illegal contract time to repudiate the contract before the illegal act is performed. As a result of this act of repentance, the court will allow recovery in the form of **restitution** from the party who has rescinded an illegal bargain, if that is appropriate.

restitution
A remedy that restores the status quo

Divisible Contracts

To avoid the injustice that voiding an illegal contract may cause, courts can apply the *doctrine of divisibility*. By dividing a contract into sections, courts can remove an illegal provision and enforce the remaining legal provisions of the contract.

Before the doctrine can be applied, the contract and the circumstances surrounding its formation must meet certain requirements. First, the contract must be **divisible** into corresponding pairs of performances that the parties treated as equivalent exchanges. If the illegal performance is severable, the remainder of the contract will be enforced. Second, the illegality cannot affect the entire contract. If the entire contract is illegal, it cannot be divisible. Lastly, the party seeking enforcement of the contract must not have engaged in serious misconduct.

divisible contract
A contract whose parts are capable of separate or independent treatment; a contract that is enforceable as to a part which is valid, even though another part is invalid and unenforceable

If a case meets these requirements, the doctrine of divisibility applies and the illegal part will be severed from the contract. Courts find this to be a more equitable result when illegality is raised.

7.5 PRACTICAL APPLICATION

When drafting contract provisions, always check the status of the law. Research will be critical to determining the enforceability of many contract provisions. When statutes or case law do not provide guidance, common sense is advised as the key to understanding legality. Examples of contract provisions are:

Exclusion of Consequential Damages:
The parties agree that Seller will not be liable for any consequential damages of any nature caused to the business or property of the Buyer by any failure, defect, or malfunction of the computer.

Waiver of Statute of Limitations:
The Buyer promises and agrees not to plead to statute of limitations as a defense to any payment that may become due under this contract and waives the statute of limitations as to any and all claims that may accrue under this contract for the period of seven years.

Disavowal of Extraneous Representations:
The Buyer has read and understands the whole of the above contract and states that no representation, promise, or agreement not expressed in this contract has been made to induce such party to enter into it.

Severability:
It is understood and agreed by the parties that if any part, term, or provision of this contract is held by the courts to be illegal or in conflict with any law of the state where made, the validity of the remaining portions or provisions shall not be affected, and the rights and obligations of the parties shall be construed and enforced as if the contract did not contain the particular part, term, or provision held to be invalid.

SUMMARY

7.1 The final element in contract formation is legality. A contract can be illegal if it violates a statute or a public policy. Illegal contracts are void and enforceable.

7.2 An illegal agreement is one prohibited by law. A number of activities which violate a statute will render a contract illegal. Usury, wagering, Sunday business, and licensing may render a contract illegal as well.

7.3 Contracts that violate public policy can also be illegal. Surrogacy contracts have come under attack as violating public policy. Covenants not to compete, incident to the sale of a business or an employment contract, also have come under close scrutiny. An exculpatory clause limits a party's liability. If the parties have unequal bargaining powers, an exculpatory clause may be illegal.

7.4 When the parties are not *in pari delicto,* a court may enforce the contract against the party who is less guilty. If a party repents from a contemplated illegal act, the court will allow recovery in the form of restitution. If a contract is divisible, the illegal portions may be excised and the remaining portions enforced.

KEY TERMS

legality
usury
surrogacy contract
prenuptial agreement
covenant not to compete (restrictive covenant)
exculpatory clause
restitution
divisible contract

REVIEW QUESTIONS

1. Define the term *legality.*
2. What are the two types of illegality upon which a contract may be voided?
3. What is a usury law, and what is its function?
4. Define Sunday laws and the reasoning behind their existence.
5. Identify two reasons for having professional licensing laws.
6. Name three types of contracts that violate public policy.
7. When are covenants not to compete permitted to restrict competition?
8. What is an exculpatory clause?
9. Define *in pari delicto* and *locus poenitentiae.*
10. What is the doctrine of divisibility?

EXERCISES

1. From your daily activities, collect examples of exculpatory clauses, such as on dry cleaning receipts, car parking receipts, theatre ticket receipts, or any others that may disclaim liability for an act. Discuss which exculpatory clauses would be enforceable or unenforceable.

2. Yvonne and Quentin Marshall are the parents of a 13-year-old daughter, Stephanie, who has just been diagnosed with cancer. The only way to save her life is through a bone marrow transplant. Neither Yvonne nor Quentin is a viable donor. The only other possibility is if Stephanie had a sibling. Unfortunately, Stephanie is an only child. Yvonne will do anything to save her daughter's life. She and Quentin conceive a child who is born one year later. The child is healthy. Finally telling the doctor their plan, they have their child tested. The child is a match, but is too young for any operation. The Marshalls wait until Sarah is 3 years old. The doctor is not sure whether the procedure is legal, but agrees to do the transplant anyway. He signs a contract where he is pledged to secrecy. The doctor is on staff at Memorial Hospital and charges for not only his professional service but the use of the facility. A day before the transplant is to take place, the hospital where the procedure is to take place finds out. They immediately file a case in court to stop the procedure because it is illegal to use a young sibling to save the life of another sibling. The next day, there is a hearing. Your attorney wants to know whether the subject matter of the contract with the doctor is legal. With the hospital? Explain your answer.

3. Paul is single but wants to have his own children. He decides to have his sperm frozen at a clinic just in case something happens to him. After a few years, Paul decides he wants to have children, but has not found the "right one." He lives in Iowa. He contemplates hiring a surrogate, but instead his sister-in-law, Lola, offers to help. They entered into a contract where Paul will raise the child and pay all medical expenses. When the child is born, his sister-in-law has second thoughts.

   (a) Is the contract a valid contract in Iowa?
   (b) Unbeknownst to Paul, the child is not his. His sister-in-law was not pregnant with his child, but his brother, Damian's—her husband. Lola just wanted Paul to pay for the medical expenses. Is the contract between Paul and Lola valid?

4. Holly and Ryan have just started dating. Ryan is cautious when he begins new relationships. He understands that sometimes women are more willing to be intimate than others. But, he does not want anyone accusing him of being pushy, or even worse, rape. He has heard about an existing contract that requires a woman to sign to consent to sexual intercourse. The contract was developed by a men's group in an attempt to protect men from allegations of rape. Ryan wants Holly to sign the contract. She's not so sure, so she brings it to your law firm for review. Is this type of contract enforceable? What issues does this type of contract raise? Discuss all issues that may be involved (besides Holly is not going out with the guy!).

5. A wealthy businessman offers a young couple $2 million in exchange for his spending 48 hours with the wife. (This undoubtedly included some intimate relations.) If the wife spent the 48 hours with the businessman, she would be entitled to $2 million. Is the contract between the parties legal? What would happen if the businessman decided not to pay the $2 million? Could the couple enforce the contract in a court?

6. Suppose you are working in California for a company that sells cardiac catheterization equipment, but the company that you are working for is based in Pennsylvania. They are incorporated in Pennsylvania and their home offices are in Pennsylvania. You are asked to sign an employment agreement which contains a noncompetition clause stating that you cannot work in California selling cardiac catheterization equipment for a period of two years after your employment ceases with the company. Because of business, your company offers you a severance package, which you accept. As part of the severance package, you agree to abide by the noncompetition clause. Is the clause enforceable? In responding to this question, discuss all issues including the law on the subject in both California and Pennsylvania.

7. Chris and Sam are in love. They want to get married but their state, Utah, still does not recognize same-sex civil unions. Wanting the world to see them as a couple, they decide to drive to neighboring Iowa where they know it is legal. Sam has some concerns. As a wealthy entrepreneur, Sam's holdings total over $5.5 million. Chris works primarily in the tourism industry as a consultant. As much as Sam wants to marry Chris, protecting his assets is important, too. Sam consults his attorney and wants a prenuptial agreement dividing the assets, including a fixed settlement amount in the event of a divorce. Chris should sign the agreement. The big question that Sam has is whether the agreement is enforceable if they marry in Iowa. Prepare a memorandum of law considering all aspects of the situation.

8. Iris wants to live forever, or at least have the opportunity to do so. She has heard of places that will freeze your body after you die and later attempt to revive you. Sounds a bit farfetched, but she believes it is possible given all the technological and medical advances of late. She contacts one of the cryogenic laboratories to discuss the process and what she needs to do to sign up. Iris executes the contract but tells no one. Three years later, she dies leaving a will, which provides the following: "I do not want to be buried or cremated. I have arranged for my body to be frozen so that I may be revived when a cure for my illness is found. My remains should be delivered to Cryonics Laboratories, 555 Stone Mountain Way, Adventura, Arizona." Iris's family is in shock. They want to give their mother a proper burial. Upon learning of Iris's death, Cryonics Laboratories contacts Iris's daughter Stephanie to discuss the arrangements for transport. Stephanie tells Cryonics to forget it. Cryonics wants to pursue this matter in court. What arguments can Cryonics make in favor of the enforceability of the contract? What arguments can Stephanie raise to void the contract? Research whether any cases have been decided on this issue to support your positions.

9. Trey loves to ski and snowboard. He decides to rent a board with Snow Mountain Rentals. Before they will rent him the snowboard, Snow Mountain requires all their customers to sign the following:

   > Your signature below indicates that you have read the posted rules and will abide by them. Also, your signature shall release Snow Mountain Rentals and its employees or agents from any liability that may be incurred while using any equipment or for any injury that may occur resulting from using any of the equipment. By signing this document, you are waiving all you rights to sue Snow Mountain Rentals.

   Trey signs the document. While coming down one of the hills, he hits something hard and breaks his arm. It turns out that he hit a tree stump that had been covered by the snow and ice. Trey wants to sue Snow Mountain for his injuries as he did nothing wrong. Is the document Trey signed valid and enforceable foreclosing his rights to sue Snow Mountain for his injuries? Explain your response.

10. A man is presently living in Marfur, a country in Africa, where young women are being taken and forced to marry men and bear their children. Zulima's father does not want her to live this kind of life. He manages to scrape together $420 U.S. dollars to send his only daughter, aged 13, to America. He gives the money to Salim, who claims he will take Zulima to America to her relatives in Baltimore, Maryland. Salim takes Zulima to America, but decides to keep her for himself. Zulima writes her father and tells him of her fate. Four years later, Zulima's father arrives in America and takes his daughter away in the middle of the night. Zulima and her father sue Salim in an American court for the return of the $420. What are the issues that Zulima and her father will face in an American court? (Limit your responses to the issues discussed in this chapter.)

CASE ASSIGNMENTS

1. Claire is 14 years old and has been diagnosed with leukemia. Her parents want to do everything they can to keep Claire alive. Claire's doctors have determined that she needs a bone marrow transplant. She can live on blood transfusions and medication for a while, but ultimately she needs the transplant. Claire's parents, Walter and Vickie Brighton, want to explore all their options. Vickie has even tried to get pregnant but has not been successful. She and Walter discuss hiring a surrogate to implant their egg and sperm, hopefully creating a genetically compatible child from which bone marrow can be donated. Vickie has located a possible surrogate. The surrogate, Gretta, wants $50,000 and all her medical expenses paid. She will agree to relinquish her rights to the child and sign a contract that formalizes their agreement. Your attorney has asked you to research the law in your jurisdiction and draft a contract between the Brightons and Gretta.

2. Continuing with the facts from above, Gretta learns that the Brightons intend to take the bone marrow from the child to help their dying daughter Claire. She is against this kind of "hocus pocus" medicine. Now in her seventh month, Claire refuses to give the child to the Brightons. The Brightons sue based on the fact that they have a contract with Gretta. What are the legal positions of both parties? Discuss all issues.

Chapter 8

Proper Form of the Contract: The Writing

Outline

Just Suppose . . .

You have learned that your uncle, Leo, has been trying to buy some property in the North Shore near Marblehead, Massachusetts. Apparently, an elderly couple, the Gerards, own around two acres with a magnificent converted farm house, which they rehabilitated a few years back. Back in 2005, Leo was contacted by a real estate lawyer stating that the Gerards were offering the property for $2 million. The parties exchanged e-mails but were never able to reach an agreement. Three years later, Leo receives an e-mail from the lawyer stating that the property is still on the market and wants to know if he is still interested. Leo then began communicating directly with Mr. Gerard. Leo offered $1.25 million for the property, which Mr. Gerard accepted. Given the price, Mr. Gerard indicated that the property was "as is" for which Leo agreed. Leo e-mailed Mr. Gerard and wrote: "Great. Send me the P&S Agreement as soon as you can. I will have my lawyer forward the down payment of 10%." Mr. Gerard responded to Leo by stating: "I am looking forward to closing ASAP. I know you will be as happy as my wife and I have been. You are purchasing the prettiest spot in all of Marblehead." All the e-mails between Uncle Leo and Mr. Gerard contained a salutation that included the type written name of the sender. When Mrs. Gerard heard that her home was selling for $1.25 million she told her husband to forget it. She claimed that she never signed any documents and that her husband was just going to have to return the deposit to Leo. Of course, Uncle Leo is furious. He had a deal with Mr. Gerard, and like it or not, he was going to go to court have

it enforced. Uncle Leo did not have a signed Purchase and Sale Agreement, but he did have all the e-mails. He believed that they reinforced his position that he had a deal. The question is: Are the e-mails sufficient documentation of the agreement? Of course, this is the million dollar, or rather, the $1.25 million question!

8.1 UNDERSTANDING THE STATUTE OF FRAUDS

The fact pattern at the beginning of this chapter sets the stage for our last requirement for enforcing a contract—whether the contract is required to be in writing. Simply complying with all the elements of contract formation may not be sufficient. In some instances, the law requires that certain types of contracts be in writing to be enforceable. The statute that sets out this requirement is the **Statute of Frauds,** which dates back to old English law, where the Parliament in 1677 passed the statute known as the Act for Prevention of Fraud and Perjuries because of numerous problems with people attempting to enforce oral contracts. Apparently, allegations of perjury were rampant in England when a contract was oral. To prevent the widespread chaos that was brewing, Parliament passed a statute requiring that certain kinds of contracts be in writing.

Statute of Frauds
A statute that requires certain classes of contracts to be in writing and signed by the parties. Its purpose is to prevent fraud or reduce the opportunities for fraud

The concept established in the English Statute of Frauds crossed over the Atlantic and became part of our law of contracts. Virtually every state, except Louisiana, has adopted some form of the Statute of Frauds, so it has become a basis for challenging the enforceability of contracts. Except for Maryland and New Mexico, which have adopted the statute by judicial decision, the remaining states have passed legislation following the original English version to some degree.

The original Statute of Frauds states that five types of contracts must be in writing to be enforceable:

1. Contracts that by its terms cannot be performed within one year of the date of their making
2. Contracts to answer for the debt of another
3. The promise of an executor to pay the debt of a decedent's estate
4. Contracts in consideration of marriage
5. Contracts involving real property

Contracts with subject matter in any of these categories cannot be oral, but must be in writing to have any legal effect.

Realistically, complying with the Statute of Frauds creates another requirement for the enforceability of contracts. Although not technically an element of a valid oral contract, the Statute of Frauds does raise a barrier to enforceability of a seemingly valid contract.

Many states have enumerated additional situations in which a writing is necessary to enforce a contract. Although each state's statutes vary to some degree, most have at minimum accepted the five categories set out in the original English statute. Exhibit 8-1 shows the California and New York Statutes of Frauds. Compare the similarities and differences.

EXHIBIT 8-1 Sample Statutes of Frauds

§ 1624. Statute of Frauds [California]

The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent:

(a) An agreement that by its terms is not to be performed within a year from the making thereof.

(b) A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in Section 2794.

(c) An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; such an agreement, if made by an agent of the party sought to be charged, is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged.

(d) An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where the lease is for a longer period than one year, for compensation or a commission.

(e) An agreement which by its terms is not to be performed during the lifetime of the promisor.

(f) An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of the indebtedness by the purchaser is specifically provided for in the conveyance of the property.

(g) A contract, promise, undertaking, or commitment to loan money or to grant or extend credit, in an amount greater than one hundred thousand dollars ($100,000), not primarily for personal, family, or household purposes, made by a person engaged in the business of lending or arranging for the lending of money or extending credit. For purposes of this section, a contract, promise, undertaking or commitment to loan money secured solely by residential property consisting of one to four dwelling units shall be deemed to be for personal, family, or household purposes.

This section does not apply to leases subject to Division 10 (commencing with Section 10101) of the Commercial Code.

§ 5-701. Agreements required to be in writing [New York]

a. Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

1. By its terms is not to be performed within one year from the making thereof or the performance of which is not to be completed before the end of a lifetime;
2. Is a special promise to answer for the debt, default or miscarriage of another person;
3. Is made in consideration of marriage, except mutual promises to marry;

[4. Repealed]

5. Is a subsequent or new promise to pay a debt discharged in bankruptcy;

6. Notwithstanding section 2-210 of the uniform commercial code, if the goods be sold at public auction, and the auctioneer at the time of the sale, enters in a sale book, a memorandum specifying the nature and price of the property sold, the terms of the sale, the name of the purchaser, and the name of the person on whose account the sale was made, such memorandum is equivalent in effect to a note of the contract or sale, subscribed by the party to be charged therewith;

[7,8. Repealed]

9. Is a contract to assign or an assignment, with or without consideration to the promisor, of a life or health or accident insurance policy, or a promise, with or without consideration to the promisor, to name a beneficiary of any such policy. This provision shall not apply to a policy of industrial life or health or accident insurance.

10. Is a contract to pay compensation for services rendered in negotiating a loan, or in negotiating the purchase, sale, exchange, renting or leasing of any real estate or interest therein, or of a business opportunity, business, its good will, inventory, fixtures or an interest therein, including a majority of the voting stock interest in a corporation and including the creating of a partnership interest. "Negotiating" includes procuring an introduction to a party to the transaction or assisting in the negotiation or consummation of the transaction. This provision shall apply to a contract implied in fact or in law to pay reasonable compensation but shall not apply to a contract to pay compensation to an auctioneer, an attorney at law, or a duly licensed real estate broker or real estate salesman.

Cybercises

Find your state's Statute of Frauds and determine what additional categories of contracts, if any, are required to be in writing. (For those in Louisiana, determine how your state has handled the issue of the Statute of Frauds.)

This chapter discusses not only the Statute of Frauds, but also the extent of the writing necessary to satisfy the Statute of Frauds and some of the exceptions circumventing that statute. Additionally, rules of interpretation are analyzed to determine the intent of the parties when the contract is in some form of a writing. But first, a thorough discussion of the types of contracts requiring a writing is essential.

The Scope of the Statute of Frauds: Which Contracts are Included?

The first question that you should ask yourself is whether all contracts need to be in writing? The obvious answer (hopefully) is "No." Remember that some contracts can be oral and be enforceable. That means that you must always ask, "Does the Statute of Frauds even apply to my situation?" In answering this question, it is probably a good practice to review the types of contracts that fall within the Statute of Frauds in your jurisdiction. If your situation is not addressed in your jurisdiction's statute, then the contract is not

required to be in writing. If your transaction falls within the Statute of Frauds, then the next step in your analysis is to review the written document(s) to determine whether they comply with the Statute of Frauds.

As you can guess, if your analysis concludes that the written document(s) do not satisfy the Statute of Frauds, the next question to ask yourself is: "Are there any exceptions that apply?" Plainly stated: "Is there a way to get around the Statute of Frauds?" If there is not an exception, then the transaction may not be enforceable. Although the writing requirement may be a technicality that may prevent the contract from being performed, often the courts will find ways to be fair in enforcing a contract, especially if the parties have benefited in some way from the transaction. Fairness may not always rule the day, but as we will see later, it is important in performing a complete analysis of the transaction. A thorough analysis is important in making a determination as to (1) whether the transaction must be in writing; (2) if so, what will satisfy the Statute of Frauds and (3) if the written documents are insufficient, are there exceptions to the Statutes application. Therefore, we will first carefully analyze the type of contracts that are required to be in writing and then determine what the Statute of Frauds requires to have the contract enforced.

8.2 TYPES OF CONTRACTS REQUIRED TO BE IN WRITING

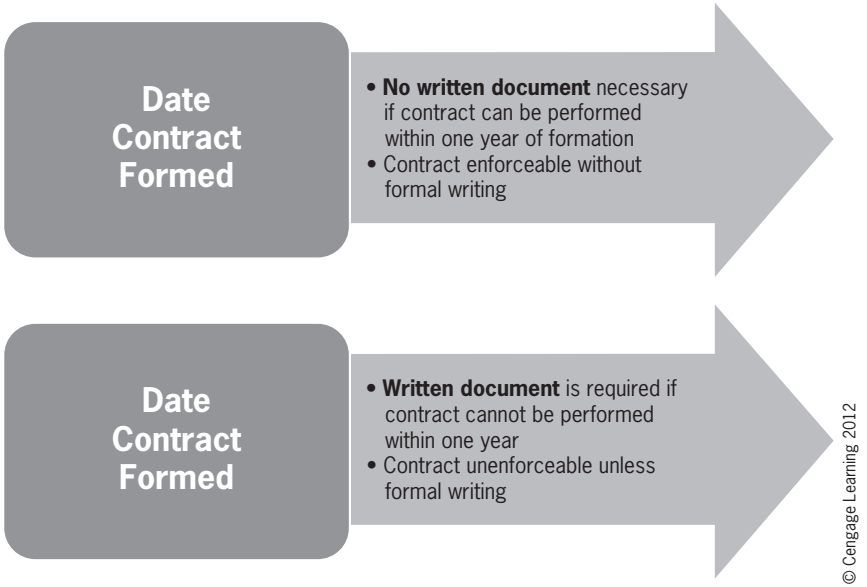
As mentioned, five general categories of contract fall within the Statute of Frauds. Each is discussed in this section.

Contracts That Cannot Be Performed Within One Year

Contracts that cannot be performed within one year of the date of the agreement must be in writing. This rule suggests that if a contract cannot be fully performed within one year after consummation of the contract, the contract must be in writing. For example, if you agree to teach school on August 15, and your position runs from September 1 through August 31, but you do not begin performance until September 1, under the Statute of Frauds the agreement must be in writing.

This provision of the Statute of Frauds has met with much hostility within the courts, because often it can cause inequitable results. One type of contract that has come under scrutiny is the lifetime contract. A contract for the lifetime of a person suggests that it cannot be performed within one year and thus must be in writing. However, some courts have interpreted this provision to suggest that the possibility exists that a person may die within one year, thereby allowing enforceability of an oral contract without requiring a writing. See Exhibit 8-2 for an illustration.

EXHIBIT 8-2 Contracts pursuant to the one year rule



Courts ask whether it is *possible* for performance to occur within the one year. If the answer is yes, then the courts do not require that the contract be in writing. For example, City Insurance Company orally agrees to insure Mr. Dennison's house for 10 years from losses from natural disasters. A court could determine that, because a hurricane could hit tomorrow, the contract *could* be performed within one year, and thus need not be in writing. Courts interpret this requirement differently and thus each provision should be examined on a case-by-case and state-by-state basis. Examine *Dobson v. Metro Label Corp.,* 786 S.W.2d 63 (Tex. Ct. App.-Dallas 1990, no writ), in which the court had to interpret a one-year provision in an oral contract.

Line of Reasoning

Dobson v. Metro Label Corp. centers on the enforceability of an employment agreement. Ron Dobson was hired by Metro Label Corporation to be its general manager for a salary of $60,000. He was hired on July 14, 1987. The employment was memorialized by its CEO in the following memorandum:

7/14/87
Offer today for General Manager @ $60,000 base salary per year with no bonus arranged initially.

Jerrome T. Abbott

Dobson quit his prior job and began work on August 3, 1987 for Metro. On September 8, 1987, Dobson was terminated. The main issue in the case was whether the above memorandum

satisfied the Statute of Frauds. If an employment agreement cannot be performed either by its terms or by the nature of the acts required within one year, the Statute of Frauds requires the agreement be in writing. To satisfy the Statute of Frauds, the agreement must contain all the elements of the agreement so that the contract can be determined without resorting to oral testimony. Thus, the writing must contain all the critical elements of the contract, including the identification of the subject matter of the contract and the parties to the contract. The court recognized that the evidence in this case established that the parties met a number of times until they agreed on a salary of $60,000. Abbott then reduced the agreement to the above memorandum. The evidence also established that Dobson was to receive medical benefits and that the employment would begin on August 3, 1987. Contracts that cannot be performed within one year must comply with the Statute of Frauds. Dobson argues that his contract covered employment for one year—August 3, 1987 to August 2, 1988. From the making of the contract—July 14, 1987—more than one year elapsed from the date of making, and thus the Statute of Frauds comes into play. The memorandum is devoid of detail. It does not identify the parties, only that it was for a general manager position at some place of employment. It does not specify the time period as well. Based on this, the court held that the memorandum did not satisfy the Statute of Frauds and found that there was not an enforceable contract.

Questions for Analysis

Review *Dobson v. Metro Label*. What actions could Dobson have taken for there to be an enforceable employment agreement? Had both Dobson and Abbott signed the memorandum, would the court's result have changed? Why or why not?

Contracts of a Third Party to Pay the Debt of Another

In most contractual arrangements, two parties are involved and there is an exchange of promises and obligations. Each party is primarily liable for its obligations under the contract. However, occasionally a third party offers assistance in paying the debt of another party. If the primary promisee does not pay, the third party offering to pay is known as a **surety** or **guarantor.** The relationship is called a *suretyship*.

surety
A person who promises to pay the debt or to satisfy the obligation of another person (the principal)

guarantor
A person who makes or gives a guaranty

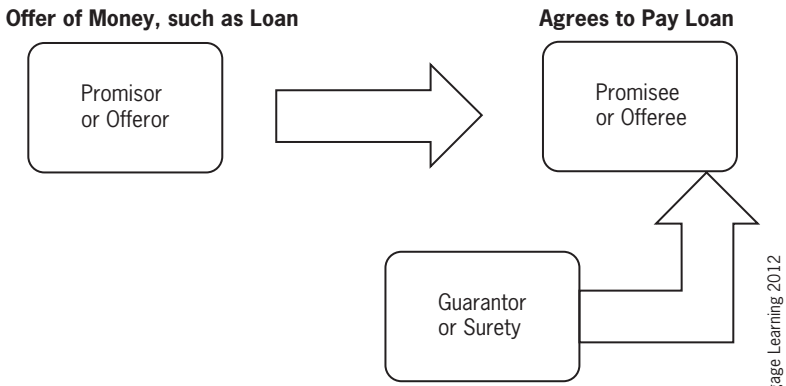
Under the Statute of Frauds, a collateral or secondary promise by a third party to pay the debt of another must be in writing. The reasons behind the requirement of a writing in this situation is that ordinarily the third party does not benefit in any way from the contract. Often the third party is only lending his or her name to the transaction for credibility. The third party who is offering to pay the debt of another must be aware of the guaranty of payment—thus the requirement of a writing. Knowledge is critical to the enforceability of a suretyship contract against the surety or guarantor. Assume that Mr. Sutherland walks into a store and says to the salesperson, "Sell my friend Robert a rain coat, and I will pay for it." This situation does not fall within the Statute of Frauds and does not require a writing, because Mr. Sutherland is the primary **obligor** to the transaction, not Robert. However, if Mr. Sutherland says, "Sell Robert a raincoat, and if he does not pay, I will pay you," this type of contract must be in writing. Mr. Sutherland is guaranteeing payment for Robert as surety because Robert, not Mr. Sutherland, is now

obligor
The person who owes an obligation to another; a promisor

the primary obligor. Notice that Mr. Sutherland also has knowledge of his promise to pay Robert's debt if Robert defaults.

The most common situation in which a guaranty or surety arrangement arises is in lending money. Typically, a party makes application to a bank for a loan. Sometimes, if a corporation or individual does not have a substantial credit history to ensure payment of the loan, the bank will require a third party to agree to pay the debt in the event that the primary obligor on the debt cannot or does not pay. The third party is, in effect, guaranteeing payment of the original obligation, even though he or she may not benefit in any way from the borrowed money. Because the third party does not benefit from the transaction, the Statute of Frauds requires that this kind of contract be in writing in order to be enforceable. If this were not so, any person could offer other individuals' names to guarantee payment without those individuals' knowledge, and thus allegedly they could be made responsible for a debt of which they had no knowledge. As protection, to be effective, the obligation must be in writing and signed by the third party. See Exhibit 8-3.

EXHIBIT 8-3 Diagram of guarantee arrangement



Main Purpose Rule

leading object rule (main purpose rule) The rule that a contract to guarantee the debt of another must be in writing does not apply if the promisor's "leading object" or "main purpose" in giving the guaranty was to benefit himself or herself

The requirement of a writing applies only when the third party intends to be secondarily liable rather than primarily liable. If the party who offers the guarantee is gaining direct advantage or benefit from the transaction, then the writing requirement is inapplicable. The question is whether the surety or guarantor's main purpose is to obtain direct benefits from the contract. If the answer is yes, then the contract need not be in writing. This rule is known as the *main purpose rule* or the **leading object rule.** Under the main purpose rule, the party making the promise must directly benefit from the transaction or gain advantage from the contract. When a court determines that the third party's promise to pay the debt of another is directly linked to that third party's interest, the transaction will not fall within the Statute of Frauds and does not have to be in writing.

As an example, suppose Martin, a house painter, has a contract to paint your house. He has been having financial difficulties and has bad credit. When he goes to the paint store to purchase the paint on credit, the store refuses. The store calls you and asks you to guarantee payment of purchase. You agree. Does this oral contract have to be in writing? No, because your main purpose is to receive a direct benefit by furthering your economic interest in having your house painted.

When considering whether a promise by a third party must be in writing, determine who benefits from the transaction and to whom the promise is being made. If the third party benefits, and the promise is made directly to the debtor, the contract need not be in writing, thereby circumventing the Statute of Frauds.

Contract Made by Executors and Administrators of Estates

probate
The judicial act or process whereby a will is adjudicated to be valid

executor
A person designated by a testator to carry out the directions and requests in the testator's will and to dispose of [the testator's] property according to the provisions of his or her will

administrator
A person who is appointed by the court to manage the estate of a person either who died without a will or whose will failed to name an executor

decedent
A person who has died

In the **probate** area, it is common for a personal representative to be appointed to administer the interests of the deceased party by distributing the assets of the estate and paying off debts. The **executor** or **administrator,** as such persons are known, is only a representative of the estate and is not responsible for the debts incurred by the **decedent** during his or her lifetime. As a result, the Statute of Frauds requires that any agreement by an executor or an administrator of an estate to pay the debts of the decedent's estate out of the executor's own personal funds be in writing. Under ordinary circumstances, the executor or administrator is not responsible for the debts of the decedent, and forcing the representative to pay the debt would be not only unfair but also unconscionable. To remedy this problem, if an executor or an administrator does agree to pay the debts of the decedent, such agreement must be in writing.

An administrator or executor might desire to pay the debts of the decedent's estate if he or she were representing a relative, parent, or sibling. The representatives may feel a moral obligation to pay the debts of their loved ones, even though they do not have a legal obligation to do so. When this situation arises, a creditor who wants to hold the personal representative responsible for a deceased person's debt must put this obligation in writing for it to be effective and enforceable.

Contracts in Consideration of Marriage

It is unusual for an agreement to marry to be in writing. There is an exception, however, under the Statute of Frauds, which requires that a contract in consideration of marriage coupled with an interest be in writing. This rule suggests that a marriage contract which involves the exchange of money or property must be in writing to be enforceable. For example, suppose the Smith family promises the Jenner family that if the eldest Jenner son marries the eldest Smith daughter, the Smiths will "provide the eldest Jenner with a $500,000 home complete with pool and tennis court." This agreement must be in writing.

dowry
Under the Code Civil, the property a woman brings to her husband when she marries

The original purpose of this section of the Statute of Frauds was to protect what was known as **dowry** rights. In medieval times, dowries played a significant role since marriages occurred more for money and family position than for love. The contract for marriage had to be in writing. We still see this today in some countries where people are

promised to each other at birth in exchange for social position and wealth without regard to matters of love or affection. Under the Statute of Frauds, these types of agreements are required to be in writing.

antenuptial (prenuptial agreement) Written contracts executed prior to marriage which divide the parties' real and personal property in the event of divorce

The most common present-day use of this section of the Statute of Frauds involves premarital agreements and cohabitation agreements. **Prenuptial** or **antenuptial** agreements are written contracts that are executed prior to marriage, establishing the rights of the parties in the event of a divorce or death. For such contracts to be enforceable, they must be in writing. Sometimes religious customs and American laws intersect forcing the courts to provide an outcome. Such was the case *In The Marriage of Shaban*, 88 Ca. App. 398, 105 Cal. Rptr. 3d 863 (Cal. App. 4th Dist. 2001).

Line of Reasoning

In the *Marriage of Shaban*, the California Court of Appeals was faced with evaluating whether an "alleged" prenuptial agreement under Islamic law satisfied the Statute of Frauds. In its evaluation of the subject, the California Court of Appeals began its opinion in a dramatic way. It stated in part:

> This appeal presents a situation that not only reaches the outer limits of the ability of a prospective married couple to incorporate by reference terms into a prenuptial agreement, but so far exceeds those limits as to fall off the edge. It is one thing for a couple to agree to basic terms, and choose the system of law that they want to govern the construction or interpretation of their premarital agreement. . . . (text of Family Code omitted). It is quite another to say, *without any agreement as to basic terms,* that a marriage will simply be governed by a given system of law and then hope that parol evidence will supply those basic terms.

The facts of the case involve a divorce of a couple that married in Egypt. After 17 years of marriage, they were divorcing, and the issue of dividing the couple's property came into question. It is important to note that the husband was a doctor who had accumulated a significant amount of property during the marriage. The husband claimed that a written prenuptial agreement existed. The document was a one page piece of paper written in Arabic signed by the husband and his father-in-law as the representative for his wife. Since the document was written in Arabic, the court had it translated—three times. None of the translations indicated any division of the property in the event of a divorce, although the husband did attempt to contend that the document stated that in the event of a divorce, any property would be divided in accordance with Islamic law. The husband hired an expert to testify to this information, but the trial court refused to allow the testimony because it found that the document was really only a marriage certificate and contained nothing that would indicate a division of property. Having established that the document was not a prenuptial agreement, the trial court then divided the couple's property in accordance with California's community property laws. The appeals court affirmed the trial court's ruling finding that the document did not satisfy the Statute of Frauds in California. To satisfy the Statute of Frauds, the writing must state the terms and conditions of the contract and in this case the prenuptial agreement. Stating that a contract of marriage made in accordance with Islamic law is not sufficient to satisfy the Statute of Frauds in that there is no certainty as to the terms and conditions of a property division. Specifically, the court found that

> the phrases "in Accordance with his Almighty God's Holy Book and the Rules of his Prophet" and "two parties [having] taken cognizance of the legal implications," no matter how much they might indirectly indicate a desire to be governed by the rules of the Islamic religion, simply bear too attenuated a relationship to any actual terms or conditions of a prenuptial agreement to satisfy the statute of frauds.

Even though the agreement referenced a dowry, it was not sufficiently specific to conclude that constituted an intent to sign a prenuptial agreement.

Questions for Analysis

Review *In the Marriage of Shaban,* specifically focusing on the document in question. Are there additional terms and conditions, if any, that could have been included in the document that have satisfied the Statute of Frauds? Why or why not? What purpose did a dowry have in the case, and what were the reasons behind its concept?

Cybercises

Determine your jurisdictions requirements for prenuptial agreements. Locate examples of prenuptial agreements and compare the different types of provisions. What are some of the common provisions found within the agreements?

Contracts for the Transfer of Real Property

Perhaps the most significant and important type of contract that must be in writing under the Statute of Frauds is a contract for the transfer or sale of real property. Virtually any agreement that involves real estate must be in writing. This includes, for example, deeds, mortgages, deeds of trust, leases, and easements. Over the years, the requirement of the writing has become more detailed in order to comply with the Statute of Frauds. Many states have instituted statutes that go beyond the dictates of the Statutes of Frauds to enable and enforce transfers of real property.

There is an exception to the rule that a transfer of real estate must be in writing, however. If an individual promises to sell real estate to another, and the party purchasing the real estate moves onto the real estate, pays part of the purchase price, takes possession of the land, and makes valuable improvements on it, a writing is not necessary. Here, the courts will not penalize the party who has relied, to his or her detriment, on the promise of another to transfer the real estate. To enforce this type of contract, most courts focus on the *doctrine of detrimental reliance.* Under this doctrine, if a person relied on an oral contract involving real property, and experienced legal detriment by performing obligations under that agreement to the extent that reasonable persons would believe that such a contract (although only oral) existed, there would be an enforceable contract. This exception to the Statute of Frauds eliminates the possibility of injustice resulting from requiring a written contract. This issue was discussed in *Harvey v. Dow*, 962 A. 2d 322 (Me. 2008) in which an oral contract for the transfer of land was at issue.

Line of Reasoning

The case of *Harvey v. Dow* involves a suit between a daughter and her parents for the transfer a piece of land on which the daughter built a house. The Dows are the parents of Teresa Harvey, their adult daughter. Throughout Teresa's early childhood, she and her parents always discussed building a home

on the land owned by her family and that they would convey a parcel of land to her for that purpose. In 1999, with her parent's permission, Teresa and her future husband Jarrod Harvey placed a mobile home on her parent's land. Teresa did not have a deed for the property nor did she pay rent. Sometime in early 2003, Teresa and her husband decided to build a house on the land where their mobile home had been located. Initially, the Dows offered to assist Teresa and her husband in financing the home from a home equity line for the house. As fate would have it, Teresa's husband was killed in a motorcycle accident. Teresa received the proceeds from a life insurance policy from Jarrod's death and used it to finance her home. Her father helped her obtain building permits for the house, although there was no discussion of her parents executing a deed at that time. There is conflicting testimony as to whether Teresa and her father discussed executing a deed when her home was completed, but construction began on her new house for a cost of approximately $200,000. The home was finished in May, 2004. It is important to note some additional facts: (1) Teresa's father helped build her house; (2) Teresa lent her brother $25,000, which it appears went unpaid; and (3) Teresa's parents did not like her new live-in partner. To say the least, Teresa's relationship with her parents deteriorated. Teresa sued her brother and forbade her parents from seeing their grandchildren. (The Dows sued Teresa to see the grandchildren!) Although Teresa continued to ask for a deed to finance other projects, her parents refused. She sued her parents to compel the conveyance of the property. The focus of the case was whether the Statute of Frauds applied or whether Teresa could show detrimental reliance and thus an exception to the Statute of Frauds. The court in this case focused on a number of facts, even though there was no writing documenting any agreement between Teresa and her parents. First, Teresa made a $200,000 investment, which her parents sanctioned. Second, Teresa's parents helped and supported her in the construction of the house. And finally, Teresa's parents acquiesced in the construction of the house even deciding where it should be built. Because of this, the Court centered its analysis on the issue of detrimental reliance. Adopting the *Restatement (Second) of Contracts,* the court stated:

> *A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.*

Restatement (Second) of Contracts § 90(1) (1981).

The Appeals Court found that Teresa had relied to her detriment in that she believed that one day she would receive the property as a gift or inheritance. And, more importantly, her father's conduct in particular implied that her conclusions were legitimate.

The court stated that had Teresa not built on the property with her parents consent, and had there only been discussions to convey the property in the future, the result may have been different. As the court observed "[a]t least as to the land on which Teresa's house now sits, a promise by Jeffrey Dow, Sr. to convey that specific parcel could be implied from his conduct, and if that implication is made, given that Teresa now has an immobile $200,000 asset on that parcel," the refusal to enforce the promise to convey the land would be fraudulent. Ultimately, to not find a promise to convey the land, even absent a written document, would be unjust and inequitable. Concluding that there are exceptions to the Statute of Frauds, the court reminded the parties, specifically Teresa's parents, that the

> Statute of Frauds does not always bar the enforcement of an unwritten promise to convey land: [S]pecific performance of a contract that does not satisfy the statute of frauds

is warranted only "if it is established that the party seeking enforcement, in reasonable reliance on the contract and on the continuing assent of the party against whom enforcement is sought, has so changed his position that injustice can be avoided only by specific enforcement." (citations omitted).This equitable exception to the statute of frauds may apply if one party's reliance has resulted in "an irretrievable change in position." (citations omitted.) It is beyond question that construction of a $200,000 immobile house constitutes an irretrievable change in position. . . .

Questions for Review

Review *Harvey v. Dow*. What facts would have changed the court's result? Are there other issues that the court could have considered in finding for Teresa? What did the court order the lower court to do? Explain your answers.

It is prudent for paralegals to be familiar with their state's Statute of Fraud's requirements. Additionally, many states enumerate other situations that require a contract to be in writing. When confronted with an oral contract situation, be sure to examine statutes and case law to determine the enforceability of the contract.

State Your Case

On May 11, 2010, Beth and Melinda entered into the following agreement.

05.11.2010

I agree to hire Beth as a housekeeper and babysitter for my daughter. The job will start on Memorial Day weekend. The salary will be $340 a week.

s/ Melinda Fontain

On August 3, 2010, Melinda caught Beth smoking pot in the bathroom of their home. She immediately terminated her. Beth claims that she was hired for one year and should be paid until May 30, 2011. Would Beth be successful if she filed a law suit against Melinda? Explain your response.

principal
In an agency relationship, the person for whom the agent acts and from whom the agent receives his or her authority to act

agent
One of the parties to an agency relationship, specifically the one who acts for and represents the other party, who is known as the *principal*

Additional Contracts Requiring Writing

Many jurisdictions require other types of contracts to be in writing. These may include oral one-year leases, consumer transactions, and promises to pay debts when the statute of limitations has run or the debt has been discharged in bankruptcy.

Another contract that may require a writing is one in which a **principal** appoints an **agent** to execute a contract on his behalf and the contract falls within the Statute of Frauds. This type of contract may have to comply with the *equal dignities rule.* Under the equal dignities rule, when a representative is appointed to perform a duty that is required

Cybercises

Determine whether your jurisdiction has adopted some form of the Equal Dignities Rule either by statute or case law.

to be in writing, both the appointment and the contract must be in writing. The reason behind this doctrine is that if one transaction requires a writing, to be on equal footing, the contract for the appointment must be in writing as well. If the transaction that the party is being asked to negotiate is not required to be in writing, the equal dignities rule does not apply. Again, it is important to check state law to determine if the equal dignities rule is followed in your state.

The Uniform Commercial Code's Statute of Frauds

The Statute of Frauds is not limited to the common law of contracts. The Uniform Commercial Code (U.C.C.), which is discussed in the second half of this book, adds another category of contracts that must be in writing. Under § 2-20(1), contracts for the sale of goods over $500 must be in writing to comply with the Statute of Frauds. The U.C.C. thus expands upon the common law rule.

8.3 SATISFYING THE STATUTE OF FRAUDS: THE WRITING

The type of writing necessary to satisfy the Statute of Frauds is not a full-blown, formal, and completed contract document. Nor does the Statute of Frauds suggest that only a typed, formal contract satisfies the Statute of Frauds. In fact, a contract scribbled on a napkin or pieces of scratch paper, a memorandum, and the like could very well satisfy the Statute of Frauds if the writing contains the minimum amount of information necessary. Section 131 of the *Restatement (Second) of Contracts* suggests the following:

> Unless additional requirements are prescribed by the particular statute, a contract within the Statute of Frauds is enforceable if it is evidenced by any writing, signed by or on behalf of the party to be charged, which
>
> (a) reasonably identifies the subject matter of the contract,
> (b) is sufficient to indicate that a contract with respect thereto has been made between the parties or offered by the signer to the other party, and
> (c) states with reasonable certainty the essential terms of the unperformed promises in the contract.

Consequently, what is required in the writing to satisfy the Statute of Frauds is the identity of the parties; the subject matter of the agreement; the material terms, including the price or the consideration; and the signature of the parties to be charged under the contract.

Identity of the Parties. Important to any contract is the identity of the parties to the contract. This information must be clearly indicated in the writing for the Statute of Frauds to be effective. If any doubt arises as to the identity of the parties, it is highly likely that the writing requirement has not been met.

Subject Matter of the Agreement. The subject matter of the contract must be identified so as not to raise questions between the parties who have entered into the contract.

The subject matter must be specific and clearly noted to satisfy the Statute of Frauds. If the subject matter of the contract is a house, the legal description must be given or a specific street address stated. The contract cannot leave any question as to the subject matter of the contract. If the subject matter is not clearly identified, the contract will not be enforced.

Material Terms. There is no specific formula for determining what constitutes the material terms of a contract, but each party must understand the substance of the contract, and this information must be identified in the writing between the parties. Such terms as quantity, warranties, size, or color of a product and delivery dates may be considered material terms. A court will look at each case to determine whether this requirement has been fulfilled.

Price or Consideration. Another material term, identification of which is essential to satisfy the Statute of Frauds, is the price term or the consideration exchanged to bind the parties to their contract. The amount and terms of payment should be clearly stated in the contract.

Signature of Party to Be Charged with Contract. The party against whom enforcement of the contract is being sought must have signed the writing if the contract is to satisfy the Statute of Frauds. To constitute a signature, a party does not have to completely write out his or her name. Rather, a party's mark, initials, typewritten name, or whatever else constitutes a party's mark will suffice. Exhibit 8-4 summarizes the requirements needed to satisfy the Statute of Frauds.

EXHIBIT 8-4 Necessary elements for satisfying the Statute of Frauds

Necessary Elements for Satisfying the Statute of Frauds				
Identity of the Parties in the Agreement	Subject Matter of the Agreement	The Material Terms in the Agreement	The Price or Consideration for the Agreement	Signature of the Party with whom Enforcement Sought under the Agreement

As a review of the concepts discussed regarding the Statute of Frauds, examine *Ray v. Frasure,* 146 Idaho 625, 200 P. 3d 1174 (2009), in which the court had to determine the sufficiency of the writing, specifically a legal description for a piece of property.

Line of Reasoning

This case involves the adequacy of a legal description to a piece of property. In *Ray v. Frasure*, the Idaho Supreme Court was asked to determine whether identifying the street address, city, county and zip code was sufficient to satisfy the Statute of Frauds. Stan Ray and Don Frasure entered into a contract to purchase property described as 2275 W. Hubbard Rd., City of Kuna, County of Ada, Idaho 83634. The contract provided a space for a legal description, but none was ever supplied. The price for the property was $264,000. The parties agreed to close the transaction on or before March 12, 2006. Originally, there was a down payment of $10,000 but was later changed to $16,000. The closing was postponed to March 17, 2009. Due to some legal technicalities, Ray requested that the closing be postponed. A call was made to Mr. Frasure's daughter, who, acting on behalf of her father, agreed to the extension of the closing. Mr. Frasure denies he agreed to the modified closing. On March 21, 2006, Ray deposited all the required monies but was notified by Mr. Frasure's real estate agent that the deal was off and relisted the property for sale. Frasure sold the property for $750,000 to another party. The issue that the court was asked to decide was whether a physical address in a real estate contract was sufficient to satisfy the Statute of Frauds. The court first established what is required by the Statute of Frauds. Under the Statute of Frauds, a contract for the sale of real property must not only be in writing and signed by the parties, but the writing must contain a description of the property, "either in terms or reference" without resort to outside evidence. This requirement, "that a sale of real property must speak for itself," is a long standing principle dating back over 100 years. Relying on that principle, the court reviewed its past legal precedents. Those cases essentially required that the real property must be "adequately described" so it can be "exactly" identified to anyone who wants to know what the seller sold the buyer. In that light, the Court stressed that "[a] description contained in a deed will be sufficient so long as quantity, identity, or boundaries of the property can be determined from the face of the instrument, or by reference to extrinsic evidence to which it refers." The court continued its analysis in the case by concluding:

> In the instant case, the contract described Frasure's real property by reference to the street address and the city, county, state and zip code in which the property was located. The physical address is not a sufficient description of the property for purposes of the statute of frauds. It is impossible to determine exactly what property Frasure intended to convey to Respondents relying solely on the physical address in the contract. The physical address gives no indication of the quantity, identity, or boundaries of the real property.

Even though Ray attempted to show that the complete legal description was easily determined, the Appeals Court refused to allow any expert testimony or outside evidence. The Idaho Supreme Court was quite emphatic by stating that it did not intend to change 100 years of case precedent and reversed the lower court decision that the legal description did not comply with the Statute of Frauds.

Questions for Analysis

Review *Ray v. Frasure*. What cases did the Court rely upon to reach its result? Why did the Court refuse to adopt a case by the Federal Bankruptcy Court in reaching its decision?

What facts would have changed the Court's result? Determine from your jurisdiction what is considered or has been held as a reasonable property description that complies with the Statute of Frauds? Compare your jurisdiction to that of the Supreme Court of Idaho. For students in Idaho, choose a jurisdiction from a neighboring state and compare it to the *Frasure* case.

State Your Case

Aquarius Consultants is a group of graphic artists who sell services to companies who want innovative design brochures. Cookie Chips is a start-up Internet company that sells its homemade cookies and brownies over the Internet. They need to have a dynamic brochure to grow their business, and they think Aquarius will fit their needs. The parties exchange the following e-mails.

9/3/10

Can't wait to work with you. The price for 300 brochures is $5000. Deposit of $1000 when ordered.

s/ AC

9/5/10

Great. We are ready to get started. We still want to work on the design of the logo, but are close. When can the brochures be ready for mailing?

s/H.M. Simpson, VP/Cookie Chips

Believing they had a contract, Aquarius began printing the brochures and sent Cookie Chips the first 100 brochures on September 15, 2010. The VP of Cookie Chips sends the following e-mail.

9/29/10

Stop. What are you doing? This is not what we want or ordered. Do not send anymore brochures.

s/HM Simpson

Cookie Chips refuses to pay for the brochures that were sent. Does Aquarius have contract with Cookie Chips under the Statute of Frauds? Explain your response.

Exceptions to the Statute of Frauds: When Does It Not Apply?

With every rule, there are exceptions. Under the Statute of Frauds, there are situations where a court may not require a contract that falls under the Statute of Frauds to be

in writing. Circumventing the Statute of Frauds is usually due to the court exercising its equitable powers. In these instances, if one party can show (1) part performance of the contract, (2) promissory estoppel under a theory of reliance, or (3) equitable estoppel, the contract will be enforced without a complete written document. The purpose of allowing these exceptions is to prevent fraud by someone who is trying to "hide" behind the rules of the Statute of Frauds when their actions indicate some sort of bad faith. Courts do not want to reward parties for their bad behavior and have relaxed some of the harshness that the statute can afford. Not all circumstances are ones that can be avoided by the Statute of Frauds. The complaining party must raise one of the exceptions to the statute and prove its position.

Part Performance. This doctrine prevents a party, usually the defendant, from benefiting from the fact that the other party, the plaintiff, relied on the promises and performed on those promises. Courts look to prevent fraud or unjust enrichment and will not condone a party's behavior because a contract, which should have been in writing, was not. Thus, part performance is a form of equitable relief that a court imposes when there is no writing memorializing the parties' intent.

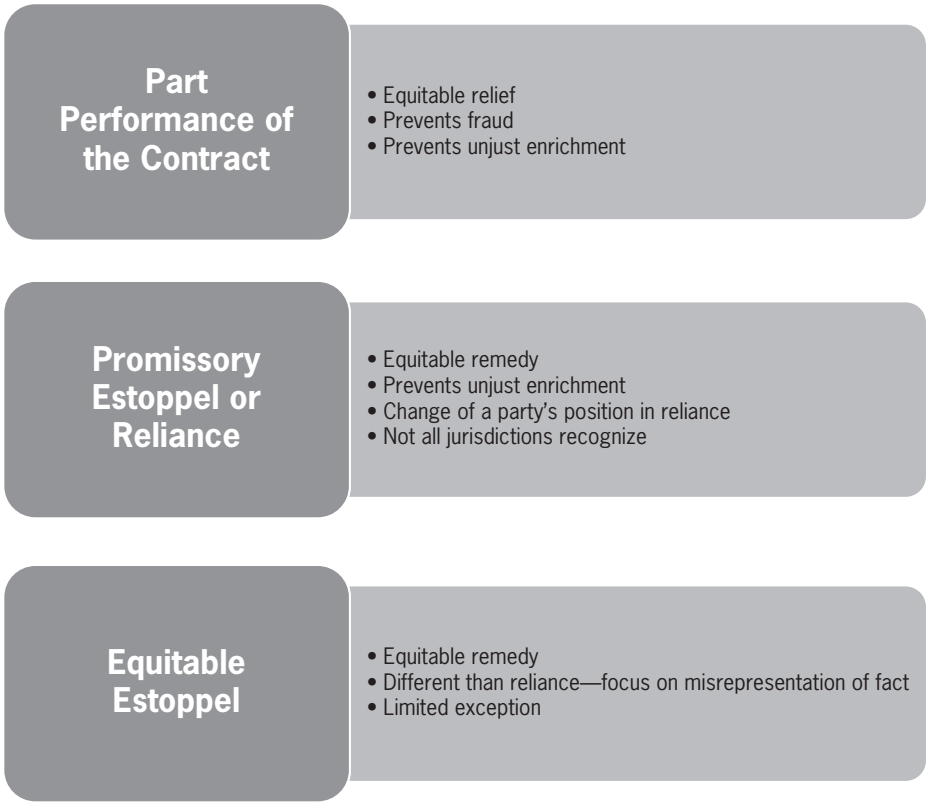
Courts may impose this equitable doctrine in cases involving (1) real property, (2) contracts which cannot be performed within one year, and (3) the sale of goods under the Uniform Commercial Code. Not all courts use part performance as a means to create a contract to avoid the Statute of Frauds. Applying this doctrine is done on a state by state basis, which requires legal research on your part.

Promissory Estoppel or Reliance. When a party relies, to their detriment, on another party's promise to do something, and has changed their position in reliance on that promise, courts may apply the doctrine of promissory estoppel to prevent unjust enrichment to one of the parties. A party's reliance on the other's promise is not a foolproof means of circumventing the Statute of Frauds and, as with the doctrine of part performance, should be carefully analyzed to determine whether the case law in your jurisdiction supports the defense.

Equitable Estoppel. Equitable estoppel is different from promissory estoppel in that its focus is a misrepresentation of fact rather than the reliance on a promise. Under equitable estoppel, one of the parties represents that a writing was either not required for the contract or has been prepared or signed. As you might guess, this is a very limited exception to the Statute of Frauds and applied in specific situations.

What all the exceptions have in common is that they avoid the writing requirement of the Statute of Frauds. Remember that these exceptions are usually for equitable reasons with uncertain results. Examine Exhibit 8-5 for a chart of the exceptions to satisfying the Statute of Frauds.

EXHIBIT 8-5 Equitable exceptions to writing requirement



State Your Case

Andie and Scott want to buy their first home but were not sure that they would qualify for a loan from a bank. They stumbled upon a deal where they could purchase a house directly from the sellers who also would finance the deal for them. The house was listed for $175,000, which is what Andie and Scott offered. The sellers, Agnes and Harvey Milton, stated they would draft up the documents. Scott e-mailed Harvey the following:

Harvey:

My wife and I are excited to be purchasing the house. The neighborhood is so beautiful. We really appreciate the fact that you are willing to finance the house directly. Once we review all the paper work, we will forward you the down payment of $25,000. When can we close?

Scott

Two days later, Scott received the draft documents, but some of the information was missing. The legal description was incomplete as was the acreage. Scott was not worried. He sent Harvey a cashier's check for $25,000. Scott had the property inspected and found that the wood on one side of the house was rotted out from termites. Andie thought this was a sign and told Scott she did not want to go through with the sale. Scott called Harvey and told him that the inspection was not good, and therefore, he and his wife decided not to purchase the house. Scott requested his $25,000 back. Harvey refused. Was there an enforceable contract? Explain your answer. What are the issues involved in this exercise?

Line of Reasoning

For a contrary view and enlightening analysis of the promissory estoppel theory of avoiding the Statute of Frauds, we turn to *Classic Cheesecake Company, Inc. v. JP Morgan Chase Bank, N.A.* 546 F. 3d 839 (7th Cir. 2008). In this case, Federal Circuit Court Judge Posner evaluated the doctrine of promissory estoppel against the backdrop of one of the leading cases on the subject from California—*Monarco* v. *Lo Greco,* 220 P. 2d 737 (Cal. 1950)—Indiana law and the Bible. The introductory sentence from Judge Posner is "[t]his appeal requires us to interpret a gloss that the Indiana courts have placed on their state's statute of frauds: an oral agreement that the statute of frauds would otherwise render unenforceable creates a binding contract if failing to enforce the agreement would produce an "unjust and unconscionable injury and loss" (citations omitted). The facts are basically that Classic Cheesecake went to JP Morgan in July, 2004 for a loan to expand their business. Classic had opportunities to expand into Las Vegas with its products. Classic met with one of the VPs who verbally represented that the loan was "a go." This occurred around September 17, 2004. Classic had to provide certain documentation including having one of its principles pay-off a student loan since part of the loan was to be guaranteed by the SBA (Small Business Association). Unbeknownst to Classic, one of the VP's superiors had problems with Classic's risks factors and in a number of e-mails expressed concern. Although the loan had not been approved, it had not been denied. The VP at JP Morgan did not share the discouraging e-mails with Classic, so when the loan was denied on October 12, Classic was surprised. The principles had invested over $1 million and relied on the bank's oral promise that the loan was forthcoming. Classic claims that for two and a half months they relied on the VP's representations and lost critical time that could have been spent seeking out other banks for the loan. Classic claims that the bank breached its oral promise and the bank responded by raising the defense of the Statute of Frauds. In Indiana, contracts for the agreement to loan money must be in writing. As the Court of Appeals observed:

> to allow the statute of frauds to be circumvented by basing a suit to enforce an oral promise on promissory estoppel rather than breach of contract would be a facile mode of avoidance indeed. Someone who wanted to enforce an oral promise otherwise made unenforceable by the statute of frauds would need only to incur modest costs in purported reliance on the promise—something easy, if risky, to do, as a premise for seeking to enforce an oral promise that may not have been made or may have been misunderstood.

The court was then faced with evaluating what constituted "unjust and unconscionable injury" to take the transaction out of the Statute of Frauds. Extensively discussing the case of *Monarco v. Lo Greco* where the doctrine of promissory estoppel developed as a defense to the Statute of Frauds. Judge Posner appears not to agree with the establishment of the doctrine or its adoption in the *Restatement of Contracts*. Indiana appears not to have adopted the concept or, at least, has given it a more narrow reading. Indiana requires that:

> *the party must show [ ] that the other party's refusal to carry out the terms of the agreement has resulted not merely in a denial of the rights which the agreement was intended to confer, but the infliction of an unjust and unconscionable injury and loss.*
>
> *In other words, neither the benefit of the bargain itself, nor mere inconvenience, incidental expenses, etc. short of a reliance injury so substantial and independent as to constitute an unjust and unconscionable injury and loss are sufficient to remove the claim from the operation of the Statute of Frauds.*

There is no claim of unjust enrichment on the bank's part, only, as the court stated, a lawsuit which obviously does not constitute unjust enrichment. The bank made nothing from this transaction as it was never consummated. And, Classic did not suffer any unconscionable acts, although it would have us believe otherwise. To reach its result, the court looked to precedent from the *Monarco* case. In that case, a son was requested by his mother and stepfather to stay on the farm, even though he wanted to leave, in exchange for them leaving almost all of their property to him. The farm prospered, but when his stepfather died 20 years later, he had left his interest in the farm to his grandson. In this case, the court had found that his stepfather's grandson would be unjustly enriched from the "sweat equity" of the son. (The court now cites to the Bible story of Rachel and Jacob where Jacob was tricked into staying on the farm for an additional year in exchange for his marriage to Rachel. Also, he cited to Jacob's reliance on the promise to wed Rachel.) The court then discusses other related Indiana cases, noting that the doctrine of promissory estoppel as a means to circumvent the Statute of Frauds had not been recognized in more deserving cases than this one. Additionally, in its analysis, the court focused on the fact that in the cases it analyzed, the time of the reliance was substantial—years—where in this case only a few months had passed. But, what was critical was the reasonableness of Classic's reliance on the VP's statements that the loan was "a go" more concrete information was unreasonable. In summarizing its position, the Court observed:

> Remember that the objection to placing promissory estoppel outside the statute of frauds is that it is too easy for a plaintiff to incur reliance costs in order to bolster his claim of an oral promise. The objection is attenuated if the reliance is so extensive that it is unlikely that the plaintiff would have undertaken it (buying an expensive specialized machine or giving up a growing company) merely to bolster a false claim. He might of course have misunderstood the "promisor" or been gambling on getting a contract, but courts seem not to think those possibilities likely enough to warrant a sterner rule. The compromise that the courts strike between the value of protecting reasonable reliance and the policy that animates the statute of frauds is to require a party that wants to get around the statute of frauds to prove an *enhanced* promissory estoppel, and the enhancement consists of proving a kind or amount of reliance unlikely to have been incurred had the plaintiff not had a good-faith belief that he had been promised remuneration. This seems to us a better understanding of the "unjust and unconscionable" rule than ascribing it to judicial indignation at dishonorable behavior by promisors.

The court concluded by stating that Classic really relied on a "hope" rather than a "promise," none of which was reasonable. But more importantly, for Classic to rely on the representations of a bank employee without more concrete or specific information was imprudent. "Rational businessmen know that there is many a slip 'twixt cup and lips, that a loan is not approved until it is approved, that if a bank's employee tells you your loan application will be approved that is not the same as telling you it has been approved, and that if one does not have a loan commitment in writing yet the need for the loan is urgent one had better be negotiating with other potential lenders at the same time." The court found that this was not a case of promissory estoppel sufficient to circumvent the Statute of Frauds.

Questions for Analysis

Review *Classic Cheesecake Company, Inc v. J.P. Morgan Chase Bank, N.A.* What cases and legal scholars did Judge Posner rely upon in his decision that were significant? What facts would have changed the result where the Court would find promissory estoppel? Determine whether your jurisdiction has acknowledged exceptions to the Statute of Frauds?

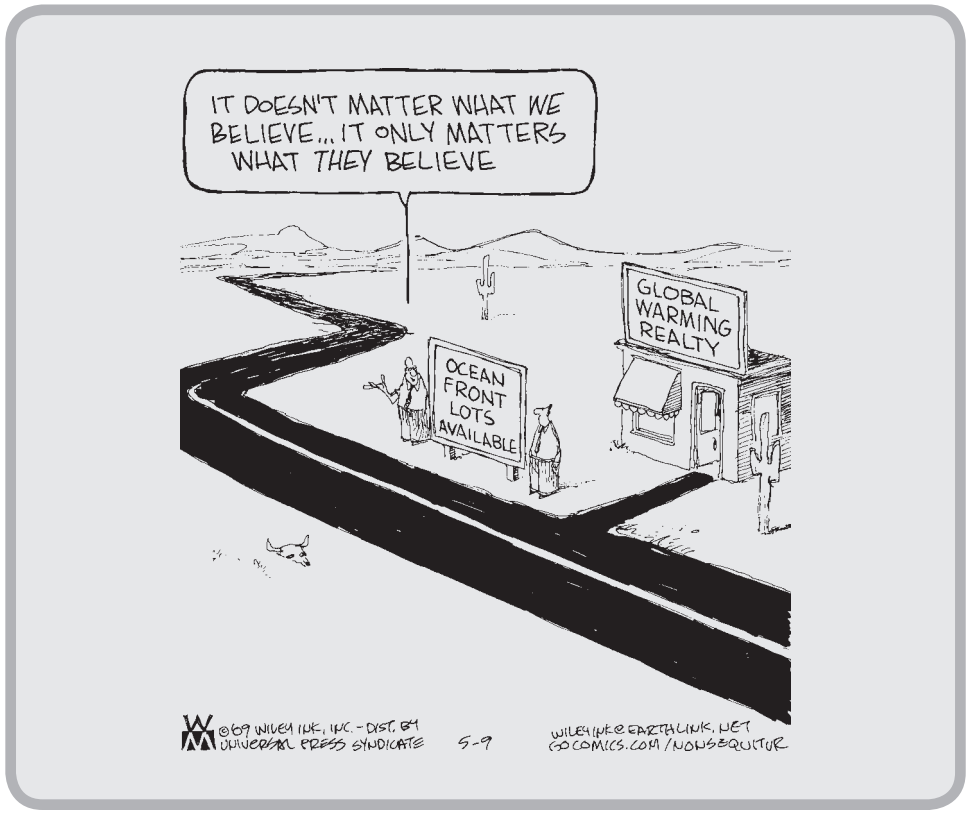
Strictly Speaking: Ethics and the Legal Professional

As a paralegal, you will communicate with many clients, attorneys, and even clerks of the court. Just like the Statute of Frauds set parameters on oral agreements, in practice that which is not written is not so. Whether we like it or not, our word is our bond and in turn our integrity. To ensure the ethical integrity of your work and your word, reduce conversations, notes, and other important information to writing. Prepare a quick memorandum to the file of a communication with the court or reduce a communication with a client to a note in the file.

Document, document, document. How many times have you heard you need to document your actions, just like you document your professional time through the billing process? Acquire good habits earlier on and you will be surprised how it will serve you in your career and your professionalism later on. As you learn the importance of having the necessary elements contained in a contract for its enforceability, put those lessons into practice by using the written word as your sword. When it is written, it is difficult to say it is not so!

8.4 INTERPRETATION OF A CONTRACT

When a contract is reduced to writing, a court must follow certain rules in interpreting the meaning and intentions of the parties to the contract when the contract language is unclear or comes into question. In interpreting a writing, the court focuses on the contract process itself, the meaning of the words, and the intentions the parties had in making their agreement. Interpreting what the parties meant is a difficult task that takes a significant amount of investigation. In determining how to interpret and enforce a contract, it is often hard to ascertain from what the parties wrote in the contract, what they actually meant.



To alleviate some of these problems, a court will attempt to determine the intentions of the parties by applying the reasonable person standard. Courts will objectively review what the parties' expectations were in making their agreement, what their conduct was in performing the agreement, and what words they chose when writing their agreement.

Rules of Interpretation

Although courts often have difficulty determining the parties' intentions in a contract, courts faced with interpretation problems use some common rules:

1. Examine the contract as a whole;
2. Investigate the circumstances surrounding the contract;
3. Construe terms more strictly against the drafter;
4. Determine the primary purpose of the parties;
5. Give common words their plain meanings;
6. Give technical words their technical meanings; and
7. Let negotiated provisions control over standardized ones.

These rules set the parameters for a court when it interprets a contract.

strict construction doctrine
A narrow or literal construction of written material

four corners
The face of a document or instrument; relates to the act of construing a document based upon the document alone, without recourse to extrinsic evidence

The doctrine that courts apply in interpreting a document is the **strict construction doctrine,** also known as the **four corners** *doctrine*. This doctrine should be the starting place for any analysis.

The Strict Construction Doctrine

The strict construction doctrine states that a contract should be interpreted within its own pages or "four corners" to determine the meaning and intent of the parties to the contract. The doctrine further suggests that this interpretation should not be strained or create an unnatural perversion of the language in the contract. Consequently, the intentions or purpose of the contract should be ascertained from the contract as a whole, not from isolated provisions or sections that may not reveal the parties' real meaning. All parts of the contract, including clauses, paragraphs, sentences, and particular words, should be considered in light of the entire contract.

The doctrine of interpretation places a burden on the drafter of the contract. The rule is that a court will construe a contract more strictly against the person who drafted the contract, because that person chose the wording and presumably knew what was intended.

Plain Meaning

plain meaning
The rule that in interpreting a contract whose wording is unambiguous, the courts will follow the "generally accepted meaning" of the words used

Further, the words chosen in the contract should be given their **plain meanings.** This suggests that a word should be given its generally accepted meaning. Resorting to an extreme or exotic interpretation of a word could frustrate the parties' intentions and the purpose of the contract. Therefore, the rule is that the words used in a contract will be given their ordinary or common meaning, unless it is shown that the parties used them in a different sense.

When technical words are used, they are to be construed in their technical sense. Terms used in the computer industry, for example, sometimes have very specific meanings that differ from their usual (plain) meanings. When this occurs, courts often employ experts to interpret the technical words used.

General versus Specific Terms

Negotiated terms prevail over standardized ones. For example, if a standard provision in a lease is that 30 days' notice will be given upon vacating the premises, but the landlord and tenant negotiate and ultimately change this provision to state a 60-day notice provision, the negotiated provision will prevail over the form. Using the same concept is the rule that handwritten or typed provisions will prevail over a standardized, preprinted form.

Courts do not, however, rely solely on the contract words themselves. They also consider the parties' actions, known as general custom and usage.

custom
A practice that has acquired the force of law because it has been done that way for a long time

General Custom and Usage

People's actions also play a part in contract interpretation. What is general **custom** and usage in a particular community or trade is critical in determining a party's intent and

purpose. This suggests that community practices guide a court in interpreting the purpose and intent of a contract. This information is established by presenting evidence of the practice normally accepted by the community (usually by employing experts in a particular field).

Another method of interpreting conduct between parties is through examination of their *course of dealing,* the sequence of previous conduct between the parties to a particular transaction. Thus, course of dealing is the specialized conduct established in private or individualized dealings. For example, a seller and a buyer have always handled their sales relationship by telephone. They make offers via the telephone and communicate acceptances the same way. One day, the seller calls the buyer and offers 50 dresses at $20 each. The seller waits two days but gets no response. The seller then sells the dresses to someone else. Unbeknownst to the seller, the buyer has communicated the acceptance by mail, which reaches the seller five days later. The buyer sues, arguing that there was a contract. The court would look to the parties' course of dealing to establish whether a contract existed.

The third consideration in a contract interpretation regarding conduct is *course of performance.* This term is directly related to a specific contract. Consequently, *course of performance* refers to the pattern of performance in the existing contract, whereas *course of dealing* focuses on the pattern of performance between the parties in prior contracts. Exhibit 8-6 is a summary of concepts to consider when interpreting a contract.

Arriving at a fair interpretation of commonly used words was the court's task in *Hellenic Investment, Inc. v. Kroger Co.,* 766 S.W.2d 861 (Tex. Ct. App.-Houston 1989), wherein the court had to interpret the word *nightclub*. This court had a challenge in interpreting the words used in the contract, and the case shows why precision in contract language is critical.

Line of Reasoning

What's in a word? In *Hellenic Investment v. Kroger*, one word defined a significant part of the contractual relationship. Pasadena Associates leased space to Kroger, a large grocery store. As part of its lease, Pasadena agreed not to lease to a bar, nightclub, or any other business of that kind. Pasadena leased to Hellenic which opened an establishment called "Hallabaloo." Under its lease, Hellenic, could use its leased space for either a restaurant or dining facility and "with the sale of alcoholic beverages, dancing, games, and related facilities and activities." Hellenic acknowledged Pasadena could not lease to a bar or nightclub under the Kroger terms and conditions. Hellenic warranted that it was not a bar or nightclub. It also acknowledged that if there were any complaints that it would alter its operations. Hellenic opened Hallabaloo, a "supper club" after investing $100,000. It was a huge success but caused Kroger many problems. Its customers were harassed; they could not park; and trash was in the parking lot on weekends. The parties tried to work things out, but could not come up with a workable solution. Kroger sued gaining a permanent injunction, which enjoined Hellenic from operating and Pasadena from leasing to a "night club." The order defined a "night club" as an "operation selling alcoholic beverages while also, in combination, playing loud volume dance music, providing a space for dancing, and allowing its patrons to dance, so long as its gross food sales make up less than 70% of the gross sales of all sources." Hellenic appealed disputing the definition and characterization of the word

"night club." Each party had experts testify as to what constituted a "night club." In its opinion, the court focused on the custom and usage of the term "night club." Under the law, evidence is permitted to explain ambiguous terms to ascertain the intent of the parties. Based upon the expert evidence presented and the explanation of what the term "night club" meant, the appeals court agreed that the lower court could have properly found that Hellenic was operating a bar or night club facility as the term was used in Hellenic's lease. The permanent injunction was affirmed with the court finding for Kroger.

Questions for Analysis

Review *Hellenic Investment, Inc. v. Kroger Company*. What actions could Hellenic have taken to satisfy the court that it was not a bar or nightclub? Did Hellenic breach its lease terms or were there other issues motivating this case? Explain your answers.

State Your Case

Carter Strand needed a bank loan. As part of the agreement with Nations Bank, Carter agreed to secure the loan with equipment consisting of all copiers, chairs, tables, bookshelves, filing cabinets, and scanners located at his place of business. When Carter was late on a number of payments, the bank sued. The bank attempted to take all Carter's business equipment, including his computers, related software and printers. Carter claims that this equipment is not covered in the loan. How would a court construe the term "equipment" under the loan agreement? What would be the court's analysis? Explain your responses.

EXHIBIT 8-6 Summary of contract interpretation considerations

Considerations in Interpretation					
Strict Construction Doctrine: Interpret document within its "four corners"	**Plain Meaning:** Documents to be given generally accepted meanings	**Negotiated Terms:** Supercede standardized or boilerplate terms	**Custom and Usage:** General practice of community or parties	**Course of Dealing:** Past conduct of parties in particular settings or transactions	**Course of Performance:** Focuses on pattern of performance between the parties from past transactions

Summary of Interpretation

When faced with the task of interpreting a contract, use the rules cited in this section as a guide. Remember, case law should always be consulted when a contract meaning is challenged. Therefore, when you are faced with an interpretation issue in a contract, ask yourself the following:

1. What are the issues being challenged in the contract?
2. Can the contract be reviewed within its "four corners" to determine its meaning?
3. If the answer to the question in No. 2 is "yes," then the strict construction doctrine will apply where the court will apply the plain meaning of the terms. For all practical purposes, the analysis ends here.
4. If the answer to the question in No. 2 is "no," then determine what is at issue?
   a. Do you have a custom and usage issue?
   b. Do you have a course of dealing or course of performance issue?
   c. Is there a challenge to specific terms over standardized terms?
5. When the contract cannot be interpreted on its face, is outside evidence necessary to establish the parties' intent? If so, then proceed with the application of the parol evidence rule, which follows.

(See also Exhibit 8-6.)

The Parol Evidence Rule

A court must not only examine the words chosen and the intentions of the parties, but it must also consider certain other rules that have evolved over the years to preserve the integrity of contracts and their interpretation. The most critical rule for interpretation of a written contract is the **parol evidence rule.** *Parol* means "oral" or "verbal." The parol evidence rule states that a written contract may not be varied, contradicted, or altered by any prior or contemporaneous oral declarations. Once a contract has been reduced to a writing that is the final expression of the parties' agreement; the agreement cannot be changed or challenged by any prior oral evidence. This rule prevents parties from changing their agreement after the contract has been finalized. Consequently, all previous oral agreements merge into the final written contract, which cannot then be modified or changed by "outside" or parol evidence.

parol evidence rule
Evidence of prior or contemporaneous oral rule that written contracts may not be varied, contradicted, or altered by any prior or contemporaneous oral declarations

Merger Clauses: The Presumption of a Contract

Including a merger clause may prevent a challenge to the final contract. A **merger clause** is a provision in a contract that negates any prior oral agreements. It provides that all prior oral or written agreements have been merged into the written contract and that the contract is the final expression of the parties' agreement. All terms stated in the contract are what the parties agreed to. Any omission of a term or provision from the contract

merger clause
A clause that states all prior oral or written agreements are merged into the existing document; related to the parol evidence rule

suggests that the parties decided to disregard it in the final contract. Merger clauses are a common tool in drafting and preparing a final contract. Exhibit 8-7 presents examples of typical merger clauses.

The merger clause gives the presumption that the contract is a totally integrated contract. Whether a contract is integrated will determine how or if the parol evidence rules applies.

The Blackberry Problem

Many professionals, legal and otherwise, use a Blackberry. It allows the user to browse the Internet, check e-mail, calendar and events, and just about any other business function imaginable. They are small and compact and make traveling and staying connected easy. But, Blackberries do have their drawbacks as was experienced by a real estate broker in a recent District of Columbia case. In *CB Richard Ellis Real Estate Services v. Spitz*, 950 A. 2d 704 (D.C. 2008) one of the issues before the court was whether a modified commission arrangement was enforceable. It seems that the broker received an e-mail with an attachment. The broker could not open the attachment. The broker responded to the e-mail not reading the attachment. What the attachment contained was a reduction in his commission. Oops! The broker did not realize that the attachment contained substantive changes and never read the document (bad habit anyway). The point from the case and the actions of the broker is that the Blackberry did not allow the broker to open the attachment. As advanced as technology becomes, there are invariably the times when it has its challenges. When the simple act of opening an attachment fails, which we all know occurs, do not assume anything about the attachment. Do not make substantive responses when you are not fully aware of the facts. This case is a good lesson to heed—technology makes our lives easier but it is not infallible. Know the limitations of your technology. Communicate before you commit either yourself or your supervising attorney to a term or condition that was unintended.

Integrated Contracts

integrated contract A written contract that contains all the terms and conditions of the parties' agreement and cannot be modified by parol evidence

An **integrated contract** represents the final expression of the parties' agreement when there are to be no additions or changes. An integrated contract cannot be changed or supplemented by any prior oral evidence. The presumption is that if any other terms were discussed, they were eliminated in preliminary discussions or drafts and thus did not become part of the final contract. The parol evidence rule protects the integrity of written contracts by prohibiting a party from changing an agreement that is final and totally integrated.

No prior evidence can be admitted if the contract is totally integrated. However, when there is a partially integrated contract, the rule is slightly different.

EXHIBIT 8-7 Typical merger clauses

Merger Clause

This instrument contains the entire agreement between the parties relating to the rights herein granted and the obligations herein assumed. Any oral representations or modifications concerning this instrument shall be of no force or effect excepting a subsequent modification in writing, signed by the party to be charged.

Entire Agreement Clause

This agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto with respect to the subject matter hereof and contains all of the covenants and agreements between the parties with respect to said matter. Each party to this agreement acknowledges that no representations, inducements, promises, or agreements, orally or otherwise, have been made by any party, or anyone acting on behalf of any party, which are not embodied herein, and that no other agreement, statement, or promise not contained in this agreement shall be valid or binding.

OR

This contains the entire agreement of the parties with respect to the matters covered by this lease. No other agreement, statement, or promise made by any party, or to any employee, officer, or agent of any party, which is not contained in this lease shall be binding or valid.

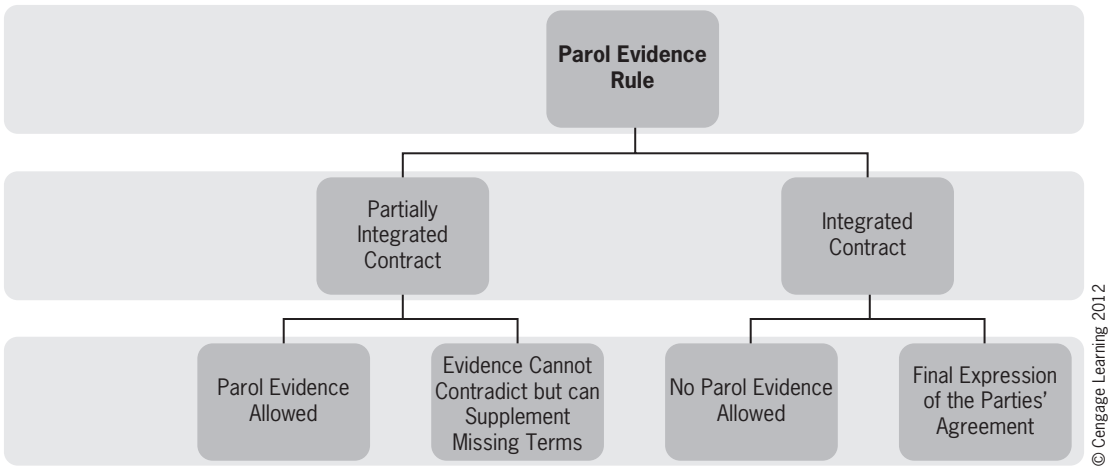
OR

This instrument constitutes the sole and only agreement of the parties hereto relating to the project and correctly sets forth the rights, duties, and obligations of each to the other as of its date. Any prior agreements, promises, negotiations, or representations not expressly set forth in this agreement are of no force or effect.

Partially Integrated Contracts

A *partially integrated* contract is a final expression of the parties' intentions but is incomplete. Usually a partially integrated contract results when the parties to the contract omit a term. The contract is silent on a term because the parties assumed the term in the contract. If the additional term does not contradict the original contract, oral evidence can be brought in to supplement the contract's missing term. See Exhibit 8-8.

EXHIBIT 8-8 Applying the parol evidence rule to contract interpretation



8.5 EXCEPTIONS TO THE PAROL EVIDENCE RULE

There are usually exceptions to every rule, and there a number of important exceptions to the parol evidence rule.

Oral Evidence May Be Used to Clarify But Not Alter. When a writing appears to be a final expression of the parties' intentions, but is incomplete, the contract is said to be partially integrated (as discussed earlier). Oral evidence will be allowed to supplement the contract consistent with the terms and conditions upon which the parties have already agreed. In this situation, oral evidence will be allowed to explain or clarify a contract but not to change or modify it. What the court looks for is consistency of the agreement and obligations that the parties have made; it allows oral evidence only to clarify the agreement.

Ambiguity. The courts allow oral evidence when the contract language is ambiguous. An ambiguity exists when a word or phrase is reasonably capable of more than one meaning. Under this exception, no new terms are presented to the court; rather, information is given to clarify ambiguous words, phrases, or the intentions of the parties to the contract.

condition precedent A condition that must first occur for a contractual obligation (or a provision of a will, deed, or the like) to attach

Conditions Precedent. Courts also allow oral evidence to show that a **condition precedent** has not been met, thus rendering the contract void or voidable. (A condition precedent is a contingency found in a contract before it comes into existence; this is discussed in detail in Chapter 9.) In this situation a party must show that, although the contract appears to be final and integrated, certain events have not occurred, which are a

prerequisite to performance of the contract terms. Conditions precedent are commonly found in real estate contracts. For example, a seller will not tender a deed unless the buyer qualifies for financing. Or, the buyer will not purchase the property unless it passes an inspection for termites or other property defects.

Any Defenses Dealing with a Formation Defect. When allegations of fraud, misrepresentation, mistake, undue influence, duress, violation of public policy, and other types of methods of destroying mutual assent are raised, the parol evidence rule does not apply. Also, when a party claims a failure of consideration, the parol evidence does not apply. By raising such a defense, a party is claiming that there has been some defect in formation of the contract and that no enforceable contract actually exists between the parties. Again, on its face the contract appears to be fully integrated and complete, but because of some act which was unconscionable or illegal, it may be found to be ineffective and unenforceable. The parol evidence rule is cast aside and any oral evidence showing the invalidity of the contract is admitted.

The key to understanding the parol evidence rule is that it applies only to written final contracts. If some exception can be found, the parol evidence rule will not apply. That is important to remember if the need to admit oral evidence is found. Knowing the exceptions will make the paralegal's task easier. Exhibit 8-9 provides a chart of the exceptions to applying the Parol Evidence Rule.

EXHIBIT 8-9 Exceptions to the parol evidence rule

Exceptions to the Parol Evidence Rule			
Oral Evidence: (1) Can be used only to supplement party's intentions; (2) Explain or clarify contract	Abiguity: (1) Oral evidence allowed (2) Explain or clarify term, word, or phrase	Conditions Precedent: Oral evidence allowed to show that condition not met	Defenses to Formation: (1) Party raises fraud, misrepresentation, mistake, undue influence, duress, violation of public policy; (2) Failure of consideration

8.6 PRACTICAL APPLICATION

A number of situations require contracts to be reduced to a writing because of the Statute of Frauds. Common contracts which have evolved over the years to deal with the Statute of Frauds issue are prenuptial agreements and guaranty agreements. Exhibit 8-10 provides examples of each.

EXHIBIT 8-10 Sample Antenuptial Agreement and Guaranty of Payment

Antenuptial Agreement—Each Relinquishing Interest in Other's Property

Agreement made the 25th day of November, 2010 between Leanne Street ("Street") of Dallas, Texas, and John Callender ("Callender") of Mesquite, Texas.

Whereas, the parties contemplate entering into the marriage relation with each other, and both are severally possessed of real and personal property in his and her own right, and each have children by former marriages, all of the children being of age and possessed of means of support independent of their parents, and it is desired by the parties that their marriage shall not in any way change their legal rights, or that of their children and heirs, in the property of each of them.

Therefore, it is agreed:

Husband Releases Rights in Wife's Property

1. John Callender agrees, in case he survives Street, that he will make no claim to any part of her estate as surviving husband; that in consideration of the marriage he waives and relinquishes all right of curtesy or other right in and to the property, real or personal, which Street now owns or may hereafter acquire.

Wife Releases Rights in Husband's Property

2. Street agrees, in case she survives Callender, that she will make no claim to any part of his estate as surviving wife; that in consideration of the marriage she waives and relinquishes all claims to dower, homestead, widow's award, or other right in and to the property, real or personal, which Callender now owns or may hereafter acquire.

Intent that Marriage Shall Not Affect Property

3. It is declared that by virtue of the marriage neither one shall have or acquire any right, title, or claim in and to the real or personal estate of the other, but that the estate of each shall descend to his or her heirs at law, legatees, or devisees, as may be prescribed by his or her last will and testament or by the law of state in force, as though no marriage had taken place between them.

Agreement to Join in Conveyances

4. It is agreed that in case either of the parties desires to mortgage, sell, or convey his or her real or personal estate, each one will join in the deed of conveyance or mortgage, as may be necessary to make the same effectual.

Full Disclosure between the Parties

5. It is further agreed that this agreement is entered into with a full knowledge on the part of each party as to the extent and probable value of the estate of the other and of all the rights conferred by law upon each in the estate of the other by virtue of the proposed marriage, but it is their desire that their respective rights to each other's estate shall be fixed by this agreement, which shall be binding upon their respective heirs and legal representatives.

In witness thereof, etc.

John Callender

Leanne Street

Guaranty of Payment

For value received, Marvin Heath hereby guarantees the payment of the within Note at maturity, or at any time thereafter, with interest at the rate of 10 per cent per annum until paid, waving demand, notice of nonpayment, and protest.

Marvin Heath

Notice in all these examples that the minimum requirements of the Statute of Frauds have been met: (1) identity of the parties; (2) subject matter; (3) material terms; (4) price or consideration; and (5) a place for a signature. These basic requirements should be kept in mind when drafting any contract. Additionally, a common clause that aids the court in contract interpretation is found in Exhibit 8-11.

EXHIBIT 8-11 Sample contract interpretation clause

If any term, provision, covenant, or condition of this agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remainder of the provisions shall remain in full force and effect and shall in no way be affected, impaired, or invalidated.

SUMMARY

8.1 The Statute of Frauds dates back to English common law and requires that certain types of contracts must be in writing to be enforceable. Most states except Louisiana have adopted the Statute of Frauds by statute or case law. The Statute of Frauds can become a barrier to an enforceable contract.

8.2 There are five types of contracts that must be in writing to be enforceable. They are (1) contracts which cannot be performed within one year after making; (2) contracts of a third party to pay the debt of another; (3) contracts made by an executor or administrator of an estate to pay the debts of the decedent's estate;

(4) contracts in consideration of marriage; and (5) contracts for the transfer of real property. Specific states may require other types of contracts to be in writing, especially those involving principals and agents.

8.3 A formal contract is not necessary to satisfy the Statute of Frauds, but certain terms must be included in the writing: (1) the identity of the parties, (2) the subject matter, (3) the material terms, (4) the price, and (5) the signatures of the parties.

8.4 When a court interprets a writing, it will look to both the words and the intentions of the parties. One of the rules of construction that the court will use is the strict construction (or four corners) doctrine. The court also will tend to give words their plain meaning and consider general usage and general custom in interpreting the contract. The most important rule for contract interpretation is the parol evidence rule, which states that oral evidence cannot be used to modify or alter a written contract. A merger clause gives the presumption of a final contract. Therefore, to decide whether the parol evidence rule applies, determine whether the contract is integrated or only partially integrated.

8.5 There are a number of exceptions to the application of the parol evidence rule. Oral evidence can be used to clarify but not vary a contract. Oral evidence may also be used when there is an ambiguity, a condition precedent, or destruction of mutual assent.

KEY TERMS

Statute of Frauds
surety
guarantor
obligor
leading object rule (main purpose rule)
probate
executor
administrator
decedent
dowry
antenuptial (prenuptial agreement)
principal
agent
strict construction doctrine
four corners
plain meaning
custom
parol evidence rule
merger clause
integrated contract
condition precedent

REVIEW QUESTIONS

1. Why was the Statute of Frauds created?
2. What types of contracts does the Statute of frauds require to be in writing?
3. What is the main purpose rule and where is it applied?
4. When can a real estate transaction be enforceable in oral form?
5. What information in a contract is required to satisfy the Statute of Frauds?
6. What is the equal dignities rule?
7. Define the strict construction doctrine.
8. What are some of the common rules that a court follows in interpreting a writing?
9. What is the parol evidence rule? List the exceptions to the parol evidence rule.
10. Distinguish between an integrated contract and partially integrated contract.

EXERCISES

1. The Museum of Modern Art hires World Construction and Alexander and Maxwell Architecture to build a modern replica of the Statute of Liberty to display at the Museum. They agree that the Museum will pay $500,000 with a replica to be delivered 18 months from the date of their agreement. There is no written document other than two letters setting forth the general terms and conditions of the project. World is concerned that it does not have a document indicating its share of the payment from the museum. Alexander and Maxwell agreed to pay $330,000 to build the replica. Does World need its agreement with Alexander and Maxwell to be in writing? Discuss all issues.

2. Using the facts from Exercise No. 1, the Museum is dissatisfied with the replica built by World Construction and Alexander and Maxwell Architecture. The museum refuses to pay either contractor any portion of the money because they intend to hire a new team to build the replica. Does World and Architecture have an enforceable agreement against the Museum? Is there a means by which the contractors can recover from the museum? Discuss all issues between the parties.

3. Mr. Brown agrees to sell Mr. Blackwell the house at 423 Cherrytree Lane for $55,000. They prepare the following document on a piece of paper:

   I, Mr. Brown, agree to sell my house to Mr. Blackwell.

   Mr. Brown (signed)

   Is this an enforceable contract? Why or why not?

4. Your attorney presents you with the following document and wants to know whether it satisfies your state's Statute of Frauds.

   AGREEMENT

   This Agreement is between AC Lumber and Real Construction for the purchase of all its plywood sheets for the price of $35.00 per sheet. This agreement shall remain in effect for one year only. Real must pay cash for its purchases.

   Signed this 1st day of August, 2009

   s/Alicia Carnes, President
   AC Lumber, Inc.

5. Serena Maloney has married Ronaldo Espinoza, European royalty. Serena convinced Ronaldo that a prenuptial agreement was not necessary. Two days after the marriage Ronaldo has second thoughts and wants to have an agreement especially since his family not only has property in the United States but has villas in Spain that have been in the family for hundreds of years. Your attorney has requested that you (1) research the type of agreement that should be drafted and its contents and (2) determine what the laws in your jurisdiction are regarding post-marriage real property agreements.

6. Using the facts from No. 5, Ronaldo's family is very upset with him and wants Serena to sign a document waiving all her rights to any of the Espinoza property. In exchange for signing the document, the Espinoza family agrees to pay Serena $10,000 a month until her death, but does not put the agreement in writing. Does the agreement for the monthly allowance have to be in writing? What issues can Serena raise in support of her claim to the $10,000?

7. Billy and Charlie agree to enter into a contract for the sale of all Billy's *Star Trek* memorabilia. Charlie agrees to pay Billy $5000 for the collection. The contract has a list of all the items which are subject to the sale. The contract states that the items are in "mint condition." The contract has a clause that it contains all the terms and conditions between the parties and is a final and binding agreement. When Charlie receives the memorabilia, he is upset because some of the pieces are not in great condition. He wants his money back. Billy refuses. Charlie sues Billy for breach of contract. Billy counters by stating that he produced all the items as outlined in the contract. What are Charlie's arguments in setting aside the contract? In the alternative, what are Billy's arguments for the contract's enforceability? Discuss all issues with particular attention to the document interpretation issues.

8. Modifying the facts from No. 7, Charlie and Billy later discuss the existence of a Kirk and Spock movie poster from the first film. Charlie really wants the poster. Although the original contract does not mention the poster, Charlie claims that Billy had orally agreed to include the poster as compensation for Charlie's claim that the other items were not in mint condition. Billy refused to give Charlie the poster. Can Charlie bring in evidence of the oral agreement for the film poster? Why or why not?

9. Janet Steenman was a doctor of internal medicine. She was offered a job with the Gatewood Health Clinic for a period of two years. Gatewood offered Janet a salary of $100,000 payable in monthly installments. Dr. Steenman began work for the clinic. The manager of the clinic stated to Dr. Steenman that she was supposed to work 40 hours a week, so she could be available for walk-in patients. Dr. Steenman refused and only worked when patients had scheduled an appointment. Many complaints arose regarding Dr. Steenman's bedside manner. Apparently, she was quite abrupt with patients. After a year of employment, Gatewood prepared a written agreement offering the Doctor a percentage of the gross collected income rather than a salary. The Doctor refused to sign the agreement and stopped coming to work. Dr. Steenman sued the Clinic for the remainder of her salary for the second year of the oral contract. Identify the issues that both sides would present in a court case.

10. Sam McAfee was the owner of Farmers Equipment and Supply Company. One of the manufacturers that Sam sold was Derring Equipment. As part of the business arrangement with Derring, Sam signed a guaranty to be responsible for any debt incurred for the sale of the equipment. Getting up in years, Sam decided to sell his business to his son-in-law, Buddy Barnstable. The business went well for a while, but in 2005, Buddy decided to close the business. Buddy had purchased some equipment from Derring and still owed a debt on it. He never paid Derring. Derring wanted its money and sues Sam for the debt. Derring claims that Sam guaranteed payment for any outstanding

debts. The guaranty stated in part: "The undersigned agrees to pay for any extension of past/or future credit extended to the debtor on behalf of Farmers Equipment and Supply Corporation." Throughout the guaranty, it refers to "the undersigned." At the bottom of the guaranty, Sam scribbled his signature above the words "guarantor(s)" and over the type word "name." Also at the bottom was Sam's address written in his own handwriting. Sam does not remember signing the guaranty. Derring sues Sam under the guaranty. Sam responds by raising the Statute of Frauds as a defense to the guaranty. Which party should win and why? Should the court allow in parol evidence regarding the signature? Use your jurisdiction's case and statutory law in your response.

CASE ASSIGNMENTS

1. A novel case has just landed on your desk. Your attorney has been hired by R. Wade Bryant, the husband who has just been sued by his wife for divorce. The reason that this case is novel is Wade married a woman of the Muslim faith. In order to marry his wife, Sari, he had to sign a SADAQ, the Islamic marriage contract. Wade did not convert to Islam and was told by the Iman the purpose of the SADAQ and some basic information about the Islamic religion. Wade signed the SADAQ for his wife and her family. The two were married in a civil and religious ceremony in 2007. Sari has filed a divorce action requesting the New York court to enforce the terms of the SADAQ. The critical information after the identification of the parties to the marriage contract is the following from the SADAQ: "The SADAQ being: "a ring advanced and half of husband's possessions." There are a number of questions your attorney has asked you to respond to. (1) Does the Statute of Frauds apply and has it been satisfied? Is the language sufficiently specific to divide the property? Can parol evidence be admitted to explain the terms of the contract? Is the SADAQ enforceable? Is Wade required to give Sari one-half of his property? What other issues need to be defined to adequately and properly represent Wade Bryant. The jurisdiction that will apply is New York.

2. Galaxy Corporation wanted to lease some warehouse space from Manner Investment Group. The two entities entered into a "handwritten deal," which was executed on the warehouse property. The handwritten lease was one page long and contained the following information:

   LEASE AGREEMENT

   The parties, Galaxy Corporation, lessee and Manner Investment Group, lessor, agree to lease warehouse property located in Gwinnett County, Georgia. The parties agree that the lease term shall be five years with monthly rent at $3570 for year one with a 5% increase over the term of the lease. The deposit for the warehouse is $5000 payable at the time this agreement is executed.

   Signed/ Marshall Shields, VP
   Galaxy Corporation

   Signed/ Diana Sutton, Managing Partner
   Manner Investment Group

The handwritten date of April 29, 2010 was at the bottom of the document. Galaxy tendered the initial deposit and first month's rent. Later that week, Manner Investment sent Galaxy a formal lease agreement which included additional costs such as the common area costs, real property taxes and insurance premiums. Galaxy refused to sign the lease stating that the one page handwritten document contained all the terms of their deal. Manner Investment wants to sue Galaxy. Prepare the memorandum of law outlining the legal arguments for Manner and the counter arguments for Galaxy. Focus on the issues discussed in this chapter.

Chapter 9

Performance and Discharge of the Contract

Outline

Just Suppose . . .

Your law firm represents a number of prominent celebrities. One of the deals one of the partners, JP Louden, was working on was a motion picture for Robert Williamson, an Academy Award-winning actor and "A-list" star. Golden Gems Films wanted Robert to play the lead in its movie *Sky High* along with Maria Sanchez, an up-and-coming star, to play his love interest. Williamson's salary was to be $5 million in a "pay or play" deal. This meant that Williamson was supposed to be paid, even if the film was not made. The parties orally agreed to the general terms of the deal with the partner receiving a copy of Williamson's contract from Golden Gems on December 20, 2008. JP offered some changes, but in general, the parties had agreed to the material terms of the deal. The film was to begin on or before April 30, 2009. Williamson was excited and even passed on some other opportunities to do this film. He really wanted to work with the young director. One week before the film was to begin shooting, Golden Gems' representative, Charlotte Walters, faxed a letter stating that the movie was off. There was no explanation to why the film was canceled. Although disappointed, Robert was more upset that he had passed up a new television series with one of the networks to do the picture. Based upon the cancellation, JP immediately demanded $5 million under the terms of the contract. Golden Gems refused to pay. Williamson is ready to have this out in court. A breach of contract action is filed the next day.

Performing contract obligations in a contract is the focus of this chapter. What happens when parties do not perform their contractual obligations? Is the nonperformance of those obligations legally enforceable? Let's find out.

9.1 CONDITIONS TO PERFORMANCE

performance
The doing of that which is required by a contract at the time, place, and in the manner stipulated in the contract—according to the terms of the contract

Formation of the contract is only the beginning process. Once the parties agree to their duties and obligations, the next step is **performance**, which occurs when the parties complete their obligations under the contract. Often though, conditions are attached to a party's performance, which can either terminate contractual obligations or continue them. Whether the conditions are met will determine the status of the contract.

A condition qualifies the contractual obligation. It acts as a trigger to the promises between the parties. Section 224 of the *Restatement (Second) of Contracts* defines a *condition* as:

> an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.

Five types of conditions are important in understanding contract law: (1) condition precedent; (2) concurrent condition; (3) condition subsequent; (4) express condition; and (5) implied condition. Each type of condition bears on a party's contractual obligations.

Condition Precedent

condition precedent
A condition that must first occur for a contractual obligation to attach

A **condition precedent** is a condition in a contract that qualifies the contractual obligation before it comes into existence. When a condition precedent is part of a contract, the condition must be fulfilled before the contract can come into existence. Words such as *when, if, before, after, on condition that, subject to, provided that, so long as,* and other words of like import create conditions precedent in contracts. When words such as these are used in a contract, the contingency must be performed before the contract comes into existence.

Perhaps the most typical contract with conditions precedent is a real estate contract. One of the standard conditions on the sale of property is that the buyer must qualify for financing. This is a condition precedent for the buyer's acquiring the right to purchase the property from the seller, and the seller does not have to sell the house to the buyer unless the seller knows that the buyer can pay the sales price. As a result, sales contracts for the purchase of real estate virtually always have a provision stating that the buyer must qualify for financing *prior to* the sale being consummated. If the buyer does not qualify for financing, neither party has any further obligation to continue the transaction.

Now let's go back to our fact pattern from the beginning of the chapter. Suppose that Golden Gems Films added the following language to the contract: "This contract is conditioned upon Golden Gems securing financing for the film *Sky High*. Unless this occurs, Golden Gems will not have any further obligations to Williamson." This language would create a condition precedent such that only when the financing is secured would the obligations of Golden Gems Films commence.

concurrent conditions
Conditions that occur at the same time

closing
Completing a transaction, particularly a contract for the sale of real estate

Concurrent Condition

The more typical contract condition is a **concurrent condition**, a condition that the parties to the contract perform at the same time. Following through with the real estate example, assume that the buyer qualifies for financing. It is now time for the **closing**, where

title
A document that evidences the rights of an owner; i.e., ownership rights

the buyer will be expected to tender a check for the purchase price of the property; at the same time, with the tendering of that check, the seller will be expected to tender the **title** and a **deed** to the buyer. These acts occur concurrently and thus are known as concurrent conditions. Many contracts contain concurrent conditions.

State Your Case

State University has an exclusive contract with a national footwear company that states that all its players and coaches will only wear that company's footwear and clothing. In exchange, the company will supply its players and coaches with footwear and clothing for all its teams. One of the players refuses to wear the footwear because his father, a former basketball star (icon), has his own line of footwear with another company and the player wants to wear his dad's footwear. Is the player bound by the contractual conditions in the university's contract? Why or why not?

deed
A document by which real property, or an interest in real property, is conveyed from one person to another

condition subsequent
In a contract, a condition that occurs after the contract comes into existence

Condition Subsequent

A **condition subsequent** is a condition in a contract that triggers the contractual obligation *after* the contract comes into existence. In this situation, a specific condition that occurs after the contract has come into existence will terminate the contract. This type of condition relates to performance of future contractual obligations: if it occurs, it will extinguish a party's contractual obligations.

Although conditions subsequent are not as prevalent as conditions precedent, they are often found in insurance policies. For example, most of us purchase car insurance. We pay the premiums but hope that an accident will not occur. As part of the contractual obligations of the parties, if an accident occurs, the insurer will pay on the policy for any damages arising from the accident. However, a condition subsequent in the policy normally states that the insured must notify the insurer within a specified period of time after the accident or loss; otherwise the insurance company need not pay the obligation. This condition of notice is considered a condition subsequent.

Line of Reasoning

Whether a condition subsequent existed was the central issue in *Lindsey v. Clossco,* 642 F. Supp. 250 (C.D. Ariz. 1986). In this case, a basketball coach's contract with a shoe distributor was challenged when the coach's contract with the university was terminated. Ben Lindsey became the head basketball coach for the University of Arizona for the 1982-83 season. Because of his position, Lindsey was approached by Clossco, a distributor of athletic products asking Coach Lindsey to agree to have the University of Arizona basketball team exclusively use Adidas products. Lindsey entered into an oral agreement for an annual "advisory and consulting" fee of $30,000 in return for Lindsey's commitment to have his team use exclusively Adidas products. The Agreement was reduced to writing. It referred to Lindsey as "Ben Lindsey, Head Basketball

Coach, University of Arizona." The important terms of the agreement provided that Lindsey was to "have the University of Arizona basketball team exclusively in Adidas brand basketball shoes." Along with these obligations, Lindsey was to be available to consult and participate in basketball clinics and any other events that were required by Adidas. Of course, the written contract provided for Lindsey's $30,000 fee. During the 1982–83 season, Lindsey's team wore Adidas products exclusively. In 1983, Clossco paid Lindsey an advance of $5,000 on the second contract year. However, in March 1983, the University of Arizona terminated Ben Lindsey as their head basketball coach. Lindsey attempted to collect on his second year contract with Clossco, but they refused. The issue was whether Lindsey's termination acted as a condition subsequent, extinguishing Clossco's obligation to perform under the contract. The Court found that it was a condition subsequent. "A condition subsequent is one referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition." No precise words are needed to create a condition subsequent but must be clear by implication. In this case, it is clear that there was an implication that the agreement would continue only if Lindsey remained the head coach of the University of Arizona basketball team. By virtue of the nature of the services, Lindsey could only perform his obligations if he was the head coach of the University of Arizona.

Questions for Analysis

Review *Lindsey v. Clossco*. What if Lindsey's services had been terminated in the middle of the basketball season, would the results of the case have changed? Why or why not? What language could Clossco have included in the contract to create an express condition subsequent?

Express and Implied Conditions

express condition
A condition that is stated

When a condition is specifically stated in a contract, it is known as an **express condition**. An express condition is normally stated on the face of the contract and is part of the obligations between the parties. Each of the parties knows the obligations to which it is committing and agrees to perform those obligations according to the terms and conditions of the contract.

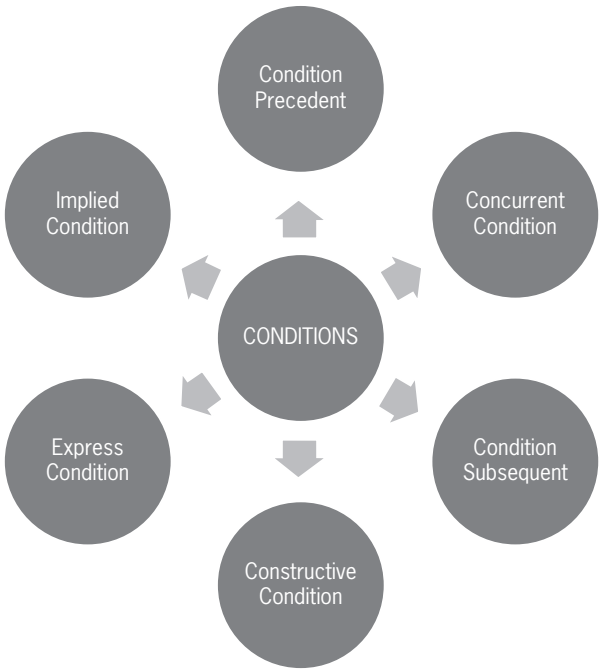
implied condition (implied in fact condition)
A condition that is inferred by the law from the acts of the parties

An **implied condition**, also known as an **implied in fact condition**, is inferred or presumed under the law. The parties understand that the implied condition exists, although it is not specifically stated in the contract.

constructive condition (implied in law condition)
A condition that is implied by a court to avoid an injustice or unfairness

To avoid injustice, a court may deem a condition to be implied to assure fairness in a contract. This is known as the rule of **constructive** or **implied in law conditions**. In this situation, the court will imply a condition, even though neither of the parties expressly or impliedly agreed to it, because the existence of the condition is implied in the parties' respective duties. The rule suggests that one party's performance is a necessary (constructive) condition of another party's responsive performance. Critical to the concept of constructive conditions is that such conditions are not recited in the contract. Exhibit 9-1 identifies the different types of conditions.

EXHIBIT 9-1 Different types of conditions



Cybercises

Using the Internet, locate examples of provisions that provide concurrent and conditions precedent in a contract.

State Your Case

A real estate developer in Philadelphia wanted to not only get some increased business, but also to support his presidential candidate. For anyone who signed a contract to purchase a condominium, the developer offered the following clause in the contract: "In the event Barack Obama fails to win the Presidential election held on November 4, 2008, Purchaser shall have the right to cancel the Purchase Agreement after giving 5 days notice to the Developer. Upon cancellation of the contract, the earnest money will be promptly refunded." Is this clause enforceable? Can it be considered a condition of the purchase of the condo? Discuss all issues.

9.2 DISCHARGING CONTRACTUAL OBLIGATIONS

When the conditions in a contract are not performed, the obligations of the parties are normally either discharged or terminated, depending on the circumstances. However, in some circumstances, contractual obligations can be terminated by the happening of certain events. **Termination** implies that the contractual obligations of the parties have ended. Whether the termination has positive or negative results depends on how the performance was discharged.

termination
A method of discharging or ending contractual obligations

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discharge
Release from a contract either by agreement or carrying out the obligations

When **discharge** occurs, a party to a contract is relieved of his or her obligations under the contract. Thus, discharge creates a valid termination of contractual duties. Discharge can occur in many ways: by performance, by agreement, by nonperformance, and by operation of law. Each has its own legal ramifications.

9.3 DISCHARGE BY PERFORMANCE

The most common type of discharge is by complete performance of the contract by the parties. When there is *complete performance,* the parties to the contract have fully performed their duties and obligations to the contract without incident. Then all the legal rights and duties of the parties are extinguished. Expectations have been fulfilled, and all the legal obligations have been fully completed; however, there are times when performance is "mostly" complete. This raises the issue of whether the contract has been substantially performed.

Substantial Performance

substantial performance
Less than full performance of a contract; performance with minor defects or deviations in performance

Sometimes the parties to a contract complete most of their obligations to the contract, but leave some minor areas unfulfilled or incomplete. This is known as **substantial performance** or *substantial compliance.* When substantial performance occurs, one of the parties to the contract has made a minor deviation from full performance of the contract, rendering the contract incomplete. In this situation, the court will determine whether the deviation was minor or material to the contract; that is, the court will ask whether the deviation in the performance is inconsequential or whether it goes to the heart of the contract. If the deviation is minor, the court can enforce the contract and provide reimbursement to the party who suffered loss due to the nonperformance. However, if the court determines that the deviation is material and goes to the heart of the contract, the court will not apply the doctrine of substantial performance. As discussed later in this chapter, the doctrine of substantial performance does not apply when the deviation is material to the contract and thus results in a **breach**.

breach
The violation of an obligation or duty

In considering whether substantial completion exists, a court can consider:

1. **Expectation of the nonbreaching party.** What was the principal reason for entering into the contract? If that expectation has been met, substantial performance may be found.
2. **Compensation to the injured party.** If the injured party's loss is easily calculated and the deviation is not material, a court could find substantial performance. When the loss is speculative and virtually cannot be calculated, the likelihood diminishes that a court will find substantial performance.
3. **Willfulness of the act.** When the party's acts are willful, deliberate, and intentional, the excuse of substantial performance will not be afforded. The court looks closely at the actions of the nonperforming party to determine the nature of the acts.
4. **Timing of performance or delay.** Unless time is crucial to the completion of the contract, a delay or time lag when full performance has otherwise been completed may result in a court finding substantial performance. The courts closely examine the performance and any damage resulting from the delay.

The doctrine of substantial performance was developed in a famous contracts case, *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889 (N.Y. 1921) where Judge Cardozo created the doctrine to prevent a claim of unfair results.

Line of Reasoning

In *Jacob & Youngs, Inc. v. Kent* case, the contractors, Jacob & Youngs built the Kents a country home that cost (back then) around $77,000. As part of the requirements for the plumbing, there was a specification for a certain brand of pipe to be used. The provision provided "All wrought-iron pipe must be well-galvanized, lap-welded pipe of the grade known as 'standard pipe' of *Reading* manufacture." The contractor did not realize that the subcontractor had purchased some "Cohoes brand" of pipe that had already been installed in the house. (It should be noted that the Kents had moved into the house and lived in it before the brand of pipe became an issue. It appeared that the Kents were trying to figure a way out of paying the final payment.) Because of the deviation in pipe brand, the Kents refused to pay the past payment of $3,483.46 to the contractor. To change the pipe would take substantial time and expense, causing the contractor to rip out large portions of the pipe from areas of the house, which already had been encased in the walls. Evidence showed, although excluded at the trial level, that the Reading pipe and the Cohoes pipe were essentially the same, just different brands. Judge Cardozo made clear in his holding that conditions and specifications are not to be treated as insignificant terms of a contract. He observed:

> The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture. (citations omitted). The distinction is akin to that between dependent and independent promises,

> or between promises and conditions. (citations omitted). Some promises are so plainly independent that they can never by fair construction be conditions of one another. (citations omitted). Others are so plainly dependent that they must always be conditions. *Others, though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant.* (emphasis added).

The Judge was careful to limit the doctrine to "insignificant" deviations or something that has clear implications, such as in the field of art. Once again quoting from the opinion, Judge Cardozo stresses:

> The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract.

Here, it was clear that the quality of the pipe was the same, only from different manufacturers. The case also discusses how damages are to be determined because the Court did not want to send the message that, although insignificant, a deviation was not without consequence. Thus, following in its reasoning, the damage to the Kents would not be the replacement of the pipe, but the difference in the value, which the Court determined to be "nothing or nominal." The end result was that the Court, in applying the doctrine of substantial performance, was creating a remedy to fit the violation. Since the contractor had "substantially performed" its contractual obligations, justice required that the result and remedy be fashioned accordingly.

Questions for Analysis

Review *Jacob & Youngs, Inc. v. Kent*. (Pay attention to the language of Judge Cardozo's opinion.) What facts would have changed Judge Cardozo's result in the case? Was it significant that the Kents lived in the house for six months before discovering the pipe problem? What message was Judge Cardozo sending regarding damages and failed performance?

State Your Case

In the movie *Moonstruck*, Loretta Castorini (played by Cher), has a father who is a plumber. In one scene, he discusses the different kinds of piping, with a husband and wife, and advises them that copper piping is the best choice. He convinces the couple to purchase the copper piping. What if Mr. Castorini used PVC piping instead of copper? Would that be considered substantial performance? What if the couple specified that only Delta brand faucets and hardware were to be used in the bathroom, but Mr. Castorini used a generic brand of faucet and hardware? What would be the result? Explain your answer for each.

9.4 DISCHARGE BY AGREEMENT

A contract also may be discharged by agreement of the parties. In this instance, the parties' agreement to discharge the obligations absolves the parties from any future liability under the original contract. This is a very common method of discharge in contract law. Discharge by agreement may occur through rescission, release, novation, accord and satisfaction, or operation of the terms of the contract.

Rescission

rescission
The cancellation of a contract by the act of a party; may be by mutual consent of the parties

Rescission is the voluntary mutual agreement of the parties to discharge their contractual obligations and duties, and thus return to the same position they were in prior to entering into the contract. When both parties agree to voluntarily discharge their contractual obligations, there is *mutual rescission;* both parties agree to cancel the contract. For rescission to be effective, both parties must agree to cancellation of the contract. Unless prohibited by the Statute of Frauds, rescission may be either written or oral.

Release

release
The act of giving up or discharging a claim or right to the person against whom the claim exists or against whom the right is enforceable

Another method to discharge performance by agreement is a **release**, which relieves the parties of their duties and obligations under a contract. Ordinarily, to be valid, a release should be in writing and supported by some form of consideration. When the parties agree to a release, the law will not allow them to pursue any legal action against each other once the agreement has been signed. Exhibit 9-2 shows a common standard release and mutual release.

EXHIBIT 9-2 Sample releases

Mutual Release on Termination of Contract

Agreement, made this 15th day of March, 2011, between ABC Construction of Chicago, Illinois, hereinafter called the Contractor, and the United States of America, hereinafter called the Government.

Whereas, the Contractor and the Government entered into a certain contract dated December 15, 2009, covering the site known as 123 Main Place (hereinafter called the Contract);

Whereas, the parties thereto desire to terminate the Contract;

Whereas, the Contractor is willing to waive unconditionally any claim against the Government by reason of such termination; and

Whereas, such unconditional waiver by the Contractor will expedite settlement of the contract and will otherwise promote the objectives of the Contract Settlement Act.

Now, therefore, the parties hereto agree as follows:

The Contractor hereby unconditionally waives any claim against the Government arising under the terminated portion of the Contract or by reason of its termination, including, without limitation, all obligations of the Government to make further payments or to carry out other undertakings in connection with the terminated portion, and the

obligation to perform further work or services or to make further deliveries of articles or materials under the terminated portion of the Contract; provided, however, that nothing herein contained shall impair or affect in any way any other covenants, terms, or conditions of the Contract.

Release of Claim under Contract

Know All Men by These Presents, that Marshall Wright of Memphis, Tennessee, in consideration of the sum of Six Hundred Fifty Dollars ($650.00) to him in hand paid, the receipt of which is by him acknowledged, does hereby, for himself and his heirs, executors, administrators, and personal representatives, release and forever discharge Daryl Brown, his heirs, executors, administrators, and personal representatives, from any and all manner of claims, demands, damages, causes of action, or suits that he might now have or that might subsequently accrue to him by reason of any matter or thing whatsoever, and particularly growing out of or in anyway connected with, directly or indirectly, that certain contract entered into on or about February 7, 2010 covering the repair of a driveway located at 3214 Walnut Street.

Dated May 26, 2011.

Novation

novation
The extinguishment of one obligation by another; a substituted contract that dissolves a previous contractual duty and creates a new one

A common form of discharge by agreement is the formation of a **novation** between the parties. A novation occurs when both parties agree to extinguish or discharge a previously existing contractual obligation and substitute a new contractual obligation for the old agreement. The original parties to the contract are discharged and new parties are substituted under the new contract for the prior obligations. A novation clearly creates new contractual rights and obligations between the parties; through this substitution, it discharges any obligations of the prior parties to the contract. All parties in a novation are required to assent to the terms, and it must be supported by consideration. In effect, a novation acts as a release of the original parties' duties and obligations to the contract. Exhibit 9-3 lists the necessary components for a valid novation.

EXHIBIT 9-3 Elements of a valid novation

1. Previous enforceable obligation.
2. Mutual assent of parties to old agreement to substitution of new parties in new contract.
3. Intention to eliminate old contractual obligations and substitute new ones.
4. New valid and enforceable obligation between the new parties.

Strictly Speaking: Ethics and the Legal Professional

The case of *In Re Oziel,* 66 A.D. 145, 844 N.Y.S. 2d 238 (2009) WL 2394793 (N.Y. August 4, 2009) highlights the improper conduct of an attorney in handling client funds involving numerous settlements. In *Oziel*, Robert Oziel was hired to represent Mrs. Judith Zwiebach and her children in the wrongful death action of her husband. What is important to understand is that under the rules of professional responsibility, client funds are just that—client funds. Unless a fee has been earned, they are segregated from an attorney's operating fund and more importantly, the client's personal funds. In this case, the attorney failed to pay settlement funds from the case and apparently used money that was deposited in the attorney's firm trust accounts for other matters, which is prohibited. In another case involving Mrs. Zweibach, the attorney submitted a forged settlement agreement, misrepresenting that a case had settled for $75,000 and had her sign a fraudulent settlement agreement. He claimed that during the process of the case, Mrs. Zweibach had signed a novation changing the basis of their original agreement. The Court did not believe that argument. Although there are a number of issues the *Oziel* case addresses, a key issue is the improper use of client funds. As a paralegal, you may be involved in settlements where a check is received or you may be involved in assisting in the bookkeeping aspect of a case, such as making a deposit. Be sure you are clear as to how money is deposited and how it is to be distributed. There are very specific rules, which attorneys must follow in handling client funds, especially those that are unearned and those from settlements. If you are involved in handling client money, know the rules in your jurisdiction. Any bar association will have the rules for handling client funds and often state statutes address these issues as well. Ignorance of the law, as we well know, is no defense, so be informed of the rules involving client funds.

accord and satisfaction
An agreement between two persons, one of whom has a cause of action against the other, in which the claimant accepts a compromise in full satisfaction of a claim

accord
An agreement

satisfaction
The performance of a contract according to its terms

Accord and Satisfaction

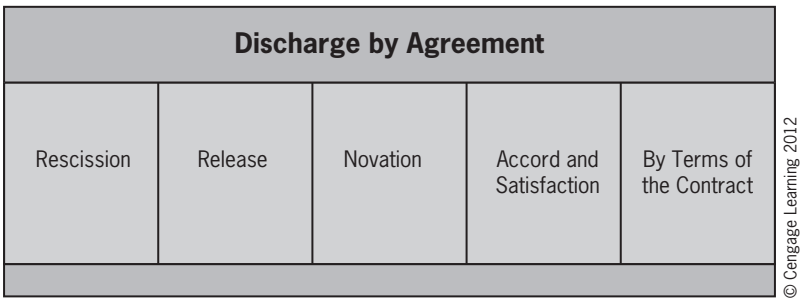
When a dispute arises between the parties, the parties can agree to terminate the rights and obligations under the contract and settle any claims and disputes between them through use of an **accord and satisfaction** (also discussed in Chapter 4 under consideration). The new agreement created between the parties is known as the **accord**; when the obligations of that new agreement are complied with by the parties, **satisfaction** occurs. This normally takes the form of a settlement that discharges performance of a contract by agreement of the parties.

Discharge by Contract Terms

Parties to the contract may agree that certain events or happenings will discharge the parties' duties and obligations under a contract. Thus, through the terms of the contract itself, the parties agree that the occurrence of certain events will discharge the contractual obligations. As long as all the parties agree to the terms, this is a valid method of discharging a contract. For example, the parties can agree that if a hurricane or flood devastates the area where the contract is performed, the contract will be discharged. Exhibit 9-4 summarizes discharge by agreement.

EXHIBIT 9-4

Summary of discharge by agreement



Cybercises

Using the Internet, locate three examples of an accord and satisfaction. What language is common to the examples?

9.5 DISCHARGE BY NONPERFORMANCE

In certain instances, the parties' obligations and duties under a contract may be discharged due to nonperformance. Discharge by nonperformance may occur through: (1) impossibility of performance; (2) frustration of purpose; (3) failure of a condition; and (4) breach. Discharge by nonperformance can have harsh legal ramifications, especially if a party is in breach. Nonperformance is not a recommended method of discharge!

Impossibility of Performance

Courts routinely allow the discharge of contractual obligations by nonperformance due to impossibility. Impossibility of performance results when some act or event makes it impossible for the contract to be performed under the terms and obligation set forth in the contract. The *Restatement (Second)* focuses on this issue. Section 261 uses the term *impracticability* rather than *impossibility,* but both terms serve the same result—a method of discharge. Section 261 states:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the nonoccurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

Common occurrences involving impossibility are destruction of the subject matter (which includes natural disasters), supervening illegality, death, or disability of the party. Notice that losing money or a losing business venture is not one of the occurrences considered to be impossibility of performance.

Destruction of the Subject Matter. When the subject matter of a contract is destroyed through no fault of the parties, the contract is discharged. Events such as hurricanes, tornadoes, floods, bombings, or fires constitute methods of discharging a party's obligations because of a form of impossibility of performance. Generally, any act of God or natural disaster falls under this category. Clauses that address acts out of one's control are known as **force majeure** clauses.

force majeure
An act which excuses nonperformance, such as an act of God

EXAMPLE: Bill Garry, a farmer, contracts with Miami Markets to purchase 500 bushels of corn for all their markets to be delivered on September 15. On September 10, a hurricane destroys Bill's entire crop of corn. He would not be responsible to perform on the contract due to impossibility of performance.

Supervening Illegality. When, after a contract has been formed, a law is passed that makes the subject of the contract illegal, a party's performance is discharged. Assume that Mrs. Goodman contracts with Ms. Waite to bear Goodman's baby (a surrogacy contract). Prior to Ms. Waite being impregnated, the state where the parties live passes a statute making surrogate motherhood illegal. The obligations cannot be fulfilled because of the supervening illegality and are thus discharged.

State Your Case

Modular Products manufactures and constructs modular buildings, such as schools and hospitals for developing nations. Modular entered into a contract with the Government of Haiti on January 5, 2009 for the construction of two hospitals and four schools in Port-Au-Prince. The project would be complete in two years. After the contract was executed, Modular immediately began shipping the modular buildings. On January 12, 2010, a 7.0 earthquake struck the capital city, destroying all the modular buildings. Modular had four more shipments to make before the project was completed. Is the Government discharged from its obligations under the contract? Does the Government have to pay for the remaining four shipments? Discuss all issues.

TECH CHECK

Cloud Computing

A technology that has received some attention is "cloud computing." Cloud computing frees your internal servers and software by using a Web-based system to store all your work. By using cloud computing rather than logging into your internal and stand alone system, you would log into a Web-based system that hosts all the program applications you need and stores all your data remotely. You can access your work data from any computer anywhere in the world. For those of us that use gmail or hotmail as our e-mail sources, think of it in the same context. When you log on to your Web-based e-mail, the site stores your current and saved e-mails. You access the e-mails from any computer. A network of remote computers runs everything. This appears to be the wave of the future. The issue for attorneys, however, is whether client confidential information is safe and secure on these cloud networks. As a result, the legal industry has been slower in accepting this new technology. The result is that as cloud computing develops, more and more law firms will probably embrace the technology as the comfort level for confidentiality increases.

Death. Death can be a means of discharging a party's obligations to a contract, as long as the contract involves personal services. Suppose you have a particular photographer, because of his reputation and knowledge, to take your graduation pictures. Prior to the shoot, the photographer dies in a car accident. The obligation is discharged. However, if your school hires a *company* to photograph each graduating student and the company-assigned photographer dies, the obligation may not be discharged, because one photographer's performance could be replaced by another.

Disability of the Party. As with death, if a party suffers a disability, such as an illness or incapacity, the performance will be discharged under the doctrine of impossibility. This method of discharge occurs if the parties' performance was essential to the contract. Note that in some instances, a party can delegate their responsibilities in a contract so that performance can occur. This is discussed in more detail in Chapter 11.

Line of Reasoning

In *Parker v. Arthur Murray, Inc.*, 10 Ill. App. 3d 1000, 295 N.E.2d 487 (1973), the doctrine of impossibility was applied where the plaintiff, Parker contracted with the Arthur Murray Dance studio for lessons. After his initial lessons, Parker decided to continue and signed a contract for 75 hours of lessons at a cost of $1,000. At the bottom of the contract in bold print were the words "NON-CANCELLABLE NEGOTIABLE CONTRACT." Parker continued his lessons and signed additional contracts containing the same language. Some of the contracts had additional language, which stated in boldfaced print "I UNDERSTAND THAT NO REFUNDS WILL BE MADE UNDER THE TERMS OF THIS CONTRACT." Parker was severely injured in a car accident. Of course, he was unable to dance and continue his lessons. Apparently, Parker had signed up for a total of 2734 hours of lessons at a cost of $24,812.80. (Have to wonder about this one!) When Parker could not perform because of his accident, he requested the return of his money. The dance studio refused citing the boldfaced language in the contracts. The Illinois court cited the *Restatement of Contracts* doctrine of impossibility of performance, which it adopted. The dance studio argued that the language of the contract waived Parker's rights to sue Arthur Murray under any legal theory. The court found that argument unpersuasive and unacceptable finding that they believed that Parker had never intended to waive a right expressly recognized by Illinois courts. Therefore, the court allowed the contract to be rescinded.

Questions for Analysis

Review *Parker v. Arthur Murray, Inc.* Could Arthur Murray have created language that would have avoided the application of impossibility of performance? What if Parker was not incapacitated but that it was simply painful to dance after the accident, would the doctrine of impossibility of performance apply? Explain your answer.

impracticability Excuses a party from an obligation in a contract that has become unrealistic because of unforeseen circumstances

Relaxing the Doctrine of Impossibility: Impracticability of Performance

Directly related to the doctrine of impossibility is a modern development referred to as **impracticability**. In situations where performance will be extremely expensive, inordinately time-consuming, and otherwise impracticable for the one who has to render

performance, courts may discharge that party's performance. Here, impracticability becomes synonymous with impossibility.

Impracticability is usually applied in the commercial context. The party alleging this defense must show that the burden of performance would be "extreme." This is not an easy standard to meet.

State Your Case

American Shipping has hired New Zealand Shipping and Freight to bring containers of its wine to the United States. American Shipping pays New Zealand Shipping $100,000 as a down payment, with the remaining $200,000 to be delivered when the shipment is received. While sailing near the coast of Africa, the ship is taken hostage by pirates and is under their control for two weeks. After the ship is released, it turns back to go home and New Zealand Shipping and Freight notifies American Shipping that it cannot bring the containers of wine to America. Does American Shipping have a claim against New Zealand Shipping for failing to bring the wine to the United States? What defense(s) does New Zealand Shipping have against American Shipping? Explore all issues.

Frustration of Purpose

frustration of purpose An event that may excuse nonperformance of a contract because it defeats or nullifies the objective of the parties under which they entered into the contract

When the purpose of the contract has been defeated by some event occurring after formation, the doctrine of **frustration of purpose** may be applied. This doctrine discharges performance by excusing it because of an unanticipated event the parties could not have contemplated. When frustration of purpose is found, the contract will be discharged.

Courts will not impose this method of discharge readily, especially when parties are simply trying to avoid a bad bargain. For the frustration-of-purpose doctrine to be applied, a party must show that the circumstance frustrating the purpose was unforeseeable and that, because of that unforeseeability, the party will not derive the benefit anticipated by the contract. The party's purpose for contracting must, therefore, be totally frustrated.

This doctrine had its origins in the early 1900s in what is known as the "Coronation Case." In that case, Mr. Henry rented an apartment from Mr. Krell, for a high fee, to view King Edward VII's coronation. Due to illness, the coronation was postponed. Henry wanted his rental money anyway; Krell refused. The court excused Henry's performance based upon frustration of purpose, and awarded no money to Mr. Krell.

Failure of a Condition

Another situation that will discharge a contractual obligation by nonperformance is the failure of a condition to a contract. As discussed earlier in this chapter, when an express condition has not been satisfactorily performed by the parties to a contract, the parties' obligations will be discharged by nonoccurrence of the condition. This is a common method of terminating a contract.

EXAMPLE: The Franklins place an offer on a house, which is accepted by the sellers, the Wrights. Within the contract is a condition that states that the buyers must qualify

for financing, otherwise the contract will be terminated. The Franklins cannot qualify for financing of the house; therefore, since a condition in the contract has been failed to be performed, the contract for the purchase of the house is terminated.

Breach of Contract

When a party fails to perform its contractual obligations, a **breach** is the result. A breach occurs when the acts of nonperformance are so material to the transaction that the nonbreaching party can treat the obligation as terminated. The *Restatement (Second)* sets out guidelines for determining whether a breach is material in § 241:

> In determining whether a failure to render or to offer performance is material, the following circumstances are significant:
>
> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will deprived;
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
> (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Although a contract may be terminated, this is not the end of the story. The person who has been injured by the breaching party can hold the breaching party to his or her contractual obligations through enforcement of a court action. The law provides certain legal remedies or methods of compensation to the nonbreaching party. These remedies, which may be either monetary or nonmonetary, are discussed in Chapter 10. The question of breach was brought before the court in *Weiss v. Nurse Midwifery Associates,* 476 N.Y.S.2d 984 (Kings County, N.Y. 1984). Pay close attention to the court's analysis.

Line of Reasoning

This is an interesting case as to what constitutes a breach of contractual duties. Nurse-Midwifery Associates were hired to assist in the birth of Weiss' child. Mr. Weiss hired the midwife services to assist in the delivery as well as provide pre-natal advice to his wife. Weiss paid $750 for the service. Under the contract, the midwife was to render pre- and post-natal services, although the contract did not directly address the issue of the midwife's presence at birth. The court did believe that the promise to attend the birth was material for the Weisses. What is interesting is the court's interpretation of the facts and the services promised. The court observed that the plaintiff purchased a package of services of which attendance at the birth was simply a part. There was no guarantee that the midwife would attend the birth in the contract. In its reasoning the court focused on the "package of services." The midwife had rendered most of the services under the contract, except for the unfortunate failure to attend the birth. The court stated that the midwife's

attendance at the birth was a "best efforts." The court based this on the fact that the parties were in constant contact and that the midwife promised to provide services to Mrs. Weiss "as needed." According to the evidence, the plaintiff and his wife contacted the midwife when they thought labor was beginning. After a series of questions by the midwife and the responses from Mrs. Weiss, it was determined that she was not in labor. When Mrs. Weiss arrived at the hospital, she went into labor quickly not giving the midwife adequate time to get to the hospital for attendance at the birth. The court found that since the Weisses had not given the midwife adequate and timely notice of the birth, the breach of contract was due to plaintiff's actions not the defendant's. The court further stated that even if the breach was not intentional, but the plaintiff's inability and failure to notify the midwife of the impending birth, relieved the midwife of any "guaranteed" obligation to attend. Here, the plaintiff made the midwife's performance materially more difficult, thereby discharging her of any further obligation to perform. Effectively, the plaintiff failed to fulfill a condition precedent to the midwife's obligations—proper notification. The court did not find a material breach on the midwife's part and dismissed the case.

Questions for Analysis

Review the *Weiss* case. What actions by the plaintiffs would have shifted the burden back to the midwife? What language should have been included in the initial contract that would have protected the Weiss from dismissal of the lawsuit? Would the result have changed had the Weiss' stated they were on their way to the hospital and the midwife was expected to attend the birth? Why or why not?

Anticipatory Breach

anticipatory breach (anticipatory repudiation)
The announced intention of a party to a contract that it does not intend to perform its obligations under the contract

In certain instances, one of the parties to a contract will learn that another party, without justification, intends to breach the contract when performance becomes due. When the words and conduct of the parties indicate that performance will not or cannot be rendered, this is referred to as **anticipatory breach** or **anticipatory repudiation**. Here the nonbreaching party believes that the other party will not perform its obligations and, rather than waiting for the actual breach to occur, the nonbreaching party may either substitute performance with another party in anticipation of the breach or immediately bring an action for breach. Insolvency or financial inability is a signal of anticipatory breach. The parties need to be careful in an anticipatory breach situation, though, because if the act by the supposedly breaching party is not unequivocal, the nonbreaching party may wrongfully repudiate the contract and thereby itself cause a breach. Consequently, indications of performance difficulties, unhappiness with the contract, or an uncertainty as to whether performance will be timely are not sufficient to manifest an anticipatory breach. As *Restatement (Second)* § 250 suggests:

> A repudiation is:
>
> (a) a statement by the obligor to the oblige indicating that the obligor will commit a breach that would of itself give the obligee a claim for damages for total breach under § 243, or
> (b) a voluntary affirmative act which renders the obligor unable or apparently unable to perform with such a breach.

To reduce the legal uncertainties that anticipatory breach may cause, the nonbreaching party may demand adequate assurances of performance. If such assurances are not given, repudiation is assumed. Section 251 of the *Restatement (Second)* states in part:

(1) the obligee may demand adequate assurances of due performance and may, if reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance.
(2) the obligee may treat as a repudiation the obligor's failure to provide within a reasonable time such assurance of due performance as is adequate in the circumstances of the particular case.

Wrongful repudiation may result in an award of contractual remedies to the injured party. Suit for anticipatory breach is not encouraged under the law if the act is not clear and unequivocal.

State Your Case

As a paralegal, you are looking for employment. You interview and are offered a job with Smith and Smith. The compensation is $40,000 annually with benefits. The offer letter states that once you accept, employment will start 60 days from the date of your acceptance. Within the 60 days, you hear that the law firm of Smith and Smith is dissolving due to an economic downturn in their business. Many of their clients have gone bankrupt. Although you have not heard anything from the partner that hired you, you are worried, so you begin interviewing again. Holland and Forbes offer you a job, which you accept. You begin immediately. After working for two weeks, the partner from Smith and Smith calls you and tells you to contact personnel so that they can begin establishing your personal file. You are shocked. You tell the partner you have accepted another job with another firm. The partner is not happy and states that he will see you in court. Have you breached the contract with Smith and Smith? Would your response change if Smith and Smith withdrew their offer after you accepted the contract? If so, why?

9.6 DISCHARGE BY OPERATION OF LAW

In some instances, contracts can be discharged because of a legal technicality, commonly known as *by operation of law.* Two methods of discharge by operation of law are bankruptcy and statutes of limitations.

Bankruptcy

When a party files bankruptcy and seeks the court's protection from creditors, contractual obligations may be discharged without providing the creditors much recourse. The Bankruptcy Act, which sets out the circumstances under which contractual obligations

can be discharged, is applied by the federal courts. Bankruptcy is a form of discharge by operation of law.

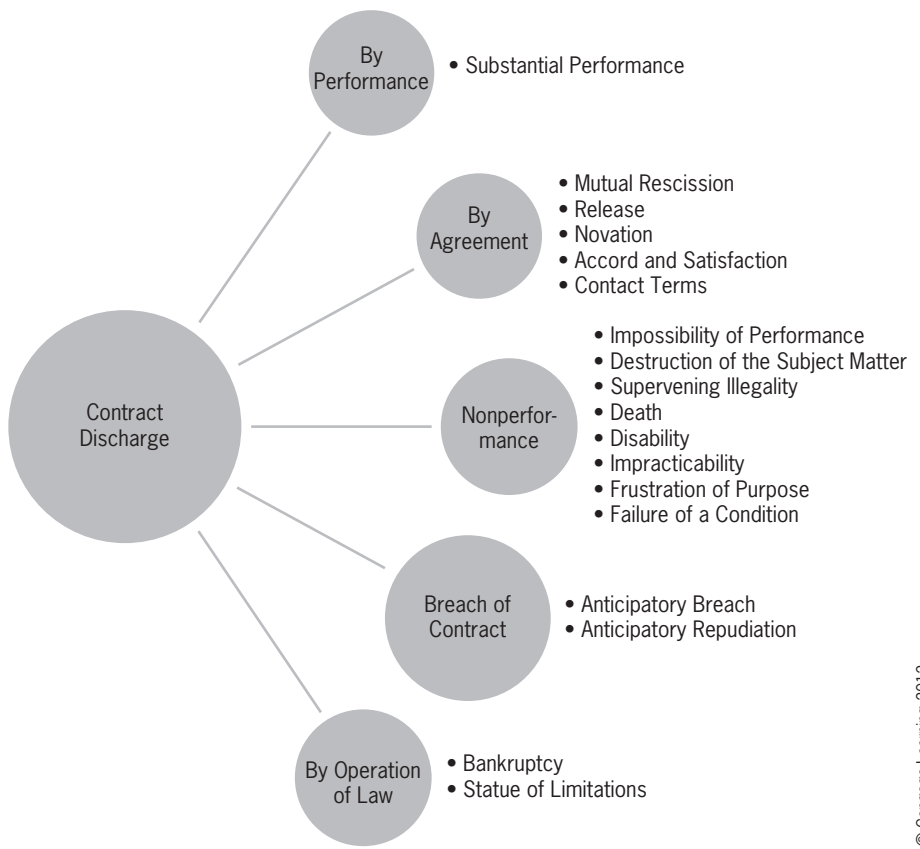
Statute of Limitations

statutes of limitations Federal and state statutes prescribing the maximum period of time during which various types of civil actions and criminal prosecutions can be brought after the occurrence of the injury or the offense

The time period in which a party must file a claim or lawsuit is regulated by state or federal statutes known as **statutes of limitations**. If a party fails to file a lawsuit or claim within the time period set forth in the statute, and the defending party claims running of the statute of limitations as an affirmative defense, the contractual obligation could be discharged.

Discharge by this method can have some inequitable results. For example, if a contractor who is hired to put up a fence leaves in the middle of the job, he or she has breached the contractual obligations. If the statute of limitations for breach is four years and you file after that time period, a court will not enforce the contract even though you have been harmed. The contract is discharged by operation of law. A diagram in Exhibit 9-5 offers a summary of the different types of contract discharge.

EXHIBIT 9-5 Summary of contract discharge



9.7 CONTRACT MODIFICATION: THREATS OF NONPERFORMANCE

Under proper circumstances, the parties to a contract may agree to change the terms of their original contract. Such a change is referred to as a *contract modification.* For example, unforeseen problems may arise, creating a situation in which continued performance would inflict undue hardship on at least one of the parties. The parties may agree to modify the contract to accommodate the new situation.

However, if a dispute arises, courts closely examine the circumstances surrounding contract modification. They will not enforce a modification made under duress or in bad faith, such as when one party unfairly threatens breach unless the other party accepts modification of the contract. Recall the *Problem Child II* example in Chapter 5. The child actor demanded more than the contracted amount of money to complete a movie. The studio felt compelled to yield to the demand in order to finish the movie. Later the studio filed suit and won. The modification of contract was not valid because it was obtained through duress (improper threats).

However, there are situations when modification of contract following threats of breach will be upheld. The key to enforceability of a modification is set out in § 89 of the *Restatement (Second)*:

> A promise modifying a duty under a contract not fully performed on either side is binding:
>
> (a) If the modification is fair and equitable in view of the circumstances anticipated by the parties when the contract was made; or
> (b) To the extent provided by statute; or
> (c) To the extent that justice requires enforcement in view of material change of position in reliance on the promise.

Another issue arising under modification is the requirement of consideration. Remember Chapter 4's discussion of the preexisting duty rule? When there is already a duty to perform, a court will not enforce the new contract, because it lacks consideration. Some states find that consideration is necessary to uphold the modification. Others, focusing on the unforeseen difficulties issue, do not require separate consideration for modification.

waiver
The intentional relinquishment or renunciation of a right, claim, or privilege that a person has

estoppel (estoppel by contract)
A prohibition against denying the validity or significance of acts done in performance of a contract

To help ensure a modification's validity, it should probably be in writing. Consequently, Statute of Frauds requirements should be considered when modifying an agreement. The court may find that either a **waiver** or an **estoppel** existed. A waiver exists when a party knowingly or voluntarily relinquishes a right or dispenses with the performance of something to which the law entitles him or her. If the modification is oral, a court may find that a waiver existed if reliance is evident. In contrast, a court may impose an estoppel theory to prevent an injustice. Under estoppel principles, a court will determine whether a party's acts or statements induced the other party to act based upon the belief that what was agreed to was true, and whether to find otherwise would cause injustice or hardship.

When a nonperformance is threatened, modification can be an effective tool to remedy a possible breach. But modifications are not always enforceable, and courts examine the circumstances surrounding a modification to determine its enforceability. Exhibit 9-6 sets forth some modification provisions found in contracts.

State Your Case

When economic times are tough, everyone is affected. Many of the television networks are cutting costs. One cost-cutting measure was communicated to the star of one of the top shows in a letter asking the star to agree to a salary freeze and forego his contractual raise for next year to assist in the cost-cutting measures. The star refuses. The network does not provide the raise, stating that the letter he received was a contract modification. The star sues the network. What are the issues between the parties?

EXHIBIT 9-6 Sample modification provisions

Disavowal of intent to modify earlier contract

It is to be understood that this agreement shall in no way act as a waiver of any of the conditions and obligations imposed on the parties by the earlier contract executed between them, and any rights that either of the parties may have by virtue of such earlier contract are to be considered in full force and effect.

Changes in printed portion of contract

No change, addition, or erasure of any printed portion of this agreement shall be valid or binding on either party.

Agent's right to modify

No agent of either party, unless authorized in writing by the principal, has any authority to waive, alter, or enlarge this contract, or to make any new or substituted or different contracts, representations, or warranties.

Written modification as necessary

There may be no modification of this agreement, except in writing, executed with the same formalities as this instrument.

9.8 PRACTICAL APPLICATION

Provisions regarding termination and discharge are common in contracts. These provisions are usually found in the performance sections of a contract. Exhibit 9-7 illustrates these types of provisions.

EXHIBIT 9-7 Sample termination and discharge provisions

Notice of Breach or Demand for Performance

It is agreed between the parties that no claim can be made for breach of this agreement unless notice of the breach, and demand for performance, is made to the other party. Notice of breach under this provision must specify the details of the claimed breach. Demand for performance under this provision must specify the details specific to the demanded performance.

Death or Disability as Terminating Contract

This contract shall terminate on the death or disability of either party from any cause whatsoever.

Payment of Sum as Basis of Right to Terminate

This agreement may be terminated only on notification by registered mail sent to [*name*], and on payment of all obligations then accrued, together with the payment of 10 percent (10%) of the remaining monthly payments, as liquidated damages.

In addition, condition provisions are common to contracts as well. Provisions to look for are set forth in Exhibit 9-8.

EXHIBIT 9-8 Sample condition provisions

Approval of Sale by Corporate Directors or Stockholders

Before the closing date, the execution and delivery of this agreement by seller and the performance of its covenants and obligations under this agreement shall have been duly authorized by all necessary corporate action, whether by the board of directors, the shareholders, or otherwise. Buyer shall receive copies of all resolutions pertaining to that authorization, certified by the secretary of seller.

Filing of Claim as Condition Precedent to Suit

Employee shall not commence any suit against employer in connection with this agreement without first filing a claim with employer, specifying the nature and basis for the claim, and no action shall be instituted until after thirty (30) days from the date of filing of such claim.

Approval of Sale by Tax Authorities

The obligations of seller hereunder are subject to the condition that seller shall have received a ruling or rulings from the United States Internal Revenue Service substantially to the effect that:

(a) For federal income tax purposes, no gain or loss will be recognized to seller on receipt by it of the total purchase price from the sale of assets, properties, and rights sold to buyer, other than assets excluded from the term "property" by I.R.C. § 337(b), provided that within the 12-month period beginning on the day of adoption of the plan of liquidation, seller shall have distributed to its shareholders all assets of seller except for those assets reasonably retained to meet claims and specifically set aside for that purpose.

(b) The day of adoption of the plan will be, for the purposes of determining the 12-month period referred to in I.R.C. § 337, the day on which the stockholders of seller approve resolutions adopting the plan.

Within ten (10) days after the date hereof, seller shall make application for such rulings from the United States Internal Revenue Service, and shall submit to buyer copies of the applications. Within ten (10) days after receipt of a tax ruling, seller will forward a copy of the ruling to buyer. Neither buyer nor seller shall be obligated to close if a ruling is found to be unfavorable to it by its counsel.

Often a paralegal may be asked to assist in preparation of an accord and satisfaction. Usually, this document relates to settlement of a disputed claim between the parties. Exhibit 9-9 will guide the paralegal in preparing an accord and satisfaction.

EXHIBIT 9-9 Sample accord and satisfaction

Agreement for Accord and Satisfaction—Disputed Claim for Personal Injuries of Property Damage

Agreement made on June 18, 2011, between Harvey Fields of Morris County, New Jersey, referred to as claimant, and Ralph Stanton, 1234 Brentwood, Bergen County, New Jersey, referred to as obligor.

Obligor agrees to pay, and claimant agrees to accept, the sum of $11,500 in full payment of a disputed claim arising from damages sustained by claimant in an automobile collision that occurred between the parties at Ocean City, New Jersey, on August 18, 2010, for which injuries claimant claims obligor to be legally liable, and which claimed liability obligor expressly denies.

In consideration of the payment by obligor to claimant, claimant releases and forever discharges obligor, his heirs, successors, executors, administrators, and assigns, from any and all actions, causes of action, claims, and demands for or by reason of any damage, loss, injury, or suffering that has been, or that hereafter may be, sustained by claimant as a consequence of such bodily injuries and property damage.

In witness whereof, the parties have executed this agreement on the date first mentioned above.

Finally, Exhibit 9-10 is an illustration of a novation.

EXHIBIT 9-10 Sample novation

Novation Between an Original Contractor, a Substituted Contractor, and a Contractee

Agreement made this 26th day of April, 2011, between ABC Contracting, of Dallas, Texas, and Smith Construction of Arlington, Texas and Bill Davis, of Dallas, Texas.

Whereas, an agreement dated February 1, 2011, was made between ABC and Davis, and ABC desires to be released and discharged from the contract contained in the agreement,

and Davis has agreed to release and discharge ABC therefrom upon the terms of Smith undertaking to perform the said contract and to be bound by its terms;

It is agreed as follows:

1. **Undertaking of Substituted Contractor.** Smith undertakes to perform the contract and to be bound by the terms thereof in all respects as if Smith were a party to the agreement in lieu of ABC.

2. **Release of Original Contractor and Agreements for Acceptance of Substituted Contractor.** Davis releases and discharges ABC from all claims and demands in respect to the agreement, and accepts the liability of Smith upon the agreement in lieu of the liability of ABC, and agrees to be bound by the terms of the agreement in all respects as if Smith were named therein in place of ABC.

In Witness Whereof, the parties have signed this agreement on the day and year first above written.

SUMMARY

9.1 Conditions may place a contingency on contract performance. Conditions that may qualify performance are conditions precedent, conditions subsequent, and concurrent conditions. Conditions also may be express or implied.

9.2 Discharge relieves a party of contractual obligations. One of the methods of discharge is by performance. It also can occur by agreement, by nonperformance and by operation of law.

9.3 Completed performance is the usual method of discharge. If there is a slight deviation in full performance, a contract may be substantially completed. To determine whether substantial completion exists, the court can look to the expectation of a party, compensation, the willfulness of the act, and the timing of performance.

9.4 Contracts also can be discharged by agreement of the parties. Ways to discharge a contract by agreement are through rescission, release, novation, accord and satisfaction, and operation of the terms of the contract.

9.5 Parties can discharge performance by nonperformance. Impossibility of performance is a method of discharge by nonperformance, which includes destruction of the subject matter, supervening illegality, death, and disability. Impracticability is related to the doctrine of impossibility. When the main purpose of the contract has been frustrated, discharge can occur. The most common method of discharge of a contract is a breach, when at least one of the parties fails to perform his or her contractual obligations.

9.6 Methods to discharge a contract by operation of law are bankruptcy and statute of limitations. Discharging a contract by these methods can have inequitable results.

9.7 Modification is a method of changing the parties' obligations to a contract. Modification usually occurs when unforeseen circumstances arise or undue hardship would result if the contract was performed.

KEY TERMS

performance
condition precedent
concurrent conditions
closing
title
deed
condition subsequent
express condition
implied condition (implied in fact condition)
constructive condition (implied in law condition)
termination
discharge
substantial performance
breach
rescission
release
novation
accord and satisfaction
accord
satisfaction
force majeure
impracticability
frustration of purpose
anticipatory breach (anticipatory repudiation)
statutes of limitations
waiver
estoppel (estoppel by contract)

REVIEW QUESTIONS

1. Define the term *condition*.
2. Distinguish between a condition precedent and a condition subsequent.
3. What are the different ways a contract can be discharged?
4. How do completed performance and substantial performance differ?
5. What can a court consider when determining whether a contract has been substantially completed?
6. Identify the ways a contract can be discharged by agreement.
7. What are the various methods by which a contract can be discharged by nonperformance?
8. List the methods by which a contract can be discharged for impossibility of performance.
9. How can a contract be discharged by operation of law?
10. What are some of the issues raised when a contract is modified?

EXERCISES

1. Find a contract for the sale of a residential house and list the conditions precedent and concurrent conditions found in the contract.
2. Frederick Houseman and Michael Monterey have been feuding over Michael's performance when putting in Frederick's sprinkler system. In their settlement of this matter, Frederick agreed to pay Michael $5,000 in settlement of all their claims against each other. Your attorney has asked you to draft a mutual release between Frederick and Michael.
3. The winner of the Ms. International beauty pageant appears to have decided which personal appearances she will make and which ones she will skip. The Ms. International organization is not happy with Ms. International's attitude and sends her an e-mail stating that as part of her contractual relationship with the organization,

she must attend all functions identified in her weekly schedule. Ms. International ignores the e-mail and misses the next day's function. The president of the organization states that if she does not attend the functions as presented, she will be replaced by the first runner-up, Ms. Virgin Islands. Ms. International fails to attend two personal appearances. The organization fires her. Ms. International claims that she was ill during this time period and could not get out of bed. She also claims that she never received the e-mail warning her about the firing. Ms. International sues the pageant for her crown back. Will she be successful in her lawsuit against the Ms. International organization? Discuss all issues between the parties.

4. Blake Haddon, Cyrus Oldsmen, and Graham Piper work for Aragon Foods. They work long hours for which they have quite a bit of overtime. In the initial employment contract, which is in writing, the contract stated that each person would be paid an hourly rate of $15.00 and anything over 40 hours would be paid at time and a half. During the first two years of the contract, there were times when Blake, Cyrus, and Graham were not paid their overtime. However, two years after they all had started, Aragon Foods had each of the employees sign a new employment contract where they would work for a salary of $40,000. The contract expressly stated that they did not get overtime. Blake, Cyrus, and Graham want to sue for the overtime that they were never paid. What effect does the new contract have, if any, on the first employment agreement? Did the second employment agreement create a novation? Explain your responses.

5. The Marlton family has one of America's most prolific private art collections. However, the family decided to part with one of their Goya paintings. Many galleries bid for the right to sell the paining, but the Gallery Auction House was chosen to sell the rare painting by Goya. One of the reasons that Gallery was chosen was because they offered a $40 million guarantee to the Marlton family. The painting was sent to the Gallery subject to the final contract terms. After the terms were agreed to, but before the Gallery signed the contract, they informed the Marlton family that they could not honor the $40 million guarantee because of the changed climate of the art market in the United States and Europe. The Marlton family is suing the Gallery for $40 million plus interest and expenses. Does the Gallery have any viable contract defenses to the Marlton lawsuit? Discuss all issues.

6. The Hallogens are a legendary rock 'n roll band. As with many bands, included in their arena performance contracts are a list of requirements that if not met may be a means to cancel the contract and the concert. On August 15, 2010, Lightning Productions executed a contract with the Hallogens for a concert to be performed on December 21 of that year. One of the provisions of the contract was as follows: "Hallogens requires M&Ms to be provided as part of their catering. However, there shall be no brown M&Ms in any bowl in the backstage area. In the event brown M&Ms are not provided, the Hallogens shall forfeit the show with full compensation." As the day approached, Lightning began making preparations for the concert. On December 21, the Hallogens lead guitarist went over to the catering area for some food. In front of him was a big bowl of M&Ms, which included the "brown ones." Notifying his band mates, the Hallogens immediately cancelled the contract. Lightning Productions sue for breach of contract. What are the positions of each party?

7. June's family has been in the farming business for as long as she can remember. Her family has one of the largest apple orchards in Washington State called Highland Farmlands. Every year Highland contracts with Bordeaux Foods for its apple harvest. This season it was exceptionally dry in Washington with many wild fires. June cannot remember this ever happening. Even though Highland Farmlands did everything it could, the orchards were destroyed by the smoke and fires. They could not supply Bordeaux Foods with any apples. Bordeaux Foods sues Highland Farmlands for breach of contract. How would Highland Farmlands defend against the lawsuit?

8. Johnson & Wilson is a law firm. They want to upgrade their firm's computer and billing system. IT Legal Consulting was hired to perform the upgrade for the law firm. IT Legal submitted a proposal, but the firm did not prepare a written contract for the services. However, the parties agreed that the work would cost $15,000. IT Legal installed the systems J & W picked, even though IT Legal believed that the system was not best suited for J & W needs. IT Legal was paid initially $10,000 for their services. The system kept crashing. Dissatisfied with IT Legal's performance, J & W refused to pay IT Legal the remainder of the money that was owed them. J & W hired another consultant who recommended that all the computers at the firm be replaced as installing any new system in the antiquated computers was like riding a moped when you need a motorcycle. IT Legal believes that they did exactly what J & W asked of them and fully performed the contract. They want the remainder $5000 that was owed to them. Does IT Legal have an action against the law firm? Explain your response.

9. Blaine and Michael want everything perfect for their wedding. They have rented a ballroom in a fancy hotel, picked their flowers and hired a band which plays great salsa music. They went around their area to hear bands and loved "Hot Spice" for their reception. They signed a contract for $4,500 with Hot Spice. On the day of the wedding a band called "Hot Spice II" showed up. Blaine was in tears. This was not the band she hired. They were going to ruin her perfect day. The lead singer, Geraldo Diaz of "Hot Spice II," stated that they worked with Hot Spice. Geraldo asked Blaine whether she had read the contract. One of the provisions stated that "either Hot Spice or Hot Spice II would perform at the wedding reception." The clause continued that "both bands will play primarily salsa and Latin music and also are available to play other standard wedding music." Blaine could not believe it. Michael consoled Blaine telling her not to worry and that he was sure the band would be fine. Anyway, they needed music. Although "Hot Spice II" rocked the reception, Blaine felt like she had been misled. She wants to sue the band for breach of contract. Does Blaine have a case? What are the parties' options in this matter?

10. Hilary and her friends wanted to see the Broadway musical *Victor/Victoria* starting Joley Anderson. Because they had dreamed of seeing Ms. Anderson since she saw her first movie about a flying nanny. The group paid $150 each for the tickets. On the day of the show, Joley took ill with the understudy performing her role. Hilary and her friends demanded a refund from the box office. They were not going to pay $150 to see some understudy. Must the box office refund Hilary and her friends their money for the tickets? Explain your answer.

CASE ASSIGNMENTS

1. Big Buys posted on its Web site this advertisement: "52-inch HDTV with DVD for $9.99." Jim Morgan was in the market for a new TV and happened to be searching the Web when he ran across the Big Buys offer. He jumped on it. He didn't care what brand of TV it was, he was getting one. Jim reviewed the specifications of the TV, hit the buy button, typed in his credit card information and hit the final purchase button. He received an e-mail confirmation within 10 minutes of the purchase. Jim was in heaven. Hours later when Jim checked his e-mail again, he received this e-mail from Big Buys:

   TO THE CUSTOMER:
   A systems error caused an incorrect price to be posted on one of our 52-inch HDTV models. The correct price was $999.99. We apologize for the error and any inconvenience, but the $9.99 price will not be honored. Any charges to your credit card will be immediately refunded. Thank you for your continued business.

   The Management of Big Buys.

   Jim was not happy and was having none of it. He wanted the TV he purchased and that was that. Jim remembers that his wife's nephew just became a lawyer and wonders whether he could help him out. Jim calls the nephew and seeks his advice. Can Jim enforce the contract for the purchase of the HDTV? Discuss all applicable issues.

2. You have been hired by a firm that acts as a sports agent for many athletes negotiating the terms of their contracts. One of their clients, Lex Rodney, is one of baseball's top players. Your firm negotiated his contract which contained a standard morals clause which specifically provided that:

   > "The Club may terminate the contract with Rodney if he shall at any time fail, refuse or neglect to conform his personal conduct to the standards of good citizenship, good sportsmanship, or fail to maintain himself in top first-class form or adhere to the rules and regulations of the club's training rules. Violation of any terms of this clause shall be a basis of the club, in its sole discretion to terminate, suspend or undertake any action appropriate to Rodney's violation."

   Rodney had used performance enhancing drugs in 2007. He claims he thought they were vitamins given to him by his personal physician and nutritionist. Four years after the event, Rodney now admits that he knowingly used the performance-enhancing drugs. Rodney is booked two years in advance for personal appearances and team fund raisers. The team owner is threatening to sue Rodney for breach of his morals clause and frustration of purpose.

   (a) The clause does not specifically prohibit performance-enhancing drugs, but your supervising attorney wants you to prepare a legal memorandum discussing all issues that both the team and Rodney can raise in the event the team decides to pursue this action.
   (b) Assume that the team and Rodney want to find a solution out of court and the public eye. Draft the contract document that the parties might execute to resolve their issues.

Chapter 10

Remedies in Contract Law

Outline

Just Suppose . . .

You are a paralegal working for a New York producer who wants to stage a musical about the life of noted jazz singer Ella Fitzgerald. The producer contacts the queen of R&B, Sadie Anderson, whom he believes is perfect for the role. Sadie's representatives are excited about the project and so is Sadie. With Sadie on board, the financial backing is a sure thing. On July 20, the parties begin circulating a draft contract setting forth the terms and conditions of the project. Sadie presently lives in the Chicago area and wants the rehearsals in Chicago. She hates to fly. But, the producer is insisting that the pre-production and rehearsals must be in New York, because all the main people he will need are based in there. Although Sadie is not thrilled about being in New York, she verbally agrees to be in New York by August 30 as the producers are shooting for a holiday opening. Based upon Sadie's verbal commitment, the producer begins renting rehearsal space, hiring musicians, and casting the actors.

The producer is also in the process of securing all of the financial backing. During this time period the negotiations continue with all the main points agreed to by the parties. On August 26, the producer gathers the new cast for some basic run-throughs. Sadie is expected on the 30th and everyone is excited about the project. On August 29, the producer receives a telephone call from Sadie's representatives stating that she was not well and could not do the project. The producer offered to postpone the project for a month, but Sadie's representatives indicated that one month was not going to make a difference. What the producer had learned was that Sadie was not ill, but refused to fly to New York. Her fear of flying was rumored among the

music industry, but no one had ever confirmed it. The producer contacted Sadie's representatives again and offered any mode of transportation she wanted to New York. Sadie still refused to perform. The producer invested a substantial sum of money relying on Sadie's verbal agreement to do the musical. He wants to pursue all of his legal options and wants you to research how and what recovery is available for Sadie backing out of the project. These facts present the issue of remedies in contract law.

10.1 DISTINGUISHING BETWEEN LEGAL AND EQUITABLE REMEDIES

When a party fails to perform its obligations under a contract, the injured party may request a court to award compensation for the losses. This compensation is known as a *remedy.* The type of remedy a court can grant will depend upon the kind of injury suffered, but remedies fall into two general categories: legal remedies and equitable remedies. A **legal remedy** is a monetary damage that the party can claim for the loss suffered as a result of the other party's failure to perform contractual obligations. Legal remedies are the type of remedy most commonly awarded in contract lawsuits and are always in the form of money known as **damages.**

legal remedy
A remedy available through legal action

damages
The sum of money that may be recovered in the courts as financial reparation for an injury or wrong suffered as a result of breach of contract or a tortuous act

The other type of remedy a court can order is a nonmonetary remedy known as **equitable relief,** or an *equitable remedy,* awarded when there is no suitable monetary remedy. The court can fashion such a remedy according to the facts of the case.

equitable relief (equitable remedy)
Relief other than money damages

10.2 LEGAL REMEDIES OR DAMAGES

Courts often determine the appropriate damages to award an injured party by evaluating the extent and severity of the nonperforming party's acts. When damages have been suffered by an injured party, the court will attempt to place the party back in the financial position it would have been in had the contract been fully performed. Consequently, monetary damages are usually awarded when someone has breached his or her contractual obligations and that breach has resulted in damages. The legal remedies that are awarded by a court can be categorized as compensatory damages, consequential damages, nominal damages, and liquidated damages. Another type of damage that you may have heard of is punitive damages. This type of damage is rarely awarded in contract cases unless the case is based upon traditional tort type claims, such as fraud.

Compensatory Damages

Compensatory damages are the actual sums of money a party has lost as a result of nonperformance by the other party to a contract. Compensatory damages are also known as **actual damages** or **expectation damages.** They are the amount of money that will place the injured party in the same position it would have attained had the contract been fully performed. They are the damages that satisfy a party's expectations under the contract.

compensatory damages (actual damages)
Damages recoverable in a lawsuit for loss or injury suffered by the plaintiff as a result of the defendant's conduct. Also called *actual damages*

Ordinarily, the compensatory damages awarded by a court are not only the actual sum lost, but also the costs foreseeable as a probable result of a breach of the contract. In evaluating the amount to award a party in a damages lawsuit, a court will determine what can be considered the natural and proximate consequences of the acts of the parties that could have been reasonably foreseen or predicted as a result of a breach. If damages were reasonably foreseeable, the court will compensate the injured party for losses that are the direct result of the breach of contract.

When the court is calculating compensatory damages, it may consider and award lost profits, any incidental expenses that resulted from the breach, and the actual amount lost (which is the difference between the actual price of the contract and any loss for substituted performance that the nonbreaching party would incur due to the breach).

Consequential Damages

consequential damages
Indirect losses; damages that do not result from the wrongful act itself, but from the result or the aftermath of the wrongful act

speculative damages
Damages that have yet to occur and whose occurrence is doubtful

Not only can compensatory damages be awarded when someone has breached a contract, but the injured party may also receive **consequential damages,** those indirect or special damages which are a foreseeable consequence of the breach. Consequential damages are usually awarded in addition to the actual damages.

There has to be some direct causal connection between the breach and the damages resulting from the breach. Mere conjecture is not sufficient. The court is mindful that consequential damages cannot be speculative. **Speculative damages** are damages that depend upon the happening of events. They are improbable and contingent. Did the parties know, or should they have known, that a breach would result in the damages claimed? If the answer to the question is yes, then consequential damages may be awarded. Perhaps the most famous and influential case on compensatory damages is an old English case, *Hadley v. Baxendale,* 156 End. Rep. 145 (Ct. Exch. 1854).

Line of Reasoning

The case of *Hadley v. Baxendale* involves a mill owner whose mill shaft was broken. In order to have it fixed properly, Hadley contracted with Baxendale, the operator of a railway, to have the broken shaft transported from the city of Gloucester to Greenwich. The purpose of transporting the mill shaft was for use as model for construction of a new mill shaft. Of course during this time period the mill would have to be closed. The railway promised that if the shaft was received by noon any day, that it would be delivered to Greenwich the following day. Due to some negligence on the part of the railway it failed to transport the mill shaft in a timely manner, which was in breach of their contract with Hadley (railway had promised to transport the mill shaft quickly). The new shaft was delayed several days, for which Hadley sued Baxendale to recover the revenues it had lost because of delay in transport. As the court observed that "here there is a clear rule, that the amount which would have been received if the contract had been kept, is the measure of damages if the contract is broken." The two main rules of damages that arise from *Hadley v. Baxendale* are that (1) an injured party may recover for damages that are a result of or are foreseeable from the "usual course of things" from the breach and (2) an injured party may recover for "special circumstances" from the breaching party only if those special circumstances are

communicated to the breaching party at the time the contract was made. In this case, Hadley did not communicate any special circumstances to the railway and thus, "loss of profits here cannot reasonably be considered such a consequence of the breach of contract as when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants." Then end result was that those damages which are not foreseeable cannot be recovered.

Questions for Analysis

Read *Hadley v. Baxendale*. Would the court's decision had been different had the clerk communicated the true urgency of the situation? What type of knowledge is required under *Hadley* for additional damages to be awarded by a court?

Coupled with the concept of consequential damages is that of *incidental damages,* or those which the injured party expends to prevent further loss. Incidental damages can be out-of-pocket expenses or any other expenses incurred to prevent any further loss or injury to the party. Incidental damages can be awarded in addition to compensatory and consequential damages.

State Your Case

Ella dreamed of her wedding day from the time she was a little girl. She wanted her reception hall to be filled with white lilies and white roses. Ella contracted with Holland Flowers to provide the flowers for the reception. The total contract price was $6,000. The contract provided that the reception hall would have centerpieces of white lilies and roses with sprays of flowers throughout the room. Ella assumed that since the centerpieces were in white that the other flower designs would be in white as well. Holland placed its order for the flowers with its supplier. The supplier told Holland that it did not have sufficient white flowers because of the season, but had lovely light pink roses. Holland was not aware that Ella only wanted white flowers and decorated the room with the white and "light pink" flowers. After the ceremony, Ella walked into the reception hall and fainted when she saw the sprays of pink throughout the room. Everyone thought the room looked romantic and festive, but Ella was inconsolable. Her wedding was ruined. Ella suffered from migraine headaches. Because of the flower fiasco, Ella got a migraine and was unable to go on her honeymoon until one week later. Ella and her new husband, Clyde, had to pay airplane change fees of $150.00 each along with change fees for the hotel accommodations. After the wedding, Ella sued Holland flowers for breach of contract, incidental and consequential damages. Will Ella be successful in a lawsuit against Holland Flowers? Explain your answer.

Cybercises

Find examples of consequential damages clauses in a contract. What are some of the common characteristics of the clauses?

Punitive Damages: An Unusual Remedy in Contracts

When the conduct of the nonperforming or beaching party is intentional, deliberate, willful, and in complete disregard of the rights of the injured party, the court may award **punitive** (or **exemplary**) **damages** to compensate the party. These types of damages are sparingly given in contract cases. Because punitive damages act as a punishment or penalty against the breaching party, they are used only in the most extreme circumstances. For example, punitive or exemplary damages might be awarded in a fraud case if the injured party could show the willful nature of the other party's acts. Punitive or exemplary damages are awarded more frequently in **tort** cases than in contract cases. However, courts can award exemplary damages when the conduct is so offensive that public policy would thus be served.

An award of punitive damages is intended to act as a deterrent to future willful conduct. When punitive damages are awarded, statutes generally provide for **treble damages** (three times the amount of actual damages) to make an example of the conduct of the party. The purpose is to discourage such heinous behavior.

punitive (exemplary) damages
Damages that are awarded over and above compensatory damages because of the wanton, reckless, or malicious nature of the wrong done by the plaintiff

tort
A wrong involving a breach of duty and resulting in an injury to the person or property of another

treble damages
A form of punitive damages or exemplary damages authorized by statute in some circumstances if warranted by the severity of the violation or the seriousness of the wrong

nominal damages
Damages awarded to a plaintiff in a very small or merely symbolic amount

Nominal Damages

Nominal damages are token damages awarded when a party has either suffered a minimal amount of loss or cannot prove the substantial loss required for a higher award. When a trial decides a victor in a case, the court can award a small amount to acknowledge the wrongful act and compensate the victor when the damages are not substantial. Nominal damages are really symbolic for the victor.

Liquidated Damages

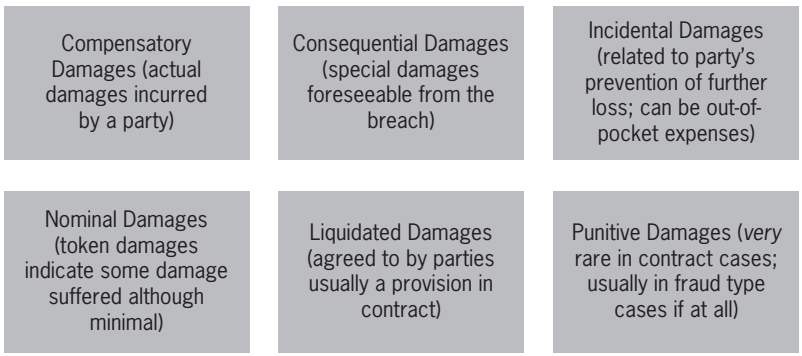
When the parties agree in advance to a particular sum that will be awarded upon a breach, that sum is known as **liquidated damages.** Liquidated damages are normally agreed to as a *contractual* provision by which the parties anticipate what the loss might be in the event of a breach; it is an estimate of the probable damages in the event of a breach. Courts look very carefully at liquidated damage clauses to be sure they are not punitive, which would be contrary to generally accepted legal principles. Liquidated damages that would act as a punishment rather than as compensation will not be upheld by a court. The liquidated damages clause must be reasonable and must fairly anticipate the cost of a breach.

The purpose of liquidated damages clauses is to avoid expensive litigation, force a party to perform contractual obligations, or diminish the loss suffered by the breaching party. The court weighs the reasons underlying liquidated damages clauses and closely examines the intent of the clause. If its basis is to extract performance in a coercive manner, the clause will likely be enforced. Consequently, reasonableness is critical in determining a liquidated damages clause's validity.

In determining whether a liquidated damages clause is reasonable, the court looks to the actual amount of the contract, how much of the contract has been performed, the amount it would cost to litigate the claim, and any other reasonable factors that the

parties may have considered in reaching the specific damage amount. It is clear that parties have difficulty accurately calculating the actual amount that could be incurred in the event of a breach. Consequently, when a liquidated damages clause has been challenged, the court examines the contract as a whole and considers the parties' intentions to determine whether the liquidated damages clause is reasonable. Exhibit 10-1 is a summary of the types of contract damages.

EXHIBIT 10-1 Types of contract damages



Strictly Speaking: Ethics and the Legal Professional

As a general rule, when an attorney agrees to represent a client, no conflict of interest can exist with another client. A conflict of interest occurs when a lawyer has a competing professional or personal interest, including financial, with a client's interest. It also occurs when one lawyer represents both parties in a dispute. Under the rules of ethics for attorneys, attorneys cannot represent a client with whom a conflict of interest exists, including another client, unless the conflict is waived. Most law firms have Web sites and often have a method of contacting the law firm through an e-mail. There usually is a box that allows the individual to provide a name, contact information and may provide space to attach an e-mail message. In some cases, an e-mail from a prospective client may unknowingly create a conflict with an existing client, especially if confidential information is supplied. A way to avoid this problem is for the law firm to post a message in the form of a disclaimer that essentially states:

By responding to an e-mail inquiry, no attorney-client relationship is established until you have spoken with an attorney, signed an engagement letter and a conflicts of interest inquiry is performed. DO NOT PROVIDE ANY CONFIDENTIAL INFORMATION IN AN E-MAIL TO THIS FIRM.

By adding a disclaimer message, at least any potential client is now on notice that the law firm is not representing their interests. Of course, what the law firm is trying to avoid is any potential problems down the road where the law firm could be sued for ethics violations creating a potential damages situation from what started as an "innocent" e-mail inquiry.

Cybercises

Locate different types of liquidations clauses on the Internet. Compare the clauses and identify the similarities in the language. Locate liquidated damages clauses that would not be considered reasonable. What language was distinguishing in the clauses that would render them unenforceable?

Mitigation of Damages

Under the common law, there is a general duty, when it is reasonably possible, to minimize the amount of damage caused by a party's nonperformance. This is known as **mitigation of damages.** The party who has been injured must make necessary and reasonable efforts to prevent escalation of the losses brought about by the breach. It is important to note that the duty to mitigate does not require a person to go to extraordinary lengths to minimize the damages. If the high risks and expenses involved would cause undue hardship to a party, there is no duty to mitigate.

A common instance involving a duty to mitigate is when a party breaches a lease. Suppose, for example, that the parties have agreed on a monthly amount to lease commercial space. Due to economics or some other unforeseen situation, the **lessee** determines that it is not feasible to make future payments on the lease agreement. During the night, the lessee quietly moves out. When the landlord discovers that the tenant has moved, there is no doubt that the landlord can sue the tenant for the payments remaining during the lease term. However, the landlord must attempt to mitigate its damages by advertising the commercial space for lease. Generally, the landlord need not go to any other or further lengths to fulfill its obligation to mitigate losses. If the landlord does lease the property, any income from the new lease will be deducted from the prior tenant's obligations. The prior tenant will be responsible for any costs and expenses in acquiring the new tenant and for any unpaid balance on the lease. The landlord would have fulfilled its duty to mitigate its damages.

In contrast, if there is an overabundance of commercial space and the landlord, after reasonable efforts, cannot lease the property, the landlord has still fulfilled its duty to mitigate. Courts do not require parties to go to extraordinary lengths to mitigate their damages, but to do only what is reasonable.

mitigation of damages
A doctrine in the law which requires an injured party to avoid or lessen the consequences of the other party's wrongful act

lessee
The person receiving the right of possession of real property, or possession and use of personal property, under a lease. A lessee is also known as a *tenant*

10.3 EQUITABLE REMEDIES

Monetary remedies often are insufficient to compensate a party for the injuries sustained. When this is so, a party can request a court to award an equitable remedy. An **equitable remedy** is a nonmonetary remedy awarded when legal remedies are either inadequate or inappropriate as a remedy for the injured party. A number of equitable remedies are available in contract law: specific performance, injunctive relief, rescission, reformation, restitution, and reliance. Which equitable remedy is appropriate for the injured party is determined by a court based upon the facts of each case. It is important to note that if a legal remedy is available, a court will not impose an equitable remedy.

Specific Performance

Specific performance is an equitable remedy unique to contract law, whereby a court requires a party who has breached a contractual obligation to perform that which was promised under the original contract. Courts can order specific performance when a legal remedy is insufficient. Specific performance can be granted if it can be shown that the subject matter of the contract is unique or that money damages would not be sufficient to

specific performance
The equitable remedy of compelling performance of a contract

make the nonbreaching party whole again, or that a duplicate or substantial equivalent is impossible. Awarding this remedy is purely within the discretion of a court. Courts will consider the effect and harm created if specific performance is granted; it is not taken lightly, because of its effects.

The remedy of specific performance is most commonly used when real estate is involved. Because of the unique nature of real property, courts generally find that any substituted performance is inadequate to make the person whole again. Thus, when determining whether specific performance should be awarded, a party must show (1) the uniqueness of the item or act that is the subject of the original contract and (2) that no substituted performance will be appropriate.

For example, assume that you contract with a company to purchase Joan Crawford's Academy Award Oscar statuette. You have tendered the cash to the seller, but after some thought a Crawford family member decides that the sale would be offensive to Ms. Crawford's memory and refuses to sell the Oscar. (Anyone who has received one since the 1950s signs an agreement that it will not be sold.) Because the Oscar is considered unique, the court could order specific performance and force the seller to tender the Oscar for the agreed price.

If a party can show that the subject of the contract is not unique, and a substitute product can easily be obtained, the remedy of specific performance is inappropriate. In such instance, money damages would be sufficient to make the party whole again and would probably be the remedy the court would award.

Although contracts for personal services are considered unique, especially when a famous personality is involved (such as a baseball player playing for a team or an actor or actress playing a role), the courts generally will not enforce a contract by ordering specific performance. Courts have viewed this as involuntary servitude, which is offensive to courts and violate civil rights. Kim Basinger, the Academy Award-winning actress, was sued for breaching an oral contract to play a role in the movie *Boxing Helena*. Ms. Basinger claimed that a contract had not been consummated, but the studio and director promoting the movie claimed that publicity and promotions had begun based upon Ms. Basinger playing the female lead. Ms. Basinger refused to play the role and was then sued. A court could probably not force Ms. Basinger to play the role through specific performance, but she could be, and was, sued for damages. Although Ms. Basinger lost her lawsuit at the trial court and a multimillion dollar award of damages was entered against her, an appeals court has reversed the trial court on a legal issue.

State Your Case

Using the facts from the case described at the beginning of the chapter, could the producer of the Broadway musical sue Sadie Anderson for specific performance? Why or why not? How would a court address the damage issue?

injunction
A court order that commands or prohibits some act or course of conduct; form of equitable relief

temporary restraining order (TRO)
Relief that the court is empowered to grant, without notice to the opposing party and pending a hearing on the merits, upon a showing that failure to do so will result in "immediate and irreparable injury, loss or damage."

ex parte
Refers to an application made to the court by one party without notice to the other party

In cases that involve services, money damages are often the remedy—or, until a resolution can be accomplished, courts can look to an alternative equitable remedy such as injunctive relief.

Injunctive Relief

A very common type of equitable remedy, used not only in contract law but in virtually all aspects of civil litigation, is the **injunction.** An injunction can be granted when one party can show that money is insufficient compensation, that immediate and irreparable harm and injury is occurring to the party, and that it would serve the party's interests to maintain the status quo until a permanent resolution can be reached.

Injunctive relief normally progresses in three stages. In the first stage, the request is for issuance of a **temporary restraining order;** the party who is suffering immediate, irreparable harm and injury requests a court to have the other party do (or refrain from doing) something that is causing harm. Often a temporary restraining order is granted **ex parte,** and is a very temporary measure, effective anywhere from 10 to 14 days. Usually an informal hearing occurs, during which a court makes a determination as to whether it is appropriate to issue the temporary restraining order. If the order is granted, the party will be restrained from acting and a more extensive hearing is held.

Cybercises

Find five examples where a court issued an injunction, temporary or permanent, to prevent irreparable harm and injury to a party in a contracts case.

Normally, the next stage is a request for a temporary injunction. A temporary injunction is issued after a hearing and notice to all parties. Here, the injured party is requesting that the other party refrain from doing something (or be required to do something) during the pendency of the action, so that no further injury can occur. A temporary injunction may also be called a **preliminary injunction.** When a court grants the temporary injunction, it is effective only until a final trial on the merits can be had.

The final stage of injunctive relief results in a **permanent injunction.** When a court determines that the activity is one that should be forever prohibited, the court can enter a permanent injunction that absolutely prohibits the party from doing (or refraining from doing) a certain act. Injunctions are commonly used in the contracts areas of covenants not to compete and construction contracts.

preliminary injunction An injunction granted prior to a full hearing on the merits. Its purpose is to preserve the status quo until the final hearing

permanent injunction An injunction granted after a final hearing on the merits

Rescission

When parties voluntarily agree to set aside a contract, this is known as *voluntary* **rescission.** Under voluntary rescission, all the parties' obligations are discharged under the contract with no negative consequences. This form of rescission normally takes place in the early stages when neither party has begun performance.

However, rescission can also take the form of an involuntary cancellation or termination of the contract due to breach by one of the parties to the contract. This is known as *unilateral rescission.* When this occurs, the injured party may ask the court to cancel the contract and restore to the injured party whatever consideration has been paid. Unilateral rescission is very common in mistake, fraud, and misrepresentation cases.

rescission The abrogation, annulment, or cancellation of a contract by the act of a party. Rescission may occur by mutual consent of the parties

Reformation

Reformation is another form of equitable remedy. To avoid an injustice, a court may "rewrite" or modify a contract to reflect the true agreement of the parties. Through the rewriting process, the court can reflect the parties' true intentions and meanings, so that injustice is avoided. This is a very common method of avoiding unfairness, and is often used in mistake cases. But in *Speranza v. Repro Lab., Inc.*, 875 N.Y.S. 2d 449 (N.Y. A.D. 2009), a New York court refused to rewrite and reform a contract used at a sperm bank.

reformation An equitable remedy available to a party to a contract provided there is proof that the contract does not reflect the real agreement

Line of Reasoning

This is a case where parents wanted to preserve the sperm that their recently deceased son had donated to a Clinic. In 1997, Mark Speranza deposited sperm specimens, which were frozen and stored in Repro Lab's liquid nitrogen vaults. No reason was given for the donation, except to say that it appears that Mark may have known he was ill. When Mark preserved the sperm, he signed an agreement with Repro stating that, in the event of his death, "I authorize and instruct Repro Lab to destroy all semen vials in its possession." The document further states that "[t]his agreement shall be binding on the parties and their respective assigns, heirs, executors and administrators." Mark died on January 28, 1998. Mark's parents became the administrators of his estate. They contacted Repro to determine whether they could preserve the sperm for donation. Repro believed that they could not, but Mary Speranza pleaded with Repro to allow her to determine her rights. Repro agreed as long as she paid the annual fee, which she did. The Speranza's found a surrogate and inquired with Repro what the

procedure was for obtaining the specimens. At that time, Repro produced the agreement Mark had signed. Again, Mrs. Speranza requested Repro to not destroy the specimens. Repro did not as long as the annual fee was paid. Mark's parents filed a lawsuit seeking to declare that the estate was the rightful owner of the specimens. The Speranzas claimed that by accepting the annual payments, the lab breached the contract terminating its agreement with Mark. The Speranzas also sought an injunction to preserve the specimens pending the outcome of the lawsuit. The court had a number of issues to confront, not the least of which was the parents' desire to try and have a surrogate have their grandchild. One of the issues was the requirement under New York law to perform testing (e.g., for HIV) on donors or depositors, especially those who are having specimens used by a stranger, i.e., not them or their regular partner. Because Mark had not been properly tested, Repro could not release the specimens. (They did not want to violate New York law.) But most importantly, Mark's parents sought to reform the contract by eliminating the directive to destroy the specimens upon Mark's death. The court defined when reformation of an agreement will occur. It stated that:

> Reformation is an equitable remedy which emanates from the maxim that equity treats that as done which ought to have been done. The purpose of reforming a contract on the basis of mutual mistake is to make a defective writing conform to the agreement of the parties upon which there was mutual assent. While the erroneous instrument must be made to correctly express the real agreement between the parties, no court can make a new contract for the parties.

The court concluded that the agreement was clear and unambiguous. Nothing that Mark's parents presented could be construed as a basis to correct the agreement in order to express the parties' real intent. The intent of the agreement was clear—that the specimens were to be destroyed upon Mark's death. There was nothing to warrant reforming the contract. Additionally, the fact that Mark's parents paid the annual storage fee did not create a relationship between them and Repro which would change the terms of the contract Mark signed. The parents had no legal right to their son Mark's specimens.

Questions for Analysis

Review *Speranza v. Repro Lab*. Had New York not had a statute governing the situation, would the court have had a different result? Why or why not? When ethical and moral issues arise in a contract that were not contemplated by the initial parties, should a court consider the personal circumstances of the parties in ruling? Why or why not?

10.4 RESTITUTION AND RELIANCE AS A REMEDY

Equity attempts to avoid injustices that may occur in the legal process. Injustices are sometimes remedied by either *restitution* or *reliance* damages.

restitution
In both contract and tort, a remedy that restores the status quo; returns a person who has been wrongfully deprived of something to the position occupied before the wrong occurred

Restitution

Restitution damages prevent another party from being unjustly enriched because of a breach by a party's acts. Restitution focuses on the value of the benefit received by a party that was unjustly obtained. Restitution can be awarded in a breach contract claim or a quasi-contract claim.

When a party has breached a contract, the nonbreaching party has the option of suing for restitution or damages. However, the nonbreaching party can request restitution damages only if there has not been full performance of the contract. If full performance has not occurred, the nonbreaching party can request recovery for the amount of enrichment received by the breaching party, even if the restitution damages exceed the original contract price. The rationale behind such a result is that the wrongdoer should not profit from its wrongful act. Consequently, courts may not limit restitution recovery to the actual contract price.

When considering whether restitution is the appropriate choice of remedies, courts pose the following questions:

1. Was the breach material?
2. Was there partial performance by the nonbreaching party?
3. Did the breaching party receive any benefit from the partial performance?

If the answers to these three questions are yes, a party has the option of requesting compensation for the reasonable value of the benefit received. Courts will then evaluate the benefit received to determine the appropriate award to the nonbreaching party. What is critical to the analysis is that full performance has not been rendered; otherwise, the appropriate remedy is compensatory damages.

Quasi Contract. Chapter 2 discusses the concept of quasi contract, under which the court, to prevent unjust enrichment, will find a contract. This is also known as a **quantum meruit.** Under the doctrine of quantum meruit (as much as one had earned), a court can award a specific amount to a party who has been damaged because of an unjust benefit to another party. Ordinarily, the court will not allow one party to benefit at the expense of another. Even if a contract was not mutually agreed upon, when a party has derived benefits from a contractual relationship through an implied in law contract, the court will allow an amount of damages to compensate the claiming party for the benefit bestowed. This is a form of restitution damages. An example of restitution in quasi-contract cases is when a doctor performs emergency medical treatment on a patient without a formal agreement. Restitution in the form of payment for the services would be appropriate.

quantum meruit
The doctrine of quantum meruit makes a person liable to pay for services or goods that he or she accepts while knowing that the other party expects to be paid, even if there is no express contract, to avoid unjust enrichment

Reliance Damages

The focus of reliance damages is the detrimental **reliance** of the nonbreaching party. Because one party has changed its position in reliance that the other party would perform under the contract, a court can award damages for the amount expended in reliance upon performance. The court thus looks to returning the nonbreaching party to the same position it was in prior to entering into the contract. Section 139 of the *Restatement* sets out when reliance damages are appropriate:

reliance
Remedy to prevent unjust enrichment; quantum meruit

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promise or a third person and which does induce the action or forbearance is enforceable notwithstanding the Statute of Frauds

if injustice can be avoided only by enforcement of the promise. The remedy granted for breach is to be limited as justice requires.

(2) In determining whether injustice can be avoided only by enforcement of the promise, the following circumstances are significant:
   (a) The availability and adequacy of other remedies, particularly cancellation and restitution;
   (b) The definite and substantial character of the action or forbearance in relation to the remedy sought;
   (c) The extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence;
   (d) The reasonableness of the action or forbearance;
   (e) The extent to which the action or forbearance was foreseeable by the promisor.

Normally, in a reliance case, one of the parties who promised to perform fails to do so and the party who relied on the promise expends money and time in reliance on the promise to perform. Although in a reliance case a part may want to seek lost profits, which are often difficult to prove and speculative, a court will award reliance damages for the monies expended during the time period the party believed a contract was in place. Since determining the actual damages would be difficult because they are speculative or uncertain, a court may award reliance damages.

Reliance damages also can be awarded under a theory of promissory estoppel. In a promissory estoppel case, the injured party relied to their detriment on the other party's promise to enter into a contract. Sometimes a court will award expectation damages—actually treating the case like a breach of contract case—or a court may simply award the expenses expended on reliance on the agreement. Courts have wide latitude in determining the appropriate measure of damages. A case that ordered reliance damages based upon a theory of promissory estoppel involved the Queen of Soul—Aretha Franklin. (For all you Motown lovers, this one's for you!)

Line of Reasoning

Elvin Associates v. Franklin, 735 F. Supp. 1177 (S.D. N.Y. 1990) involves a lawsuit between a New York producer who thought he had hired Aretha Franklin to play Mahalia Jackson in the musical version of her life on Broadway. Sometime in 1984, Ms. Franklin was contacted by Ashton Springer, a principle in Elvin Associates. He wanted Franklin to play Mahalia Jackson in a Broadway production. Expressing interest, Franklin told Springer to contact her agent. Springer did just that. Negotiations commenced and finally in February of 1984, the agents communicated that Ms. Franklin had agreed to the terms of the contract to play on Broadway. Besides working out the financial terms with Franklin's agent, Springer dealt directly with Franklin on the artistic and production matters. The two even spoke about dates with Franklin's response being "This is what I am doing." As a result, Springer hired a choreographer, George Faison. Springer and Faison flew to Detroit to meet with Franklin to discuss details of the production including the rehearsal

schedule. They agreed to a tentative April date with the performances to begin in May of that year. After that meeting, Springer began getting his financing together, contacted theaters to reserve performance dates and contacted designers for the costumes and production. Around that time, Springer heard that Franklin had been canceling performances due to a newly acquired fear of flying. Concerned, Springer contacted both Franklin and her agents, who assured him that there were no problems with her remaining in the production. Springer even offered alternative transportation by ground, but Franklin assured him that it was unnecessary. While all this was happening, Springer contacted his attorney to finalize all the contracts. All financial terms had been worked out including Franklin's salary and other financial requirements. Again, Franklin's agents communicated that everything was still "a go." The only point that still needed discussion was where the rehearsals would take place. Franklin wanted Detroit, but Faison stated that because of all the people involved in the production, the rehearsals had to be in New York. Additionally, as part of the contract, Ms. Franklin included her standard rider where at the end it stated "This contract/agreement shall not be deemed valid until executed by ARTIST." And, it also stated "DO NOT DEVIATE." Although drafts were exchanged, the above was not inserted because the parties had already begun performance on the contract and believed it was unnecessary. From the beginning of May until June 7, the day rehearsals with Franklin were to start, no material changes were made to the terms of the contract. It is important to note that production continued in full swing, with Franklin even singing one of the songs for the show over the telephone to Springer.

On June 7, the first day of rehearsals Franklin was a "no show." The explanation was that Franklin refused to fly. Springer paid the cast for the week and tried to find another star to play the role. He was unsuccessful. A few months later Springer tried to revive the production, but was unable to secure the necessary financing. Springer sued Franklin for breach of contract. In the reasoning of the case, the court found the language in the rider important and essentially dismissed the breach of contract action. But as the court stated, "[t]hat, however, does not end the case." Springer had asserted an alternative theory of recovery based upon a theory of promissory estoppel. The court set forth the elements of a claim based upon promissory estoppel, which are:

> A clear and unambiguous promise; a reasonable and foreseeable reliance by the party to whom the promise is made; and an injury sustained by the party asserting the estoppel by reason of his reliance. (citations omitted) The "'circumstances [must be such as to render it *unconscionable* to deny' the promise upon which plaintiff has relied." (citations omitted).

The court then aptly stated [i]t is difficult to imagine a more fitting case for applying the above-described doctrine." All the facts support the theory that Springer relied upon Franklin's representations; that she was enthusiastic about the production and intended to perform. She had even committed to the basic financial terms of the contract through the agents, although a formal contract had not been signed. This provided a basis for Springer to begin pulling the production together. Additionally, the court found that Franklin did not give any indication that she did not intend to perform. Quite the contrary, she was active in all aspects of the negotiations and production details. Third, Franklin's fear of flying did not add a condition to the contract nor create an ambiguity. In fact, the court stated that it was reasonable to assume that Franklin would find alternative means of transportation to New York if she could not conquer her fear. Therefore, it would be unconscionable not to compensate Springer for the losses he incurred base entirely justified upon his reliance on Franklin's oral promises."

There was a separate opinion on the damages. A magistrate judge did an investigation. The recommendation to the trial court was that Springer should be awarded: $52,182.12 in out-of-pocket expenses with interest; and, $182,181.95 for various unpaid debts. Ultimately, the court forced Franklin to pay $209,360.07 in reliance damages.

Questions for Analysis

Review *Elvin and Associates v. Franklin*. What facts in the case would have changed the result in favor of Aretha Franklin? Was the court's award of reliance damages reasonable under the circumstances? Why or why not?

State Your Case

Using the facts from the fact pattern at the beginning of the chapter, would the producer have an argument for reliance damages? What is the basis of your response?

As the *Franklin* case recognized, reliance damages are an equitable remedy when a party reasonably relies on a party's promise to enter into a contract. For a summary of equitable remedies, review Exhibit 10-2.

EXHIBIT 10-2 Equitable remedies

Equitable Remedies					
Specific Performance (compels a party's performance to perform a contract)	**Injunctive Relief** (prevents or commands a party to act or refrain from acting because of irreparable harm or injury)	**Recission** (two types: **voluntary,** where parties agree to cancel contract, and **involuntary,** where one party cancels or terminates the contract)	**Reformation** (court-imposed remedy that rewrites contract to reflect true intentions of parties)	**Restitution** (prevents unjust enrichment of one party. Focuses on value received by a party)	**Reliance Damages** (usually awarded in expectation cases or where party expended money in reliance on party's promise of contract)

TECH CHECK

Outsourcing as a Remedy

In a virtual world, more and more services are being delegated to independent contractors through outsourcing. Outsourcing involves transferring an internal service or process to outside contractors or vendors. One issue that arises in the outsourcing arena is, of course, client confidentiality. Thus, as outsourcing becomes

more prevalent, the process of protecting a client's information becomes even more important. Outsourcing takes all forms and entails many functions, such as document review, billing, discovery, and litigation support. With outsourcing, you will effectively be data sharing, which will require you to know and understand the best methods of transferring data securely. Data transfers can take many forms, but commonly are through extranets, file transfer protocols (FTP) or virtual private network access (VPN). How a data transfer occurs depends on your firm or employer's protocols. When dealing with an outside vendor, be sure you are protecting the data you are sending and have a back-up plan if the data is lost, destroyed, or damaged. Regardless of the process, always be thinking ahead as to how to protect the client (and your interests) as the practice of law in the virtual world continues to evolve.

10.5 ELECTION OF REMEDIES

election of remedy A requirement in the law that a party to a lawsuit must choose between different types of relief allowed by law on the same set of facts. The adoption of one has the effect of barring use of the others

When two or more available remedies for a breach of contract action exist, but are inconsistent, a party may be required to make an **election of remedy.** Under this doctrine, when remedies are mutually exclusive, a party elects one remedy or another and is bound by the remedy chosen. After choosing one remedy over another, the party cannot go back and request another remedy hoping for a better result. Once the election is made, the choice is absolute.

Remedies that are mutually exclusive are compensatory damages and restitution damages. A party cannot ask for both, as this may result in a prohibited double recovery. Consequently, when analyzing a remedy, the following questions should be asked:

1. Has performance begun?
2. If so, has the performance been completed?
3. Does the client require a legal remedy or an equitable remedy?
4. If a legal remedy, what type of damages has the party suffered?
5. If an equitable remedy is appropriate, which one?
6. Are the remedies chosen mutually exclusive? If so, which remedy should be elected?

10.6 PRACTICAL APPLICATION

Paralegals will find many different types of remedy clauses in contracts. One type of clause that must be carefully analyzed is a liquidation clause, as it cannot appear to act as a penalty. Careful drafting can avoid the pitfalls that may accompany a liquidated damages clause. Remember, the amount of the liquidated damages clause can dictate its validity. Consequently, consideration of a client's situation is critical. Exhibit 10-3 illustrates some helpful language.

EXHIBIT 10-3 Sample liquidated damages clauses

Liquidated Damages

In the event either party should breach this contract, the parties agree that the breaching party shall pay to the other party the sum of _____ dollars ($____) as liquidated damages.

Liquidated Damages for Violation of Covenant Not to Compete

Employee agrees that in the event of violation by employee of the agreement against competition contained in this agreement, employee will pay as liquidated damages to employer the sum of _____ dollars ($____) per day, for each day or part thereof that employee continues to so breach such agreement. It is recognized and agreed that damages in such event would be difficult or impossible to ascertain, though great and irreparable, and that this agreement with respect to liquidated damages shall in no event disentitle employer to injunctive relief.

Delay in Completion of Contract—Liquidated Damages

For each and every day that the work contemplated in this agreement remains uncompleted beyond the time set for its completion, [first party] shall pay to [second party] the sum of _____ dollars ($____), as liquidated damages and not as a penalty.

The sum stated in the immediately preceding paragraph may be deducted from money due or to become due to [first party] as compensation under this agreement.

In addition, many contracts set forth the general provisions for remedy in the event of a breach. Some examples of these provisions are found in Exhibit 10-4.

EXHIBIT 10-4 Sample remedy provisions

Remedies for Breach of Employment Contract

Any breach or evasion of any term of this agreement by either party will cause immediate and irreparable injury to the other party and will authorize recourse by such party to injunction and/or specific performance, as well as to all other legal or equitable remedies to which such party may be entitled under the provisions of this agreement.

Remedies as Cumulative

All remedies transferred to either party by this agreement shall be deemed cumulative of any remedy otherwise allowed by law.

Breach of Contract—No Liability by Seller for Incidental or Consequential Damages

In no event shall seller be liable for incidental or consequential damages nor shall seller's liability for any claims or damage arising out of or connected with this agreement or the manufacture, sale, delivery, or use of the products with which this agreement is concerned exceed the purchase price of such products.

SUMMARY

10.1 There are two general types of remedies: legal and equitable. A legal remedy is a monetary remedy, whereas an equitable remedy is a nonmonetary remedy. If money damages will suffice, equitable remedies are not available. The type of injury will dictate the type of remedy.

10.2 Legal remedies are known as damages. Damages may be compensatory, consequential, punitive, nominal, or liquidated. Compensatory damages are the actual amount lost by the injured party. Consequential damages are the damages that are a direct consequence of the breach. Damages that are rarely awarded in contract cases are punitive or exemplary damages; these are punishment or penalty damages. Nominal damages are token damages and are awarded when the actual amount of damages is not proved. Liquidated damages are agreed to in the contract, but must not be excessive. In any damage case, the injured persons are required to mitigate their damages.

10.3 Equitable remedies are nonmonetary remedies that include specific performance, injunctive relief, rescission, reformation, restitution, and reliance. Specific performance is forced performance on a contract. Injunctive relief acts to restrain a party from doing something or to require that something be done. There are three stages: temporary restraining order, temporary injunction, and permanent injunction. Rescission is when parties agree to set aside their contract. Reformation is when a court corrects a contract. These types of remedies are available only if damages will not make the party whole again.

10.4 Restitution is another remedy which prevents another party from being unjustly enriched as a result of a party's act. Restitution is awarded in breach-of-contract cases and quasi-contract cases. Reliance damages award a party money when a change of position occurs in reliance that another party will perform on a contract, but the performance does not occur. For quasi-contract or unjust enrichment actions, restitution may not be an appropriate measure of damages.

10.5 Parties are required to elect a remedy when more than one remedy is available but they are mutually exclusive. Compensatory and restitution damages are mutually exclusive; therefore, one must be chosen over the other.

KEY TERMS

legal remedy
damages
equitable relief (equitable remedy)
compensatory damages (actual damages)
consequential damages
speculative damages
punitive (exemplary) damages
tort
treble damages
nominal damages
mitigation of damages
lessee
specific performance
injunction
temporary restraining order (TRO)
ex parte
preliminary injunction
permanent injunction
rescission
reformation
restitution
quantum meruit
reliance
election of remedy

REVIEW QUESTIONS

1. What is the difference between a legal remedy and an equitable remedy?
2. What are the various types of legal remedies?
3. Define compensatory damages.
4. Distinguish between compensatory damages and consequential damages.
5. When are exemplary damages awarded in contract law?
6. What is the doctrine of mitigation of damages?
7. Identify the equitable remedies.
8. Define specific performance and explain when it may be awarded by a court.
9. What are the general stages for injunctive relief?
10. When can restitution be elected as an equitable remedy?

EXERCISES

1. Joe Valentine, an avid baseball card collector, went to purchase a Nolan Ryan rookie card at Sports Card World in Arlington, Texas. After browsing awhile, he found the Nolan Ryan card he was looking for. A young clerk asked Mr. Valentine if he could be of assistance. Mr. Valentine pointed to the Ryan card. The clerk quickly looked at the price and said the card was $100. Valentine was surprised at the low price, as he was prepared to go up to $900. Wasting no time, Valentine wrote Sports Card World a check and basked in his find. A day later, Mr. Valentine received a telephone call from the owner of Sports Card World. The owner was very upset that the clerk had misread the price and the real price for the card was $1,100, not $100. The store owner stated he would refund Valentine's $100 and apologized. Mr. Valentine refused the refund and stated that they had a contract. Sports Card World sued Mr. Valentine. Discuss all issues and remedies the court would consider.

2. Your attorney has just been retained by a new client, Cannon Construction Company. It appears that Cannon entered into a contract with Speedy Lumber Company whereby Speedy was to supply the lumber for Cannon's construction project with the City of Indianapolis. The contract was for $50,000, with delivery to be June 15, 2010. Time was important to Cannon. The contract had a liquidated damages clause for $60,000 in the event either party breached. Speedy had problems with its supplier in Washington State and called Cannon stating that they could not ship the lumber until June 30, 2010. Cannon was furious. What rights and remedies does Cannon have against Speedy?

3. Paul is a wealthy collector of rare stones. It has recently come to his attention that the famous "Faith diamond" is for sale. The Faith diamond is a magnificent 15-carat stone which has been in the possession of the Vandergeller family for generations; however, the Vandergeller's have decided to sell the Faith diamond to raise enough money to pay certain vexatious creditors. The eldest son, KiKi, is the family's representative for the purpose of selling the Faith diamond for the best possible price.

Paul contacted KiKi and offered him $5 million for the precious stone. KiKi accepted Paul's offer. Paul then immediately sent KiKi the following letter via telecopy:

May 19, 2010

VIA: FAX AND REGULAR MAIL
FASCIMILE NO. 123-456-7890

Your Highness KiKi
The Vandergeller Mansion
900 Britain Way
London, England B98ENG8

Re: Sale of Faith Diamond

Dear KiKi:

The purpose of this letter is to confirm our conversation regarding the sale of the Faith diamond (the "Diamond").

I have agreed to tender the sum of $5,000,000 in the form of a certified check (the "Check") to you within ten (10) days from the date of this letter, and you having the authority to do so, on behalf of your family have agreed to deliver the Diamond to me within five (5) days after receiving my check. The Diamond will be delivered to the address printed on this letterhead.

Please contact me if you believe the above terms do not accurately represent our conversation.

Of course, if you have any other comments or questions regarding the foregoing, please do not hesitate to call.

Very truly yours,

Paul

Two days later, KiKi agreed to sell the diamond to an Arab sheik for $8 million. The sheik knew that $8 million was well above the fair market value, but as he explained, "What do I care, it's only money." The sheik paid KiKi in full immediately. According to the terms of the agreement between KiKi and the sheik, the diamond was to be delivered within 21 days from the date of payment.

Of course, as a matter of courtesy, KiKi informed Paul that the diamond has been sold to someone else. Paul, who incidentally has a genuine love and

admiration for this precious stone, is disappointed. Paul appeals to KiKi's sense of decency and asks KiKi to honor the agreement between them. KiKi apologetically declines.

Paul comes to you for advice. Describe to Paul his remedies, if any, against KiKi, the Vandergellers, or the Arab Sheik.

4. Real Estate tycoon, Donald Barrett, has a new project in downtown Chicago. It is a 50-story upscale condominium tower overlooking the river. Barrett decided to offer the condos to his friends and family at a discounted price. The preconstruction price was $760 a square foot. As the project progressed, the sale price for the units began to increase dramatically. Units in the building were selling for $1500 a square foot, which was a nice increase for Barrett's friends and family. Not so fast claims Barrett. He notifies the "friends and family" buyers that their contracts are canceled. If they still want the condo's they will have to pay closer to the current market price. The basis of Barrett's contract cancellation is a clause in the contract which states:"Seller has the right to cancel this contract if the initial purchase price increases more than 25 percent of the initial costs. A full refund of the earnest money will be tendered to the buyer. This is the exclusive remedy of the purchaser." One of the purchasers, Bill Marley, is not happy. He thought that Barrett's offer was because he was a loyal friend. So much for friends. He wants to challenge the clause. What remedies does Bill have against Barrett? What are Barrett's arguments in defense of his actions? Discuss all issues.

5. Crystal Auction House was presenting for auction a rare sculpture of a dragon from the Ming Dynasty. A collector of Chinese art bid on a dragon. The collector's bid was the winning bid in the amount of $30 million. When he was notified that he was the successful bidder, he refused to pay. He claimed that he never had any intention of paying for the sculpture because he believes the sculpture was looted and belonged to the Chinese government. What remedies does the Crystal Auction House have against the art collector?

6. Lou wanted to decorate his apartment, but he knew that he was hopeless in design. He was a bit color blind. He heard of this great designer who was decorating for the East Hampton crowd. The designer was Carson Caswell. He met with Carson and loved his ideas. Carson began the renovation and design on his apartment; then, ten days into the project, Carson left a letter for Lou stating that he had opportunities in LA and was off to California. Lou could not believe it. He had invested $50,000 in the renovation already and who knows what it would cost to hire someone else. Lou was not having any of this. Lou decided that Carson needed to finish the job. What actions in equity could Lou file to force Carson to perform? Are there legal remedies which would be sufficient to make Lou whole? Discuss all issues.

7. Using the facts from No. 6, except that Carson sends a replacement Keith Korrs to finish up the project. Lou is furious as he hired Carson not a substitute. Does Lou have to accept Keith as the designer to finish the renovation of his

apartment? Explain your response. What legal or equitable remedies does Lou have against Carson? Against Keith? Explore all areas.

8. Jake contracts with Berry Berry Farms for 100 pints of strawberries, 100 pints of blueberries, and 100 pints of raspberries at $2000 to prepare his award winning desserts. He needs the berries by June 30 because he is contracted to prepare the desserts for a big banquet in Hollywood. On June 15, Berry Berry Farms notifies Jake that it will not be able to meet his needs and cancels the order. Jake sues Berry Berry Farms and wins a breach a contract action. The court has a separate hearing on damages. At the hearing Berry Berry presents evidence that other farms in the area had the different types of berries to deliver to Jake for his desserts. Jake never attempted to find another supplier. What damages should the court award Jake? Would your response be different if Jake did attempt to find other suppliers but no farm was able to produce the amount of berries he required?

9. Madeline was in charge of the "Debutante Cotillion." Each year the room was decorated with beautiful flowers. It was their signature. This year Madeline contracted with a new florist, Floral in Motion, who she heard did unique flower designs. A contract was signed by the parties which identified the date of the cotillion was April 17. The price for all the flowers was $10,000. On the day of the cotillion, no one from Floral in Motion showed up. Madeline called and called, but there was no answer, only an answering machine. To say that Madeline was furious was an understatement. She wanted blood! Floral in Motion shows up the next day with the flowers. Apparently, they had the wrong date. Madeline sues Floral in Motion. What are the damages that Madeline is entitled to? Can Madeline recover punitive damages?

10. Jack Wallston wanted to make an offer to purchase a house from Lionel Ingram. The purchase price for the house was $355,000. In the contract for the purchase of the house was a clause that stated "Buyer shall pay a nonrefundable $15,000 earnest money deposit. In the event of default by the Buyer, earnest money shall be forfeited to Seller as liquidated damages, unless Seller elects to seek actual damages or specific performance." Additionally, the contract contained another clause that stated "Buyer represents that buyer has sufficient funds to close this sale in accordance with the agreement and is not relying on any contingent source of funds unless otherwise set forth in this agreement." Wallston went to the bank to secure financing. The bank offered financing, but also added that Wallston had to secure $100,000 of his own money for closing. Not happy, Wallston sought financing elsewhere. The contract initially had a closing of September 15, but Wallston requested that it be extended to October 1. Ingram refused. He also realized that Wallston did not have adequate money to secure financing. He placed the house back on the market. Ingram received an offer on September 25. Wallston was still having problems with his financing. He contacted Ingram to let him know that he was still trying to get financing for the house. He needed additional time. Ingram notified Wallston that he had found another buyer and that he was going to institute an action for the earnest money deposit. Since Wallston did not secure financing, Ingram believed he

was entitled to the earnest money deposit. Your attorney asks you to answer the following questions:

a. Were the liquidated damages enforceable in your jurisdiction? Explain your answer with a discussion of the law.
b. What defenses, if any, could Wallston raise against Ingram?

CASE ASSIGNMENTS

1. A new client just called to set up an appointment regarding his contract with State University. Apparently, the new client is the "former" basketball coach for State University's Women's Basketball team. The team has the best record in Division One. All you know is that the coach was terminated. The coach faxed a copy of the contract prior to the meeting which contained a Liquidated Damages Clause. Two provisions that caught your attention were the following: The parties agree that should another coaching opportunity be presented to Ms. DiAngelo or should Ms. DiAngelo be interested in another coaching position during the term of this Contract, she must notify the University's Director of Athletics of such opportunity or interest and written permission must be given to Ms. DiAngelo by the Director of Athletics before any discussions can be held by Ms. DiAngelo with the anticipated principal. This contract is for five years. In the event DiAngelo fails to remain at University for the term of five years, DiAngelo shall pay to the University as liquidated damages an amount equal to her base salary, less amounts that would otherwise be deducted or withheld from her base salary for income and social security tax purposes, multiplied by the number of years [or portion(s) thereof] remaining on the contract. DiAngelo's original salary was $200,000. The contract did provide for annual increases. You are preparing for the meeting. Make a list of the questions that should be asked Ms. DiAngelo so your law firm can prepare the case.

2. Continuing with the facts from 1, you learn that there was a modification in year 3 of the contract that extended DiAngelo's contract for another five years. The modified contract was signed on July 20, 2010. All terms remained the same except that DiAngelo's salary increased to $400,000 per year and now included a monthly car allowance of $500.00 and a monthly housing allowance of $2000. In the meeting you learn that DiAngelo was offered a job with College A&M. DiAngelo has been sued by State University under the contract. The University is seeking enforcement of the liquidated damages clause, breach of contract, and specific performance. Your attorney wants you to research the issues that are relevant to the case and prepare a memorandum addressing DiAngelo's issues and possible defenses. (Note: If you are assuming certain facts for your memorandum, be sure to include them in the fact section.)

Chapter 11

Third-Party Contracts

Just Suppose . . .

For years, your favorite band was Aerosmith. You think that the lead singer Stephen Tyler is the best vocalist in rock history. They are touring in the United States, and you discover that they are performing in Detroit, just a couple of hours away from where you live. You and a bunch of your friends buy tickets that cost $200.00 each—a high price, but seeing Tyler sing in person is worth it! Since the concert starts at 8 P.M., you decide to stay at a hotel near the stadium where Aerosmith is performing. You and your friends arrive early and are ready for the concert of a lifetime. The band comes onto the stage opening with "Dream On." But the voice coming from the singer on stage is not Stephen Tyler. You are incensed. You and your friends want your money back. You came to see Stephen Tyler and only Stephen Tyler—not a substitute. You go to the box office and demand your money back. They refuse. You and your friends decide to sue. No one can substitute for Stephen Tyler, no one. This situation presents a question as to whether a third party can substitute performance for another. But more importantly, was there a proper delegation of Tyler's duties to another singer? This chapter addresses the different types of third-party relationships in contracts.

Outline

11.1 DEFINING THE RELATIONSHIP IN THIRD-PARTY CONTRACTS

In the definition of contracts, the law focuses on an exchange between two parties, the promisor and the promisee. The contract sets out each party's duties and obligations, with performance being the final phase of completion of the contract. There are situations, though, when the promisor and the promisee intend for a third party, who is not directly involved in the contract, to reap advantages from the contractual relationship. This situation involves what is known as a **third-party beneficiary contract**. A third-party beneficiary contract requires an original agreement between the promisor, the promisee, and a third party who benefits from the original contract. The person who benefits from the contract, who is known as a **beneficiary**, is a person or entity who will receive benefits from a contract. The beneficiary may or may not know of the benefits to be received.

third-party beneficiary contract
A contract made for the benefit of a third person

beneficiary
1. A person who receives a benefit from a contract
2. A person who is entitled to the proceeds of a life insurance policy when the insured dies

The law categorizes beneficiaries into two groups: intended beneficiaries (which include donee beneficiaries and creditor beneficiaries) and incidental beneficiaries. The *Restatement (Second) of Contracts,* § 302 describes intended and incidental beneficiaries as follows:

(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties, and either
   (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
   (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

Note that the definition of an incidental beneficiary is by exclusion. Although the *Restatement* blurs the distinction between the various intended beneficiary categories, the most widely recognized are donee and creditor beneficiaries.

Intended Beneficiary

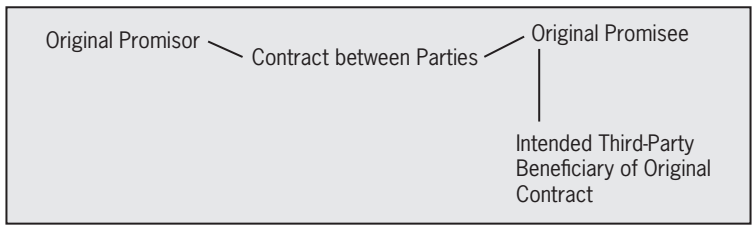
If when contracting, the parties intend a specific third party to benefit, that party is an **intended beneficiary**. The intended beneficiary is not directly involved in the contracting process, yet the process will affect his or her rights. To determine whether a third party is an intended beneficiary, ask three basic questions:

intended beneficiary
Third party who will specifically benefit from a contract

1. Did the promisee *intend* the third party to benefit from the contract?
2. Did the beneficiary *rely* on the contractual rights conferred?
3. Did the performance run directly from the promisor to the third-party beneficiary?

If any of these questions are answered yes, the third party is probably an intended beneficiary of the contract. Exhibit 11-1 illustrates a third-party intended beneficiary situation.

EXHIBIT 11-1 Third-party intended beneficiary relationship



Donee Beneficiary

donee beneficiary
Third-party beneficiary to a contract. The benefit is in the form of a gift which may be revoked

donee
A person to whom a gift is made

A type of intended beneficiary is a **donee beneficiary**. In this circumstance, a promisee makes a gift to the third-party **donee** who benefits in some way from the contractual relationship between the original promisor and promisee.

The most common donee beneficiary situation involves life insurance policies. One person agrees to purchase insurance on his or her own life, or the life of another person, and names a third person as beneficiary. If the insured person dies, the beneficiary receives the proceeds of the life insurance policy. The promisor is the insurance company and the promisee is the insured, who may be a spouse, for example. The survivor, often a spouse, is the intended donee beneficiary. As this situation suggests, in a donee beneficiary situation, the benefit flowing from the contract is a gift. Consequently, a person may choose to change the intended beneficiary without obtaining the agreement of that intended beneficiary. This is often done using a change of beneficiary form provided by the insurance company. Exhibit 11-2 is a sample change of beneficiary form.

EXHIBIT 11-2 Sample change of beneficiary form

Election of Change of Beneficiary of Life Insurance Policy

In accordance with the provisions of Policy No. _____, I hereby elect to change the beneficiary as follows:

(Name)	(Date of Birth)	(Relationship to Insured)
(Name)	(Date of Birth)	(Relationship to Insured)
(Name)	(Date of Birth)	(Relationship to Insured)

I request that this change be endorsed on the policy. By this election I hereby revoke all other and former designations. I make this election subject to all of the conditions and provisions of the policy as well as any existing assignment and, unless otherwise provided by me in this application for change of beneficiary, I expressly reserve the full and absolute right to make other and further changes at any time I may elect. It is understood and agreed that all decisions upon questions of fact in determining any unnamed beneficiaries herein designated, made by the Company in good faith, based on proof by affidavit or other written evidence satisfactory to it, shall be conclusive and fully protect the Company in acting in reliance thereon.

I represent and certify that no insolvency or bankruptcy proceedings are now pending against me.

Upon endorsement of the change of beneficiary as above requested, the policy should be returned to (name of insurance company) at (address).

It Witness Whereof, I have hereunto set may hand and seal, this _____ day of _____, 20 _____.

_____
Owner of Policy

_____
Acknowledgement or Witness

Cybercises

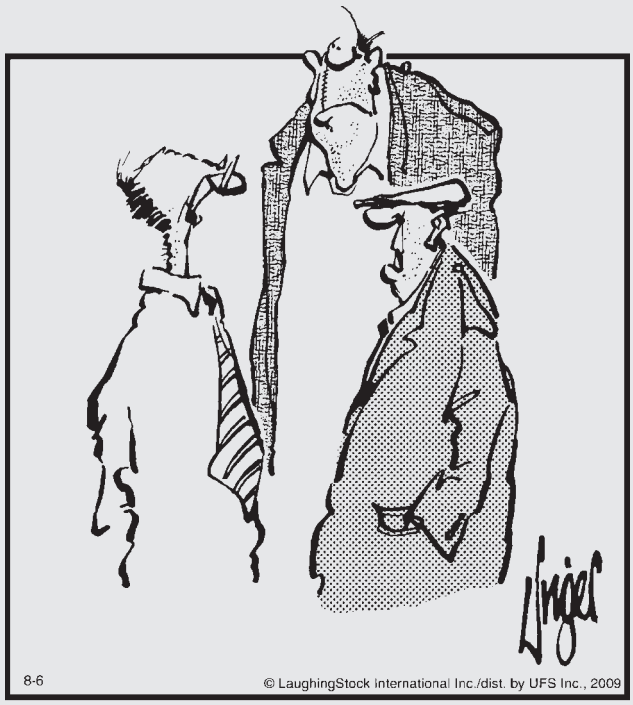
Locate an example of a change of beneficiary form on the Internet. Prepare the form with you as the new beneficiary; the original beneficiary, one of your family members, and the original promisor is either a spouse, parent, family member, significant other, or whoever you choose.

One issue that often arises is whether the donee beneficiary has a right under the contract to the benefits, once promised. If the beneficiary has a vested right in the contract, the designation of beneficiary may be irrevocable unless the beneficiary consents to any changes in the contractual arrangement. Whether the donee beneficiary has a vested interest in the contract is determined by a court.

Creditor Beneficiary

creditor beneficiary
A creditor who is the beneficiary of a contract made between the debtor and a third person

A **creditor beneficiary** is a third party to whom the promisee owes a legal duty and obligation. This relationship often arises out of a debt. The creditor beneficiary benefits from a contractual arrangement between the promisor and promisee, whereby the promisee will pay the third-party creditor beneficiary an amount due and owing by the promisor. In this situation, the creditor beneficiary has the right to enforce the original contract in the event of a breach. Review *Galvan v. Jackson Park Hospital*, 187 Ill. App. 3d 774, 543 N.E. 2d 822 (1989), which distinguished between a donee beneficiary and a creditor beneficiary.



"This is my nephew, Eric. He wants to borrow that $100 you've owed me for the past four years."

Herman: © Jim Unger / Dist. by United Feature Syndicate, Inc.

Cybercises

Using various search engines on the Internet, find examples of donee beneficiary and creditor beneficiary situations. (Go beyond the typical insurance or debtor situations such as the *Galvan* case in the Line of Reasoning section.)

Line of Reasoning

In *Galvan v. Jackson Park Hospital*, the court was faced with an interesting fact situation. William Galvan became a patient at Jackson Park Hospital on January 16, 1981. He was admitted for medical and psychiatric care. Several days after being admitted, Galvan attempted to hang himself rendering him comatose until his death.

Galvan's family intended to sue the hospital for claims it may have had for the attempted suicide. The hospital and the Galvan family began negotiating a settlement of all the claims it had against the hospital in exchange for $675,000 to cover any nonreimbursable medical expenses and convalescent care for the remainder of Galvan's life. For this, the Galvans agreed to "release and forever discharge any and all persons and entities, including but not limited to [Jackson Park Hospital]," its affiliates from any actions they have or will have against the hospital or its affiliates. On March 12, 1982, the Galvan family signed the settlement and release. The release was then delivered to the hospital's legal representatives for signature on March 15, 1982. William Galvan died on April 17, 1982. The release was never signed by the hospital. On May 17, 1982, one

of the hospital's representatives informed Galvan family's attorney that the settlement offer of $675,000 was withdrawn. The Galvans sought to enforce the settlement and release.

The question before the court was whether the Galvan family as third-party beneficiaries had enforceable rights to an agreement that was subsequently breached. The court held that "a donee beneficiary has no vested interest in an agreement that was subsequently breached or repudiated when the $675,000 settlement monies were not paid.

In its reasoning, the court distinguished between a donee beneficiary and a creditor beneficiary. It stated that "A donee beneficiary, as distinguished from a creditor beneficiary, is a third party to whom the benefit comes without cost, such as a donation or gift. A creditor beneficiary is a third party to whom a preexisting duty or liability is owed." The court went on further to state that "[w]here the donee beneficiary's right is contingent upon the occurrence of certain events, [such right] does not vest until the occurrence of these events." Since the hospital never signed the settlement and release, the Galvan's rights never vested.

Questions for Analysis

Read the *Galvan* case. What facts would have changed the court's result? What distinguishes a creditor beneficiary from a donee beneficiary? Explain your answer.

incidental beneficiary A person to whom the benefits of a contract between two other people accrue merely as a matter of happenstance. An incidental beneficiary may not sue to enforce such a contract

Incidental Beneficiary

A party who will benefit only indirectly from a contract is an **incidental beneficiary.** The benefit conferred is not intentional. Therefore, this beneficiary has no rights of enforcement against either the promisor or promisee to the original contract. (See Exhibit 11-3 for a summary of the types of third-party beneficiaries.) In *Matter of Estate of Atkinson,* 1991 WL218455 (Ohio App. 3 Dist. 1991), the appeals court sets out the distinction between incidental and intended beneficiaries.

Line of Reasoning

The case of *Matter of Estate of Atkinson* focuses on a business transaction where Mrs. Evelyn Atkinson made loans to two different individuals. The first was to Larry Copeland for $64,366.20. The loan was dated August 8, 1985. Language in the loan agreement stated that in the event of Atkinson's death prior to the satisfaction of the loan, the "Remainder of loan to be paid to Barbara Morris" who was Mrs. Atkinson's daughter. The second loan was to Daniel Line for $40,000 and dated March 10, 1988. As part of the terms of the loan, language was agreed to that stated, "In the event of Atkinson's death, the Promissory Note shall be assigned to Barbara Morris." Mrs. Atkinson died on June 21, 1989. Both notes were included in the Schedule of Assets in the probate matter. Mrs. Atkinson's daughter, Barbara, filed challenges to the Schedule of Assets arguing that she was a third-party beneficiary of the loans and that the items should not be included in the probate. The issue before the court was whether Barbara was a third-party intended beneficiary or a third-party incidental beneficiary. The lower court (probate court) found that Barbara was an incidental beneficiary and included the assets in the probate estate. Barbara appealed from that ruling. The appeals court agreed that the central issue was the distinction between an intended and incidental beneficiary. This was the pivotal issue in the case. The appeals court stated that the test in Ohio was the "intent to benefit test" to determine the type of "beneficiary." The court observed that

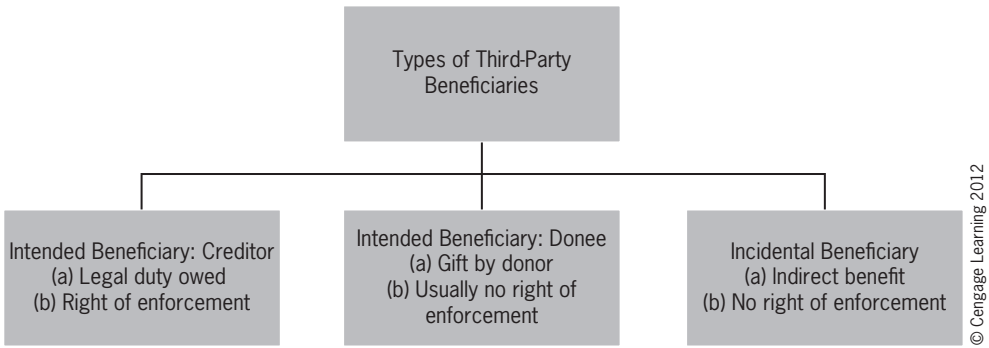
> Under this analysis, if the promisee * * * intends that a third party should benefit from the contract, then that third party is an 'intended beneficiary' who has enforceable rights under the contract. If the promisee has no intent to benefit a third party, then any third-party beneficiary to the contract is merely an 'incidental beneficiary,' who has no enforceable rights under the contract."

Based upon this definition, the probate court found that Barbara was an incidental beneficiary with whom the appeals Court agreed. The transaction was made for the benefit of Mrs. Atkinson and Copeland and Kline. The court also distinguished these transactions from an insurance policy in that Barbara's support was not the primary reason for the transaction, thus making her only incidental to the contract.

Questions for Analysis

Review *Matter of Estate of Atkinson*. Are there any facts that would have changed Barbara's status from an incidental beneficiary to an intended beneficiary? Was the court's reasoning sound in this matter? Explain your response.

EXHIBIT 11-3 Summary of third-party beneficiaries



State Your Case

Condo Developers Venture purchased a building in the middle of Paradise Valley. The city of Paradise Valley contracted with Water R Us to supply the city with water to its fire hydrants. The area was in the middle of a drought and Water R Us was unable to supply water to the hydrants in the city. Condo Developers building had a fire in one of its apartments. They contacted the city fire department who immediately responded only to find out that there was no water supply in the fire hydrants. The building burned to the ground. Condo Developers sued the city of Paradise Valley and Water R Us under a theory that they are a third-party beneficiary to the city's contract. Present your arguments for and against the position that Condo Developers were third-party beneficiaries.

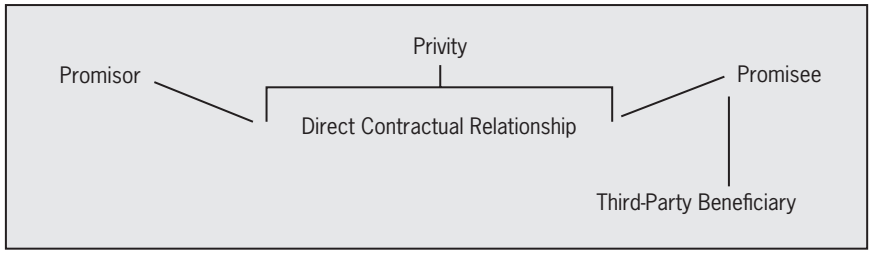
privity
An identity of interest between persons, so that the legal interest of one person is measured by the same legal right as the other; continuity of interest; successive relationships to the same rights of property

11.2 THE PRIVITY PROBLEM

A promisor and a promisee are in a direct contractual relationship known as **privity.** Under traditional notions of contract law, only those parties who had a direct relationship could sue when a breach or other legal problem arose. The issue of privity thus is raised when the right of a third-party beneficiary is violated. Could the third party sue the promisor, even if the third party was not in privity? Case decisions have answered this question in the affirmative and have allowed third-party beneficiaries to sue in their own right. See Exhibit 11-4 for a diagram of privity in contracts.

EXHIBIT 11-4

Privity relationships



Review *Galie v. Ram Associates Management Services, Inc.* 757 P.2d 176 (Colo. Ct. App. 1988), in which privity was the issue in a third-party beneficiary situation.

Line of Reasoning

Thomas Galie entered into an agreement with Business Buyers of Colorado (BBC), where BBC was to arrange for the purchase of a business. BBC also agreed to obtain financing. BBC hired RAM to obtain the financing for Galie's business.

Through RAM, Levine Family Holdings, Inc., d/b/a Jesse C. Levine and Company (Levine) agreed to finance Galie's business acquisition. The president of RAM informed the president of BBC that the financing had been obtained and the money would be available within 60 days. This information was communicated to Galie by BBC.

Levine failed to provide the financing for Galie's business venture. Galie filed suit against all parties, but the trial court dismissed his lawsuit stating that since there was no privity of contract between Galie and RAM, the case should be dismissed. The issue was whether there was privity of contract between Galie and RAM. The appeals court disagreed. As the court reasoned, "[O]ne may enforce a contractual obligation made for his benefit although he was not a party to the agreement." There is no requirement that privity of contract exist in order to prevail on a third-party beneficiary claim. The court sent the case back to the trial court for further proceedings based on its conclusion that privity did exist.

Questions for Analysis

Review the *Galie* case. What facts were important to the court's decision? Why was privity not a requisite in a third-party beneficiary contract? What facts would have changed the appeals courts result?

11.3 DISTINGUISHING BETWEEN ASSIGNMENTS AND DELEGATIONS

assignment
1. A transfer of property, or a right in property, from one person to another
2. A designation or appointment

delegation
The act of conferring authority upon, or transferring a duty, to another

When third parties agree to accept rights and obligations under a contract, another type of third-party relationship is involved. This relationship may be either an **assignment,** which is a present transfer of a contract right; or a **delegation,** which is the transfer of a contract duty. Under either an assignment or a delegation, the contract has already been created, and rights or obligations are transferred after the contract is executed.

In understanding assignments and delegations, some critical distinctions must be made. First, an assignment transfers *rights,* whereas a delegation transfers *duties*. This is significant because duties cannot be assigned. Second, rights are personal and are those which one ought to have or receive from another person, whereas duties are something that are owed to another person. They are not personal and can be freely delegated. Finally, assignments may extinguish the assignor's rights, whereas delegation of duties does not completely remove the liability of the original party to a contract.

11.4 ASSIGNMENTS

assignor
A person who assigns a right

assignee
A person to whom a right is assigned

An assignment is a transfer of a contractual right to a third party. The individual who is making the transfer is known as the **assignor** and the person who is receiving the contractual right transferred is known as the **assignee.** Upon completion of the assignment, the assignee acquires the rights the assignor had. All performance required from the assignor under the contract is now the responsibility of the assignee.

Assignments commonly arise in lease situations. For example, Mr. Turner is a landlord who leases his house to Ms. Peterson, a tenant. The rental is for one year at $500 a month, payable on the first of each month. After six months, Ms. Peterson gets a new job and moves out of town. She does not want to breach the lease, so she transfers her rights under the lease to her friend, Ms. Stewart. Now Ms. Stewart, who is the assignee, has all the responsibilities under the lease including the obligation to pay the rent. Ordinarily, the formal lease agreement between the parties contains a provision dealing with assignments. Some typical types of assignment provisions are shown in Exhibit 11-5.

EXHIBIT 11-5 Sample assignment provisions

Assignment

1. Sam Connor shall have the right to sell, assign, and transfer this agreement with all his right, title, and interest herein to any person, firm, or corporation at any time during the term of this agreement, and any such assignee shall acquire the rights and assume all of the obligations of Sam Connor under this agreement.
2. This agreement may be assigned by Sam Connor only upon condition that he give Michael Old notice of such assignment in writing by personal service or registered mail to Michael Old.

Conditional Assignment

The duties and obligations of performance under this agreement may be assigned by Michael Old provided that the assignee shall be capable of performing such duties and obligations in a manner satisfactory to Sam Connor.

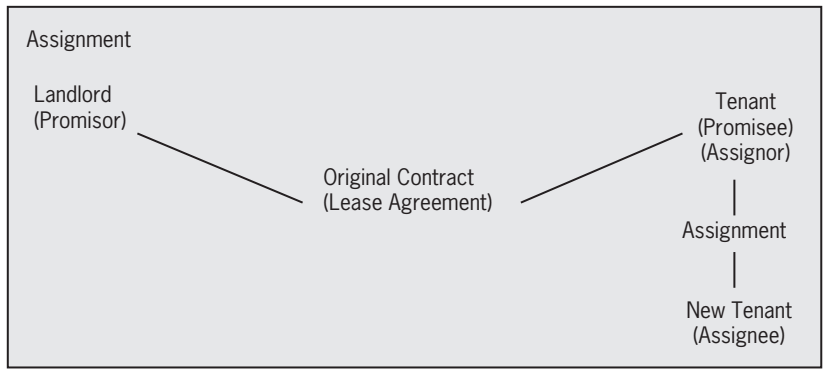
Assignment to Corporation

In the event that Sam Connor desires to conduct business as a corporation, Michael Old shall, upon Sam Connor's compliance with such requirements as may from time to time be prescribed by Michael Old, consent to an assignment of this agreement to such corporation.

Notice that in these provisions, no specific language is used for the assignment. What is important in vesting the rights to the assignee is that the assignor indicates a present intent to vest the rights and to transfer those contractual obligations to the assignee. Although a writing is not a requirement for an assignment, unless it comes under the Statute of Frauds, the assignment should indicate the rights to be assigned and transferred, to avoid any confusion between the parties. This formally memorializes the transfer of rights.

Although consideration is not required to perfect an assignment, in most business contexts consideration is present between the parties. This helps ensure the validity of the assignment. Exhibit 11-6 is a diagram of an assignment.

EXHIBIT 11-6 Assignment relationships



Perfecting the Assignment

There are no specific requirements necessary to perfect an assignment. However, it is good business practice to give notice of any assignment to the original promisor in the contract. This preserves the assignee's rights under the transfer from the assignor. Notice is appropriate because usually the original promisor to the contract now has to tender performance to or receive performance from a different party. If notice is not given to the original promisor, the required performance may still be tendered to the assignor (the original promisee); this may make the assignor liable to the assignee. But if the original promisor does not have

notice of the transfer, the original promisor will not be held responsible for any legal injury to the assignee. Consequently, it is a good idea to formalize any transfer or assignments of rights and obligations by a notice of assignment to affected parties.

In addition, problems often arise when notice is not properly given and the assignor attempts to assign its rights twice. In effect, the assignor is improperly benefiting twice from the assignment. Courts can follow two approaches to determine who can recover when a subsequent assignment is made by the assignor. Most states follow the rule that the first person to receive the assignment has superior rights over any later assignee, even after notice is given to the original party to the contract. This is known as the *American Rule* and generally produces fair results. In a minority of states, the rule is that the assignee who first gives notice of the assignment to the original promisor has a superior right, even over those who claim prior benefits. This is known as the *English Rule* and often produces unfair results.

Cybercises

Determine your jurisdiction's rule in determining the superiority of an assignment. (Does your state follow the American Rule or the English Rule?)

When an assignment is completed, the assignee assumes the position of the original party to the contract, with all the rights, duties, and benefits of the contract as well as the obligations. In effect, the assignee is now substituted for the original party to the contract, and is treated as though he or she was the original contracting party.

Assumption of Rights and Obligations Under an Assignment

The assignor warrants to the assignee that the assignor has a valid legal right to transfer the right assigned and that no valid defenses can be raised against that assigned right. In return, the assignee warrants that it will perform as required under the original contract and will do so in a complete and satisfactory manner. These warranties are both express and implied, and protect the parties to the contract and the assignment. If either party to the assignment breaches any obligation, the injured party may sue.

State Your Case

Yachts for a Day is one of the lessees at the Yacht Harbor Mall, the lessor. Yachts is having some financial difficulties and needs to close its business. Yachts finds a new tenant for the space and executes a contract of assignment with Internet Connection, Inc. Internet will assume all the responsibilities under the original lease. What Yachts forgets to do is tell the Mall—the lessor—of the assignment. Will the assignment be effective? Is Yachts for a Day still liable for its space at the Yacht Harbor Mall? If the mall accepts a rental payment from Internet Connection, will that affect the mall's position regarding the enforceability of the assignment?

TECH CHECK

Software as a Service—SaaS

Knowing how data is used and stored in your job or law office is important. Not only does data storage raise confidentiality issues but security issues as well. The standard model has been server models that are controlled by the law firm. Data is

imputed into the system with access controlled by the employer. Sure you can use security techniques to protect your information through passwords and encryption, but largely, the data still is within the domain of the law firm or employer and not accessible by a third party. Another method of information storage is through a third party—a SaaS, or software as a service. The control of your data in many respects is in the hands of the SaaS. Set aside the security issues for a moment; with SaaS you are dependent on the Internet connection to that system. For example, if the system is down for some reason and you do not have an alternative system (which is the point), then deadlines could be missed or data access delayed. Of course, there are advantages to having SaaS, such as accessibility, mobility, and unlimited storage for your data. How your law firm or employer handles the developing technology issues is important for you to understand as you embark on your paralegal career. Confidentiality and security is paramount. Preserving those needs should be your priority.

11.5 NONASSIGNABLE CONTRACT RIGHTS

An assignment is not an unbridled contract right that can go unchecked or unchallenged by the original parties to the contract. *Restatement (Second)* § 317(2) suggests when contract rights cannot be assigned:

> (2) A contractual right can be assigned unless
> (a) the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him, or
> (b) the assignment is forbidden by statute or is otherwise inoperative on grounds of public policy, or
> (c) assignment is validly precluded by contract.

Contracts often attempt to limit the right of assignment. Clauses such as "no assignment shall be made," or "no assignments shall be made without the prior written consent of the promisor," are representative of wording parties may draft to prohibit or limit an assignment. Sometimes parties to a contract use language that try to void *any* assignment, with phrases such as "all assignments made under this contract shall be void" or "any attempt by any party to this contract to assign any rights and duties shall be hence further null and void," thus limiting the parties' right to transfer. However, courts narrowly interpret these provisions to prohibit assignments and often allow assignments even when they violate a contractual provision. Courts view the provision as a promise not to assign, but not as a prohibition against it. Apparently, no language will absolutely prevent assignments. However, Exhibit 11-7 provides some suggested language.

EXHIBIT 11-7 Sample language prohibiting assignments

Covenant Not to Assign

It is agreed by the parties that there will be no assignment or transfer of this contract, nor of any interest in this contract.

Assignment—Notice by Registered Mail

This agreement and the payments to be made hereunder may be assigned by Sam Connor, on condition, however, that such party gives notice in writing by registered mail to Michael Old.

Nonassignability Clause—General Provision

This agreement shall not be assigned by either party without the prior written consent of the other party.

Assignment—Consent to Assignment of Pecuniary Interest

This agreement shall not be assignable without the consent of both parties; but this provision shall not prevent either party from selling, assigning, or transferring a pecuniary interest in any specific property acquired pursuant to this agreement.

When assignments do not require notice or approval by the parties to a contract, a party may challenge an assignment on the ground that there will be either a material change of a duty and obligation under the contract or an increased burden on the party who is required to perform under the contract. Courts look closely at these arguments, but usually uphold the assignments. If the contract involves a unique duty and is substantially different from the original agreement, the court will not enforce the assignment. However, if the rights involved are not unique and assignment will not impair the performance of the parties, the court will usually enforce the assignment even over the objections of one of the original parties to the contract.

There are exceptions to assignment where the duties are personal or professional in nature. When the person involved has been hired specifically because of talent, expertise, or profession, assignment often is not permitted. Persons such as actors, artists, attorneys, and physicians fall under this category. Such persons are selected because of their special attributes, and assigning those duties to someone else generally violates the spirit of the contract. If the service required can be performed by anybody in a particular trade, a court will allow the assignment of a personal professional service contract. A court will analyze this on a case-by-case basis. *Evening News Association v. Peterson*, 477 F. Supp. 77 (D.D.C. 1979), illustrates how an assignment of a personal services contract was questioned.

Line of Reasoning

Peterson was a newscaster/anchorman with Post-Newsweek Stations from 1969 to 1978. In June, 1978, Post-Newsweek sold the television station, WTOP-TV (located in D.C.) to Evening News, which included its

operating license. Included in the sale was Peterson's contract for employment. Peterson's contract was for three years from July 1, 1977 to June 30, 1980 with an extension. The contract had a designated salary and benefits with increases included in the terms.

There was no express provision in the 1977 contract concerning its assignability or nonassignability, although it contained the following integration clause:

This agreement contains the entire understanding of the parties . . . and this agreement cannot be altered or modified except in a writing signed by both parties.

The issue in this case is whether a contract of employment between an employee and the owner and licensee of a television station, providing for the employee's services as a newscaster/anchorman, was assigned when the station was sold and acquired by a new owner and licensee.

In its analysis, the court noted that Peterson's duties under his 1977 contract did not change in any significant way after the Evening News' acquisition. In addition, the Evening News met all of its required contract obligations to the defendant and its performance after acquisition in June, 1978, was not materially different from that of Post-Newsweek. However, Mr. Peterson claimed that the close relationship and rapport that existed between him and his news director and his executive producer were important and nonassignable. Thus since neither his news director nor his executive producer continued under the new owner, he could not perform his duties. What the court determined as critical was that Mr. Peterson did not contract with the news director or the executive producer but with Post-Newsweek. Either party could have left the previous organization. Therefore, in its reasoning the Court found that Peterson did not contract with Post-Newsweek in 1977 to work with particular people or because of a special policy making role he had with the company. The court further found that Post-Newsweek did not contract with "Peterson because of any peculiarly unique qualities or because of a relationship of personal confidence with him."

In summary, the court finds that the performance required of Mr. Peterson under the 1977 contract was (1) not based upon a personal relationship or one of special confidence between him and Post-Newsweek or its employees, and (2) was not changed in any material way by the assignment to the Evening News.

In reaching its result, the court analyzed the distinction between an assignment and a delegation. It observed "[t]he distinction between the assignment of a right to receive services and the obligation to provide them is critical. This is so because duties under a personal services contract involving special skill or ability are generally not delegable by the one obligated to perform, absent the consent of the other party. The issue, however, is not whether the personal services Peterson is to perform are delegable but whether Post-Newsweek's right to receive them is assignable."

Contract rights as a general rule are assignable. This rule, however, is subject to exception where the assignment would vary materially the duty of the obligor, increase materially the burden of risk imposed by the contract, or impair materially the obligor's chance of obtaining return performance. In this case, the services provided by Peterson to Evening News have not changed from the Post-Newsweek contract. Both before and after the sale, Peterson anchored the same news programs.

As the court stressed:

> The general rule of assignability is also subject to exception where the contract calls for the rendition of personal services based on a relationship of confidence between the parties. In almost all cases where a "contract" is said to be non assignable because it is "personal," what is meant is not that the contractor's right is not assignable, but that the performance required by his duty is a personal performance and that an attempt to perform by a substituted person would not discharge the contractor's duty.

Given the silence of the contract on assignability, its merger clause, and the usual rule that contract rights are assignable, the court cannot but conclude on the facts of this case that defendant's contract was assignable.

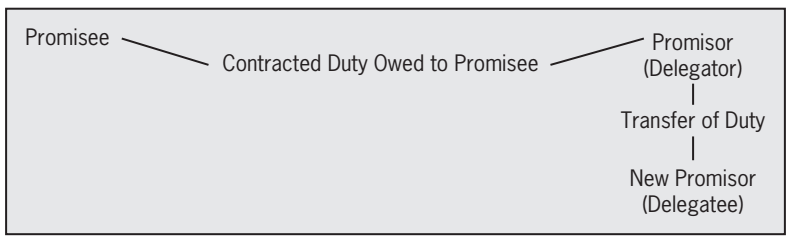
Questions for Analysis

Review *Evening News Association v. Peterson*. What additional facts in this case would have changed the court's result? Why did the court find a valid assignment?

11.6 DELEGATION IN CONTRACTS

Assignments and delegations are different. An assignment involves rights, whereas a delegation involves duties. Under a delegation, the original promisor finds a new promisor or a substitute to perform the original duties under the contract. The *delegator* is the original promisor and the *delegatee* is the new promisor, the person who will perform the delegated duties. Exhibit 11-8 illustrates a delegation.

EXHIBIT 11-8 Delegation relationships



For a delegation to occur, the duty cannot be unique and it must be one that is assumed by the delegatee. The *Restatement (Second)* sets out a position on delegations in § 318:

(1) An obligor can properly delegate the performance of his duty to another unless the delegation is contrary to public policy or the terms of his promise.
(2) Unless otherwise agreed, a promise requires performance by a particular person only to the extent that the obligee has a substantial interest in having that person perform or control the acts promised.
(3) Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.

As with assignments, delegations may be prohibited contractually. The contracting parties may state that "there shall be no delegations under this contract and any

delegations attempted under this contract shall be void." Courts normally enforce this type of provision in a contract.

Delegations have different legal ramifications than assignments. Unlike an assignment, the delegator of a duty remains liable on the original contract. In fact, if a delegator denies that the obligation to perform exists, this denial may constitute a repudiation of the contract for which the delegator can be sued. Therefore, in a delegation, the delegator is not relieved of liability under the original contract.

As with assignments, certain types of duties are not delegable. When specific skills or talents of a particular party are involved, these duties are not delegable. Examples of such duties are those of an attorney, artist, dancer, or actor. The skills or talents of the persons in this example are unique, and delegating a duty would be a burden to the original promisee.

However if the skill contracted for is not particularized or unique, the duty may be delegated even over the objection of the original promisor. Assume that you are a house painter and you have been hired to paint the Mitchell house. On the day you are to paint the Mitchell house, you are also scheduled to paint the McGee house, so you delegate your contract to another house painter. In this case, the delegation would probably be valid. However, if you hired a famous artist to paint your portrait, and he or she attempted to delegate that duty to an unknown painter, the delegation would probably be prohibited.

When issues arise as to whether a duty is delegable, the court looks to see how personalized the duty is. If the performance is too personalized or unique, the party to whom performance is to be rendered can refuse to accept performance from the delegatee and may hold the original party liable. But if the recipient of performance takes a wait-and-see approach when the performance is delegated, the right to object may be cut off. Here, silence may imply assent and thus waive the right to enforce performance against the delegator.

An assignment and a delegation may occur simultaneously. A party can assign rights, and the recipient of those rights can also assume the duties under the contract. The presumption in the law is that when there is an assignment, there is usually an implied delegation as well. Unless there is a clear intention to the contrary, the assumption will be that if an assignment occurs, the delegation is implied. This is the position set out in *Restatement (Second)* § 318. Exhibit 11-9 is an example of assignment and delegation language. See also Exhibit 11-10.

EXHIBIT 11-9 Sample assignment and delegation language

No assignment of this agreement or of any duty or obligation of performance hereunder shall be made in whole or in part by Sam Conner without the prior written consent of Michael Old.

EXHIBIT 11-10 Comparison of assignments and delegations

Assignment	Delegation
1. Transfer of *rights*	1. Transfer of *duties*
2. Writing not necessary, except if Statute of Frauds applies	2. Writing not necessary, except if Statute of Frauds applies
3. Extinguishes assignor's right	3. Does not extinguish duty of delegator
4. Not effective if contractual limitation	4. Delegator remains liable on contract
5. May not be effective if personal in nature	5. May not be effective if personal in nature or skill required

Strictly Speaking: Ethics and the Legal Professional

Can an attorney assign his duties to a paralegal? Can an attorney delegate her duties to a paralegal? An interesting ethical question dilemma is posed. If by definition an assignment is a transfer of a right to another party, then an assignment of attorney's duties to his paralegal would not only be unenforceable but considered the unauthorized practice of law. That issue is pretty clear. We delve into a grey area when an attorney transfers or delegates duties to a paralegal. Arguably the duties of an attorney are personal in nature and cannot be freely delegated to a paralegal. Of course, we have licensing requirements of attorneys, but attorneys delegate responsibilities all the time to their paralegals. The question is what happens when a paralegal assumes responsibilities that are delegated. In this situation, the legal obligation to perform the duties still remains with the attorney. Ultimately, the attorney is responsible for the work product of the paralegal regardless of the delegation of duties to perform certain tasks.

State Your Case

Using the facts from our introduction in this chapter, will your lawsuit be successful against Aerosmith and the promoters of the concert? Discuss the arguments for all sides.

11.7 NOVATION DISTINGUISHED

novation
A substituted contract that dissolves a previous contractual duty and creates a new one

Another type of third-party contract (discussed in Chapter 9) is a **novation,** a substitution of a new contract for an old one. Three parties are involved in this situation. As you will recall, you have the two original parties to the contract—the promisor and the promisee—and now a new third party who is going to contract with the original promisor.

Cybercises

Find examples of assignments on the Internet and draft an assignment between yourself (as the tenant) and a friend (as the assignee). The landlord is your contracts instructor.

The parties are agreeing to replace the original contract with a new one, invalidating the prior contract and, in effect, releasing the original promisee.

There are significant differences between a novation and an assignment or delegation. In a novation, all parties must mutually agree to the new contract, because the novation releases the prior parties from their obligations, whereas an assignment or delegation does not. In an assignment, or delegation, the rights and obligations are exact, where the assignee (delegatee) is replacing the assignor (delegator) as the primary party responsible on the contract. In a novation, a new contract with differing terms may exist, with new rights and responsibilities.

An example of a novation could be in a mortgage transaction. Lawrence and Sheila Broadhurst own a home that has a mortgage of $200,000 against the house. They want to sell their house and buy a bigger one because of their growing family. Vincent Zahn wants to buy the house and assumes the mortgage of the Broadhursts. In the event that Zahn defaults on the mortgage, the Broadhursts still would be responsible. However, Zahn gets a new mortgage under his name with his own terms and conditions; the Broadhurst's mortgage would be paid and Zahn's mortgage would create a novation. The new mortgage created a new contract in substitution for the old one relieving the Broadhursts from their obligations under the original mortgage.

11.8 PRACTICAL APPLICATION

Drafting is important in creating an effective assignment or delegation clause. A number of examples have already been set forth in this chapter. However, a paralegal may be asked to draft an assignment with the corresponding acceptance of assignment. To assist the paralegal in this task, Exhibit 11-11 gives some guidance.

EXHIBIT 11-11 Sample assignment with acceptance

Assignment

(1) For $10.00, I hereby assign to Andrew Marcus all my right, title, and interest in and to the contract dated September 15, 2010, between Albert Charles and myself on the lease for my sailboat, a copy of which is attached to this assignment.

Dated this _____ day of _____, 20____.

_____

Assignor

OR

(2) By this assignment dated this 18th day of October, 2010, I hereby delegate to David Stevens all of my duties and obligations of performance under a contract dated July 15, 2008, between Kevin Hampton and myself concerning the senior class photography pictures.

By accepting this assignment, David Stevens agrees to assume and perform all duties and obligations that I have under the contract and to hold me harmless from any liability for performance or nonperformance of such obligation.

_____
Assignor

Acceptance

In consideration of the right, title, and interest that are being assigned to me, I hereby accept the foregoing assignment, and agree if the foregoing assignment is consented to by Harvey Childs, I will assume and perform all the duties and obligations previously to be performed by Kevin Hampton under the contract referred to in the foregoing assignment as if I had been an original party to the contract, and agree to indemnify and hold Kevin Hampton harmless for any liability for performance or nonperformance of the duties and obligations assumed by me.

Dated this _____ day of _____, 2010.

_____
Assignee

Assignment

I hereby assign to David Stevens my claim and demand against Marvin Todd for $10,571 arising out of the judgment dated November 1, 2011, for purposes of collection; and hereby grant to David Stevens the full power to collect, sue for, or in any other manner enforce collection thereof in his name or otherwise.

Dated this _____ day of _____, 2011.

_____
Assignor

SUMMARY

11.1 Although contracts normally have two parties, a promisor and a promisee, sometimes a third party, known as a third-party beneficiary, reaps advantages from a contract. There are intended beneficiaries, donee beneficiaries, creditor beneficiaries, and incidental beneficiaries.

11.2 A third-party beneficiary contract does not require privity between the parties. Third-party beneficiary contracts do not require a direct contractual relationship for the third party to have rights against the original promisor and promisee.

11.3 An assignment is a present transfer of a contractual right, whereas a delegation is a present transfer of a contractual duty to another party.

11.4 Assignments transfer the contract rights form an assignor to an assignee. No specific requirements are necessary to perfect an assignment, but written notice is normally appropriate. When an assignment is effectuated, the assignee assumes the obligations and rights of the assignor.

11.5 Certain contract rights are nonassignable. Often parties contractually agree that rights are not assignable, but courts closely interpret such restrictions. When the duties are unique or are personal or professional in nature, assignment will often be prohibited.

11.6 A delegation involves duties between the parties. Unlike assignments, prohibitions against delegations are ordinarily enforced by the courts. Duties that require specific skills are not delegatable, but general skills or tasks can be delegated even over the objection of a party. Assignments and delegations often occur simultaneously.

11.7 A novation is a type of third-party contract in which a new contract is substituted for an old one. In a novation, all parties must agree, and the rights and obligations of the original contract may be changed.

KEY TERMS

third-party beneficiary contract
beneficiary
intended beneficiary
donee beneficiary
donee
creditor beneficiary
incidental beneficiary
privity
assignment
delegation
assignor
assignee
novation

REVIEW QUESTIONS

1. Define how a third-party beneficiary contract is created.
2. What is an intended beneficiary?
3. Name the categories of intended beneficiaries and cite their differences.
4. How is privity of contract defined?
5. What is an assignment? A delegation?
6. Identify the key distinction between an assignment and a delegation.
7. What approaches do courts follow when two assignments have been made for the same transaction?
8. When are contract rights nonassignable?
9. Define delegator and delegatee.
10. When can duties not be assigned under a contract?

EXERCISES

1. Your attorney has asked you to draft a Notice of Assignment and Assignment of a lease dated July 15, 2011, between Harry Crawford, landlord, and Lyle Morgan, tenant. Lyle wants to assign his rights to Molly Riley. The assignment is for the property located at 11863 Main Avenue, Hartford, Connecticut, and is effective the date the assignment is drafted. Draft both the Notice of Assignment and the Assignment.

2. Either contact three insurance companies and ask for a change of beneficiary form from each or find three different examples on the Internet. Compare the forms and list the similarities and differences between the forms.

3. Identify the type of third party beneficiary in the following transactions. Explain your answer in each.
   a. Harry and Dorothy build a pool and tennis court in their backyard to increase their property value. Prior to the renovations, their next door neighbor's house was valued at $300,000. After the renovation, the house was valued at $325,000.
   b. Danny wants to purchase a life insurance policy where his second wife, Ellie, is the beneficiary. Danny divorces Ellie and changes the beneficiary to his children, Penny and Brady, from his first marriage. Ellie is upset when she finds out.
   c. Rider and Big Marv are prisoners in the Huntsland State Prison. The prison enters into a food service contract with Food Ventures, Inc. Rider and Big Marv hate the food and sue the prison to change its food service vendor.
   d. Skinny Legs loans money to Clark in the amount of $5,000. Clark is having trouble paying the loan to Skinny Legs, so Clark arranges to sell the loan to George for $3,350.
4. Melissa and Garry Rustnik purchased a condominium at Gardens Edge in South Beach, Florida. Under the condo agreement, Melissa and Garry had to pay a monthly condo fee for common areas. Next to the condos is a golf club. In the condo agreement, it specifically stated that "The Golf Club is privately owned is not considered part of the owner's monthly common area fee charged by the Condo Association." All owners of a Gardens Edge condo will automatically become members of the Golf Club. The monthly fee is $200, which is paid directly to the Golf Club by the condo owner. After Melissa and Garry had been owners of their condo for three years, they received a letter from the Golf Club increasing the monthly fee to $250 and adding an appreciation fee of $25 monthly for non-food staff. Melissa and Gary never used the facility and refused to pay the new fees. The Golf Club claims that if the Rustniks do not pay, they will place a lien against their condominium. The Rustniks do not have a direct contractual relationship with the Golf Club. Discuss the issues that the parties could raise in a legal action.
5. Everett Langley set up a brokerage account with Accounts Traders in the name of his son Graham Langley. Mr. Langley deposited $20,000 in the account where it accrued interest annually in the amount of $500.00. Approximately five years later, Mr. Langley closed the account and transferred the money to another account. Graham never knew about the brokerage account. Needing Graham to complete some tax forms, Mr. Langley mailed the tax forms to his son. Seeing that the account now had nearly $25,000 in it, Graham decided to sue Accounts Traders and his father for the proceeds from the account. Does Graham have a valid claim against Accounts Traders or his father? Discuss all issues.
6. Maria and Jose Gomez were happily married for 20 years. They had two children, Juan and Anita. Maria died and was buried at the Oaklawn Memorial Cemetery. Three years later, Jose married Marisol with whom he lived for nearly 30 years. During the marriage, Jose contacted the Oaklawn Memorial Cemetery and contracted to buy the two plots next to his beloved first wife Maria.

He wanted to be buried next to both his wives some day. Marisol agreed and she signed a contract with Oaklawn to be buried next to Jose. Unfortunately, after celebrating their 30th wedding anniversary, Jose died. While preparing the grave, the cemetery discovered remains next to Jose's grave. Apparently, this was common as there were many unmarked graves from the Civil War located at the cemetery. The cemetery notified Marisol of the unmarked grave and asked her whether she wanted to choose another gravesite or have the present grave excavated at double depth—essentially Jose and Marisol would be buried together. Marisol signed a contract with Oaklawn to have a double depth excavation so she could be buried with Jose. Two years later, Marisol died. Jose's daughter Anita went to visit her father soon after Marisol's death and noticed that the earth around her father's grave appeared new. She inquired with the cemetery and was told that her step-mother was buried in the same grave as her father. Anita was upset. She did not want Marisol to be buried in the same grave as her father. She sued the cemetery for breach of contract in that her father did not agree to have Marisol buried with him. Does Anita have a lawsuit against the cemetery for breach of contract? What issues must Anita overcome?

7. Richard Wight entered into a credit card agreement with Bank of USA. Richard paid his card on time every month. Since most of Richard's charges were for his design business, he requested that Bank of USA change the name on his account to Richard Wight Design Gallery. Bank of USA issued a new card in the company's name with a new card number. Business began to wane, and so did Richard's payments. Ultimately, Richard stopped paying on this credit card. After a number of letters requesting payment, Bank of USA sued Richard Wight personally for the outstanding credit card debt. In the lawsuit, Richard claims he assigned his contract rights to his company and therefore was not responsible. Alternatively, Richard claims that issuing a new card and new account number, Bank of USA created a novation releasing Richard from any liability. Does Richard have viable legal arguments?

8. Sanford Paving was hired to pave the parking lot at Memorial Hospital. The work was to commence on June 1, 2010 and finish 30 days later. There was a clause in the contract that stated: "This contract may not be assigned without the express consent of Memorial Hospital." Sanford had bid a job with the City and never thought they would get the job. But on June 10, they received the good news. The job was worth hundreds of thousands of dollars for them. Sanford did not have time for the hospital job. Sanford contacted his cousin, Vinny who owned Vinny's Paving and Construction Company. Sanford asked Vinny to do the hospital job and Vinny agreed. When the hospital CEO saw Vinny's trucks in his parking lot, he was livid. He didn't hire Vinny's Paving, but Sanford Paving. The CEO called Sanford and told him that he did not agree to Vinny performing the paving work. Sanford assured the CEO that Vinny would do a good job and that he would be personally responsible. Vinny did not finish the job until July 31, 2010, over one month after the completion date in the original contract. The extra month costs the hospital lost revenues from parking fees and many angry phone calls from staff that had to park off-site. The hospital sues Sanford Paving for breach of contract. One of the

allegations was that Sanford did not have the authority to assign the contract to another contractor or alternatively, Sanford did not have the authority to delegate the duties of paving to another contractor. Does the hospital have a feasible argument? Would the hospital's position be weakened if Vinny had finished the contract on time? Explain your responses.

9. Stewart Jacobs signed a promissory note for $400,000 with Gainsworth Finance. Two years after signing the note, Mr. Jacobs requested that the note be drafted with his company, Jacobs Construction, as the primary obligor on the note. Gainsworth agreed. As construction jobs ceased, so did Mr. Jacobs payment on the note to Gainsworth. In a letter, Gainsworth demanded payment from Mr. Jacobs. Jacobs ignored the letter. Gainsworth sued. In his response, Jacobs raised the defense of novation. He claimed that Gainsworth agreed to substitute his company as the primary obligor on the note. Does Mr. Jacobs have a viable defense? Explain your response.

10. Judge Hudson Marley is retiring next year. He has been on the bench for over 40 years. As is custom, all retiring judges have their portraits painted by local artist, Mary Osborne Smith. Ms. Smith's work is renowned and Judge Marley is looking forward to working with her. The court enters into a contract with Mary. In the contract, there is a clause that states that "Artist may not assign or delegate any rights or duties in this contract. The Court is hiring Mary Osborne Smith exclusively and solely." Judge Marley begins sitting for Mary weekly. He notices that she has an assistant sketching alongside her. The assistant appears to be sketching on the canvass for which the Judge's portrait is to be painted. Mary failed to tell the court that she has arthritis and has difficulty painting for long periods of time, which is why she has an assistant helping her. The Judge is furious and communicates what he has seen to the Chief Judge of the court. The court wants to sue Mary based on the above nonassignment and delegation clause. What are Mary's arguments that she has not breached the contract? Does the court have a remedy against Mary for breach of contract?

CASE ASSIGNMENTS

1. Flowers Factory Outlet entered into a lease with ARD Developers for space located in the warehouse district of the city. The lease was for 10 years. In the lease, the following clause was present: "Flowers Factory Outlet may assign the lease to a subsidiary and at the time of the assignment, the tenant herein named shall have no further responsibility under the terms of the lease." With ARD's knowledge, Flowers assigned the lease to Discount Flowers in year five of the lease. In year six, a dispute arose between Discount and ARD causing Discount to stop paying its rent on the lease. Now, ARD wants to sue both Flowers and Discount. Your firm represents Flowers Factory Outlet. Prepare a memorandum discussing the legal issues that Flowers can raise in its defense. (Be thorough in your analysis and discuss both sides of the argument.)

2. Victoria Kaelin went to Home and Outdoor Furniture to purchase a bird bath. The salesperson quoted Victoria $543.33 for a wrought iron bird bath. The salesperson accepted Victoria's money for the bird bath. Apparently, the salesperson needed reading glasses, as the price for the bird bath was $1,543.33. Home and Outdoor Furniture refused to deliver the bird bath unless Victoria paid an additional $1,000. They also offered to refund Victoria her $543.33. Victoria paid the $1,000 in protest (she really wanted that bird bath!), but then sued Home and Outdoor Furniture for breach of contract. You are working for a judge and she wants you to prepare the opinion discussing all issues in this case. (In your opinion address all the contract issues that relate to these facts, i.e., was there a valid offer and acceptance? Defenses to mutual assent?)

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Part II

An Introduction to the Uniform Commercial Code

Chapter 12

Sales: Article 2 of the Uniform Commercial Code

Just Suppose . . .

The Mattins have lived in their home for over thirty years. They still have shag carpeting in their family room—remnants of the 70s. It is time for a change. Maddy Mattin goes down to a discount carpet store, Carpets Galore. They have every kind of carpet imaginable. After hours of roaming the displays and looking at samples, she decides to purchase a neutral taupe for the family room and as a surprise for her husband, Ben, she decides to replace the bedroom carpet with a deep emerald green. The total price for the carpeting included $5,600 for the carpet itself, $900 for the installation, and a $100 fee to move the furniture. She paid Carpets Galore a deposit of $1,700. The day before installation she agreed to pay another $1,700 with the remaining amount to be paid upon completion. Carpets Galore subcontracts the installation and furniture moving to Sam's Interior Settings. On the day of installation, Maddy had to work, so she let the men from Sam's Interior in her house to install the new carpet in both rooms. When she returned hours later, she was horrified to see that the seams in the carpet were very visible and the edges of the carpets were bubbling. She immediately called Carpets Galore to complain. Sam's Interior tried to fix the problems to Maddy's satisfaction, but to no avail. The damage was done. Maddy refused to pay Carpets Galore the remaining balance owed for the carpet and installation. Carpets Galore and Sam's Interior want their money. They sue Maddy and Ben Mattin. The question for the judge is what law applies to the transaction—the Uniform Commercial Code or the common law of contracts. That's the central question in this chapter.

Outline

Determining which substantive law applies is critical in examining a contracts case. The Uniform Commercial Code focuses on sales transactions where the common law generally applies to services and sales between nonmerchants—people like us. Understanding both bodies of law is central to any study of contracts. Let's now begin our discussion of the Uniform Commercial Code and its application.

12.1 UNDERSTANDING THE UNIFORM COMMERCIAL CODE

As the common law of contracts lagged behind the needs of the commercial world, statutes were passed to regulate commercial transactions. These general statutes adopted by some states cured the problem for a while, but the need arose for a uniform system of laws to govern commercial transactions. Therefore, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") began developing what we now know today as the **Uniform Commercial Code** (U.C.C. or Code). Although the Code received a lukewarm reception in the early 1950s, by 1968 all the states except Louisiana had adopted or amended the Code as proposed by the Conference. The general intent of the U.C.C., as stated in Article 1-102, is (a) to simplify, clarify and modernize the law governing commercial transactions; (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; and (c) to make uniform the law among the various jurisdictions.

Uniform Commercial Code
One of the uniform laws, which has been adopted in much the same form in every state. It governs most aspects of commercial transactions

Article 1-102 of the U.C C. thus set the stage for this statute to govern transactions between merchants and nonmerchants in the United States.

The U.C.C. has now been adopted, in whole or in part, by all 50 states, including Louisiana in the late 1980s, making it state law throughout the United States. However, Louisiana has not adopted Article 2 of the U.C.C.—Sales—continuing to follow its existing civil law and Napoleonic Code. Generally, because the U.C.C. is recognized throughout the United States except for the noted exception of Louisiana, this allows uniformity for parties who are entering into commercial transactions and thus removes some of the mystery and confusion from standard commercial dealings.

The Uniform Commercial Code has developed into eleven articles which includes two newer articles—Leases and Fund Transfers—governing various stages of commercial transactions. For assistance in understanding how to interpret and apply the various Code sections, the Conference included "official comments" appended to each section of the text of the Code. These comments have guided courts and lawyers in interpretation of Code sections. Exhibit 12-1 sets out the general articles of the U.C.C.

EXHIBIT 12-1 Articles of the U.C.C.

Detailing all the articles is beyond the scope of this text; therefore, the focus of this book's second part is on Article 2 of the U.C.C., Sales. Article 2 complements the common law of contracts. Article 2 has seven parts:

Part One: General Construction and Subject Matter
Part Two: Form, Formation, and Readjustment of the Contract
Part Three: General Obligations and Construction of Contracts
Part Four: Title, Creditors, and Good Faith Purchasers
Part Five: Title Performance
Part Six: Breach, Repudiation, and Excuse
Part Seven: Remedies

Exhibit 12-2 provides an explanation of the contents of each article.

EXHIBIT 12-2 Contents of Article 2

Contents of Article 2						
Part one: General Construction and Subject Matter. **Explanation:** This section sets out the general scope of Article 2 and specifies important definitions used in sales transactions.	**Part two:** Form, Formation, and Readjustment of the Contract. **Explanation:** This section focuses on general formation of the sales contract, including offer and acceptance. It sets out some of the guidelines for formation of a contract, including requirements under the Statute of Frauds.	**Part three:** General Obligations and Construction of Contracts. **Explanation:** This section deals with interpretation of terms and expressly focuses on the various warranties provided under the U.C.C. It also defines legal requirements for delivery terms in connection with a sale.	**Part Four:** Title, Creditors, and Good Faith Purchasers. **Explanation:** This article deals with the passing of title from seller to buyer and the ramifications when title is questioned.	**Part Five:** Title Performance. **Explanation:** This section focuses on the rights of seller and buyer when performance is tendered.	**Part Six:** Breach, Repudiation, and Excuse. **Explanation:** This section mainly focuses on the buyer's rights when the seller has not tendered goods purchased. This section explores situations when performance of parties is not perfect.	**Part Seven:** Remedies. **Explanation:** The last section addresses the remedies available to sellers and buyers when there is a breach in performance or failure of performance.

Although Article 2 focuses exclusively on sales of goods, it is incumbent upon anyone who is analyzing a sales transaction to also pay close attention to the general definition section in Article 1-201. This section defines approximately 46 terms which are used exclusively in commercial transactions and specifies how those definitions are applied under the U.C.C.

Cybercises

Determine when your state or territory initially adopted the Uniform Commercial Code into law.

It is noteworthy to mention that in 2003, the NCCUSL proposed amendments and changes to Article 2. As of the publication of this text, January, 2011, no state or territory has adopted any of the proposed amendments. What this means for you is that when researching a client's Article 2 issues, or any U.C.C. issue for that matter, always be sure to be using the most current version of the relevant statutory section in your jurisdiction. Whether you are using an online service or a hard copy version of the statute, check all updates to be sure you are using the most current version of your state's U.C.C. articles.

International Sales Contracts: What law applies?

CISG
Governs international sales between merchants

With the Internet's accessibility, it is important to mention a critical addition to the body of law dealing with sales transactions. International sales transactions are governed by the United Nations Convention on Contracts for the International Sale of Goods ("**CISG**") presented in 1980. As an international agreement, it has to be adopted by each country

Cybercises

Locate a copy of the CISG and identify whether Mexico, Canada, United Kingdom, and Russia have adopted the CISG. Identify two significant differences between the U.C.C. and CISG.

recognizing it. The United States has adopted CISG along with seventy other countries. Essentially, unless the parties agree for a particular body of law to apply to an international transaction, if the CISG was adopted, it applies to the transaction. The caveat is that the CISG does not apply to consumer transactions.

International sales transactions are beyond the scope of this text; however, it is important to note its existence and applicability. Also, it is important to remember that the U.C.C. and CISG differ in many substantive areas, so do not assume that the standards applied in the U.C.C. are either the same or will have the same results under the CISG. Standards in formation are significantly different as well as the documentation needed to create a contract.

12.2 THE SCOPE OF ARTICLE 2

Certain basic rules must be understood prior to any study of Article 2. Article 2 deals with the sale of goods, and both the words **sale** and **goods** are specifically defined in the article.

sale
A transfer of title to property for money or its equivalent from seller to buyer

goods
All personal property or movables, commodities, including futures and fungibles

A *sale* is defined in § 2-106, which states that a sale "consists in the passing of title from the seller to the buyer for a price." Article 2 covers both present and future sales of goods, and defines a *present sale* as "a sale which is accomplished by the making of a contract."

The next important definition under Article 2 is of the term *goods.* As identified in § 2-105, *goods* are "things which are movable at the time of identification to the contract for sale." This Code section further states that goods may be the "unborn young of animals and growing crops and other identified things attached to realty, if they are not attached to the land at the time of the sale." Thus, to determine whether Article 2 applies to a transaction, ask whether a sale has been consummated and whether the sale is of goods as defined under Article 2.

EXAMPLE: Stephanie wants to purchase a golden retriever from Arthur's Pet Shop. The sale of a dog is covered under the U.C.C. A dog is considered a good as defined under the U.C.C.

EXAMPLE: Danny wants to buy a used motorcycle from Harley's Cycle Shop. The sale is covered under the U.C.C. because a motorcycle is the type of "good" that falls under the definition and is a sale under the U.C.C.

EXAMPLE: The installation of an air conditioner would not be a sale under the U.C.C. as it is considered a "service" and not a sale of goods. The sale of the air conditioning would fall under the U.C.C., however.

seller
A person or entity who sells property it owns; a vendor

buyer
A person or entity who makes a purchase

merchant
A person who regularly trades in a particular type of goods

When it has been determined that a transaction falls under Article 2 of the U.C.C., the analysis turns to determining who are the parties to the sale. Article 2 requires that a sale be between a **seller,** who provides the product, and a **buyer,** who agrees to purchase the product. Article 2, however, makes a distinction between sales between merchants and nonmerchants. A **merchant** is defined in § 2-104 as follows:

> "merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the

practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary by who his occupation holds himself out as having such knowledge or skill.

If the transaction is between two merchants—a seller merchant and a buyer merchant—the parties are held to a higher standard of dealing than *nonmerchants* (persons who are not in the business of selling a product). The Code requires that parties who are merchants to a sales transaction must act in good faith and in a commercially reasonable manner. This means that the parties must act fairly in their dealings and according to acceptable standards of common conduct for persons in that particular industry.

When nonmerchants are involved, the U.C.C. requires only that the nonmerchants act in good faith in their dealings. This is a lower standard than for merchants. No matter what the other's status, each party must act within the confines of the U.C.C. When a merchant deals with a nonmerchant, the merchant is held to a higher standard than the nonmerchant and will be judged by that higher standard in the course of dealing. The U.C.C. sets out all these relationships and how they are applied.

Hybrid or Mixed Purpose Contracts: Which law applies?

Some contracts have a dual purpose—a sale and a service. This often raises questions as to which law applies to the transaction. Most courts have adopted an approach known as the "predominant factor or purpose" or "primary purpose" doctrine. Whatever the name, the analysis is the same. The court determines what the main purpose of the contract was and applies the U.C.C. if the main purpose was a sales transaction or the common law of contracts if a service was the main purpose of the contract. In our introductory fact situation, Maddy and Ben were purchasing carpet and having it installed in their home. The primary purpose of the contract was for the purchase of the carpet—a sale under the U.C.C. and not for the installation of the carpet. Thus, when analyzing a contract transaction determine whether the service was the primary purpose of the transaction and the goods incidental (for example, if you hire a person to paint your house, common law applies; the purchasing of the paint would be incidental to the transaction) or whether the goods are the primary purpose with the labor or service incidental, such as in our introductory fact pattern.

State Your Case

a. Mary Castillo is an artist who is making quite a reputation for herself. She was asked to paint a portrait of the Secretary General of the United Nations. In preparation for the Secretary's first sitting, Mary purchased a number of oil paints to replenish her supply. She wanted to be sure she had everything she needed. During the first sitting, the Secretary received a telephone call that required his immediate attendance at a session and ultimately his return to his native country. Since the Secretary was

unavailable, the United Nations cancelled the contract. Mary wanted to be paid for the portrait. She invested time and money in the preparation for the job. What law would govern this transaction, the U.C.C. or the common law?

b. Assume the same facts from part a, but when Mary tested the paints many of the tubes were either dry or too thin. She could not paint with such sub-quality paint. Mary wants her money back, but the paint supply store refuses. If Mary sues the paint supply store, what law applies to the transaction, the U.C.C. or the common law of contracts? Explain your responses to both questions.

12.3 FORMATION OF THE CONTRACT: DEPARTURE FROM COMMON LAW

Under the Code, contracts are formed in the same manner as under common law. The parties must indicate an offer and a corresponding acceptance. However, the rules with respect to offer and acceptance have been greatly relaxed under the U.C.C. to accommodate the realities of the commercial business world. In fact, these rules have been relaxed to such an extent that often terms are left open, quantities are uncertain, and even the time of agreement is unclear. Under the U.C.C., lack of definiteness in the offer often is not a barrier to formation of the contract. (Recall from Chapter 3 that, under common law, indefiniteness means the terms are not sufficient to constitute an offer. Not so in the formation of a contract under the U.C.C.) Specifically, § 2-204 sets out the principles required for formation:

(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.
(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.
(3) Even though one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

Thus, if the parties intend for a contract to exist, the Code often allows the court to find one. Even when terms are indefinite, missing, or later supplied, decisions under the Code often find that a contract existed between the parties if the conduct of the parties indicates that one was intended. For example, Marla decides it is time to get back into shape. She goes to a local sporting goods store to purchase a "total gym" machine. It normally comes with accessories which are out of stock. Marla decides that she wants the machine and gives the store manager a down payment. They sign an installment agreement. The machine is delivered to her home. When the accessories came into stock, the store manager contacts Marla. There was no discussion as to the price of the added accessories. Marla believed they were part of the price. The store manager tells her they are extra. Marla wants to return the exercise equipment because she believed she was purchasing the machine with the accessories. The machine has already been installed in Marla's home. A court would probably find a contract for the purchase of the machine.

Another major departure from the common law is § 2-206, relating to the effectiveness of an offer and acceptance. Recall that, in the common law, an offer by fax may require an acceptance by fax. This is clearly not the case under the sales provisions of the U.C.C. Section 2-206 states:

(1) Unless otherwise unambiguously indicated by the language or circumstances
   (a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;
   (b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.
(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

This section of the Code clearly departs from the common law principles examined in previous chapters. Let us first look at § 2-206(1)(a). When an offer specified a mode of acceptance, the common law required that acceptance be by that specific mode, without any deviation. The Code relaxes this requirement by allowing the seller to accept by the means set out in the offer *or* any other medium that is reasonable under the circumstances. Thus, acceptance can occur by shipping goods rather than communicating the acceptance back to a party, as set out in § 2-206(1)(b). For example, the party can accept by communicating the acceptance through the same form of communication, or the party can accept by shipping conforming goods.

EXAMPLE: Blue Sky Video orders DVDs from VideoNet, a supplier of DVDs. Without any communication, VideoNet ships Blue Sky's order without communicating its acceptance. A contract is formed.

EXAMPLE: Fabrication Outlet needs 500 bolts of material to replenish its stock. Fabrication contracts with NYC Fabrics with its specifications. NYC Fabrics faxes details of costs and shipping terms. Fabrication wants a different carrier. Fabrics ships with its stated carrier. Fabrication accepts the goods. A contract is formed.

accommodation
An obligation undertaken, without consideration, on behalf of another person

The Code also allows a party to ship nonconforming goods as an **accommodation** to the party requiring the goods. When nonconforming goods are sent as a prompt shipment, the Code does not treat this as an acceptance of the offer. The buyer then has the opportunity to either accept or reject the nonconforming goods; if they are rejected, the buyer may return them at the seller's expense.

Accepting by prompt shipment of goods can cause many problems and unnecessary expense, however. The person to whom the goods were shipped generally does not have any responsibility for the shipment of nonconforming goods, and thus the entire responsibility for the act falls on the party who did the shipping. Nevertheless, this practice is commonplace in the commercial context.

firm offers
Under the Uniform Commercial Code, a merchant's written offer to buy or sell goods that will be held open for a period of time without requiring consideration to be valid

Not only does the Code make it easier for a contract to be formed, but it also makes it more difficult for **firm offers** to be revoked. Section 2-205 modifies the common law once again and provides:

> An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated, or, if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

The Code does require that an offer be in writing, but does not require consideration to keep an offer open. The firm offer rule under the U.C.C. does not require any consideration to keep the offer open for an agreed period of time. If a merchant makes an offer in writing for specific goods and for a specific amount of time, and signs the writing, the Code treats this as a firm offer. This offer is irrevocable for a "reasonable" period of time, which the Code has interpreted as not to exceed three months. Exhibit 12-3 shows some illustrations of firm offers.

EXHIBIT 12-3 Sample firm offers for sale

Firm Offer for Sale Agreement—By Merchant—Open for Less than Three Months

Ms. Patsy Ruben
1234 Field Street
Dallas, Texas 76543

June 1, 2011

Dear Ms. Ruben:

I, Suzanne Stuckey, of 2345 Brentwood, Wichita Falls, Texas, hereby offer to [buy or sell] 100 round tables for Twelve Thousand Dollars and No Cents ($12,000.00) on the following terms:

[state your terms]

This offer shall be kept open until September 1, 2011, which is ninety days from the date of this offer.

Very truly yours,

Suzanne Stuckey

Firm Offer for Sale Agreement—Specifications of Manner of Acceptance—Offer Revocable if Acceptance Not Received by Specified Date

Ms. Debbi Gray
1234 Old Mill Road
Burbank, California 12345

November 1, 2011

Dear Ms. Gray:

I am making the following firm offer, which I assure will be held open for your acceptance from November 15, 2011, until December 15, 2011.

The subject of this offer, and the conditions under which this offer is made, are as follows:

Fiory Dresses for $25.00 each, cash on delivery. The dresses will be delivered to your place of business within thirty (30) days of ordering.

Your acceptance must be received not later than the close of business on December 15, 2011, at 5678 West 18th Street, Burbank, California. The offer is revocable if your acceptance is not received by the above-specified date.

Very truly yours,

Catherine Zorra

Firm Offer for Sale Agreement—Acceptance on Offeree's Form

Mr. Harry Zachary
Exercise, Inc.
1700 Main Street
Dallas, Texas 76543

December 1, 2011

Dear Mr. Zachary:

In accordance with our telephone conversation of November 28, 2011, it is understood that I shall have until December 31, 2011

to accept your offer to [buy or sell] 10 stair-masters for Four Thousand Dollars ($4,000.00), on the following terms:

[state each term]

Please indicate your agreement with this statement by countersigning the enclosed copy of this offer and returning it to me by December 15, 2011.

Very truly yours,

Joseph Andrews

I agree to this offer as stated.

By: _____
Harry Zachary, President of
Exercise, Inc.

_____
Date

TECH CHECK

Social Networking and Sales Contracts

Facebook and Twitter have changed the way we communicate. Initially these sites were created as a social network—a way to keep in touch. Now, that concept has been expanded to include the area of sales. Retailers now have Facebook pages advertising merchandise and coupons to visitors of the site. Who would have thought that a social network—a way to keep in touch with friends and family—would spur retailers to use it as a way to sell merchandise. The question for us is how will this affect how consumers do business and how the law, such as the Uniform Commercial Code, applies to this type of sales and marketing. Some retailers even have a Twitter page. Will an advertisement or offer on a retailer's Twitter page constitute a valid offer? This remains to be seen. What is important to recognize is that not only has the way we communicate with each other changed but how we buy and sell merchandise has changed significantly as well. The law is usually slow to catch up to technological advances and trends. But, now the Internet has opened up another method "creating sales" contracts with the public. Stay tuned to the ever-changing landscape of the Internet and how it affects how we do business and create contracts.

Cybercises

Find three major retailers on Facebook and see whether their pages have offers and advertisements that can create contracts. See what type of sales activities are on their Twitter pages or other social networks. Are any potential contracts created by their activities?

12.4 MODIFYING THE MIRROR IMAGE RULE

Recall that, under the common law, an offer and acceptance must be exact and that any deviation is a counteroffer. The common law is very strict in its interpretation of the mirror image rule and does not allow any change in the terms of the offer and the acceptance. This rule was substantially changed under the U.C.C. The Code does not treat the new or different terms as a rejection of the offer or even as a counteroffer, but rather interprets these terms as an additional proposal to an existing contract. The Code specifically states in § 2-207:

> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

Although the Code does set out specific limitations for an acceptance, the Code leans toward finding a contract between the parties. This is completely opposite to the view of the common law. Section 2-207 continues:

> (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
> (a) the offer expressly limits acceptance to the term of the offer;
> (b) they materially alter it; or
> (c) notification of the objection to them has already been given or is given within a reasonable time after notice of them is received.

Section 2-207(3) takes contract formation a step further. This section suggests that when the parties *act* as though they have a contract under Article 2, they do in fact have a contract. Section 2-207(3) provides:

> (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case, the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

Consequently, Article 2 is more broadly interpreted to favor formation of a contract compared to the strict requirements under the common law. This can cause problems for courts, but more so for a seller and a buyer. Caution should be used when contracting under the U.C.C.; whether seller or buyer, the best advice is to bargain for the terms and clearly set forth the intent.

Courts have had a difficult time interpreting § 2-207. Consequently, case results are in conflict among jurisdictions. Carefully review your state's version of the U.C.C. and judicial decisions interpreting § 2-207. A case which examined § 2-207 was *Paul Gottlieb & Co., Inc. v. Alps South Corp.,* 985 So. 1(Fla.App. 2 Dist. 2007).

Line Of Reasoning

Knowing the contents of the "small print" on the back side of a standard form contract was the central issue in the *Gottlieb* case. Gottlieb was a fabric converter from New York City who supplied its customers knitted fabrics. Alps manufactured medical devices in St. Petersburg, Florida for amputees. Specifically, Alps produced liners used by the amputees to attach to a prosthetic device. Alps was always looking for a new material to add comfort for its clients. It tested various products and new fabrics. Alps found a specialty fabric produced by Gottlieb known as "TL2626 Coolmax." Alps began incorporating the fabric into the liners its clients used for their prosthetics. The relationship was on a positive track when Gottlieb starting running out of supply and Alps had rejected some of the fabric samples. These problems began in August, 2000, about six months after Gottlieb began supplying the fabric to Alps. Gottlieb tried to satisfy Alps and found a substitute fabric, which was not disclosed to Alps. Alps did not disclose how the fabric was being used to Gottlieb. Although Gottlieb did not know of Alps' use, it did indicate that the new samples must conform to the original samples. The substituted yarn did not work as well and Alps began receiving complaints from its clients. Alps stopped using Gottlieb's liners because of the complaints and because of what it considered a "defect" in the product. When Alps found out about the substituted yarn product, it failed to pay Gottlieb for a shipment of product. Gottlieb sued Alps for breach of contract. Alps countersued for breach of warranty. At issue is the language on the back of the standard form contract the parties had used for six transactions. The language states:

> BUYER SHALL NOT IN ANY EVENT BE ENTITLED TO, AND SELLER SHALL NOT BE LIABLE FOR INDIRECT OR CONSEQUENTIAL DAMAGES OF ANY NATURE, INCLUDING, WITHOUT BEING LIMITED TO, LOSS OF PROFIT, PROMOTIONAL OR MANUFACTURING EXPENSES, INJURY TO REPUTATION OR LOSS OF CUSTOMER.

One of the questions before the Appeals Court was whether the above language was a material alteration to the contract to make it unenforceable and thus an exception under 2-207(2) of the Uniform Commercial Code. The court determined that this case was a "battle of the forms" issue as set forth in U.C.C. 2-207. Both New York and Florida had the same versions of the 2-207. The court discussed at length 2-207 and its origins. The real question is whether the additional or different terms, such as the limitation of liability clause, are part of the contract and are legally enforceable. As the Court stressed:

> The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract *unless:*
> (a) The offer expressly limits acceptance to the terms of the offer;
> (b) They materially alter it; or
> (c) Notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

In this case, the court noted the difference between the common law mirror image rule and the U.C.C. which allows more flexibility is its approach. Because this case deals with merchants, the additional terms become part of the contract unless either objected to or fall within an exception. Both Gottlieb and Alps agree that there were no objections to the limitation of liability clause. The question then for the court in performing its analysis is whether the additional term materially altered the contract. If so, it would be excluded. Alps has the burden to prove that the term was a material alteration. This court queried whether hardship or surprise should be included

in the analysis. Following the federal Seventh Circuit Court of Appeals in *Union Carbide Corp. v. Oscar Mayer Foods Corp.*, 947 F.2d 1333 (7th Cir.1991), the court determined "that a change is material if agreement to it cannot be presumed." Quoting Judge Posner, who explained:

> What is expectable, hence unsurprising, is okay; what is unexpected, hence surprising, is not. Not infrequently the test is said to be "surprise or hardship," but this appears to be a misreading of Official Comment 4 to U.C.C. § 2-207. The comment offers examples of "typical clauses which would normally 'materially alter' the contract *and so result in surprise or hardship* if incorporated without express awareness by the other party" (emphasis added). Hardship is a consequence, not a criterion. (Surprise can be either.) You cannot walk away from a contract that you can fairly be deemed to have agreed to, merely because performance turns out to be a hardship for you, unless you can squeeze yourself into the impossibility defense or some related doctrine of excuse.

Union Carbide, 947 F.2d at 1336

In reviewing the fact, the court noted that six contracts with the limitation of liability clause had been exchanged between the parties with no objection. Alps simply did not read the contract. This does not constitute surprise and was not an excuse absolving Alps of its terms. Furthermore, these types of clauses are common in contracts and do not constitute surprise. Regarding hardship, there was no evidence that Gottlieb ever offered to reimburse Alps for its inability to supply nor reimburse for any consequential damages. In fact, Alps never communicated any kind of damage suffered due to the breach of the contract. Therefore, the court found that Alps did not establish a hardship. The limitation of liability—consequential damages—clause was enforceable. Note that the court did, however, allow for other damages because of the breach. The lesson of this case is failure to carefully read a contract will not be a defense to its enforcement, at least under the U.C.C.

Questions for Analysis

Review the *Gottlieb* case and 2-207 of the U.C.C. What facts would have changed the result between the parties? Would your jurisdiction have similar results to the Florida court's results? Explain.

Cybercises

Using your state's version of 2-207, find three cases which applied 2-207 with differing results. Examine and explain why the cases have different results.

Missing and Open Terms

A contract can be formulated between the parties even if terms are missing or have not been agreed to. The U.C.C. focuses on the parties' intent: if the parties intended a contract, a contract will be found. For example, most of us would think that if the parties failed to agree on a price, there would be no contract. Not so under the U.C.C. Section 2-305 provides that:

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if
   (a) nothing is said as to price; or
   (b) the price is left to be agreed by the parties and they fail to agree; or
   (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.
(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.
(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as canceled or himself fix a reasonable price.
(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do, must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

Consequently, leaving open even a critical term such as the price will not defeat the contracting process. This is a major deviation from the common law.

In addition to leaving price terms open, delivery terms can also be omitted and the Code may still find a contract between the parties. Under the Code, delivery is to be in one shipment (§ 2-307) at the seller's place of business (§ 2-308), at a reasonable time (§ 2-309). Illogical as it may seem, the Code fills in the omitted terms as though they were part of the parties' communications.

Finally, if the method of payment is omitted, the Code provides the answer to the payment problem. Section 2-310 states:

Unless otherwise agreed

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and
(b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (Section 2-513); and
(c) if delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due at the time and place at which the buyer is to receive the documents regardless of where the goods are to be received; and
(d) where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

Additional Consistent Terms

Unlike the common law, when the offeree proposes additional terms to the original offer, a contract can still be formed. As long as those terms are consistent with the basis of the

contract, a contract is found. Granted, a party can condition its acceptance upon acceptance of the additional or different terms, but unconditional additions will constitute an acceptance.

Of course, there are exceptions to this rule. If the additional or different terms materially alter the contract, a contract will not be formed. Further, if the party to whom the changes are directed objects to the additional or different terms within a reasonable period of time, there is no contract. Finally, the offeror can specifically limit acceptance to only these terms and provisions in the offer, thereby avoiding any possibly objectionable deviations. Some provisions to alleviate problems when the seller does not want additional terms to be part of the offer are:

(1) This offer may be accepted only on the exact terms set forth in this offer, and no additional terms or modifications shall be accepted.
(2) This order supersedes and cancels all prior communications between the parties, except as specifically shown on the face of this order. No conditions in the acceptance by seller and no subsequent agreements or communications in any way modifying the provisions of this order or increasing charges under this offer shall be binding unless made in writing and signed by the authorized representative of buyer.

The buyer may nevertheless propose additional terms, as shown in Exhibit 12-4. The seller may then send a letter either confirming acceptance of the additional terms or rejecting them. Exhibit 12-5 provides drafting assistance.

EXHIBIT 12-4 Buyer's proposal of additional terms

Notice to Seller—Acceptance Demanding Additional Terms

Ms. Joanne Lacey December 1, 2011
1234 West Main Street
Austin, Texas 76543

Dear Ms. Lacey:

Your offer on November 15, 2011, for 25 wicker chairs for $1,800.00 is accepted. But, in lieu of shipment being made on or before January 31, 2012, I must have an earlier delivery date, with shipment to be completed on or before January 15, 2012. It is also necessary that the following additional terms apply to the order:

[state each additional term]

This notice is not to be construed as an acceptance of your offer unless the additional terms set forth in this notice are agreed to by you.

Very truly yours,

David J. Thompson

Notice to Seller—Transaction Between Merchants—Limitation of Time for Rejection of Additional Terms

Ms. Joanne Lacey
1234 West Main Street
Austin, Texas 76543

December 2, 2011

Dear Ms. Lacey:

You are hereby notified that unless I receive, on or before January 15, 2012, notice of your rejection of the terms that modify your offer of November 27, 2011, the new terms shall become part of the agreement between us.

Very truly yours,

David J. Thompson

EXHIBIT 12-5 Seller's acceptance or rejection of modified terms

Seller's Acceptance of Modified Terms

Mr. David J. Thompson
5678 East Street
Austin, Texas 76543

December 5, 2011

Dear Mr. Thompson:

I hereby consider your letter of December 1, 2011 as an acceptance of the offer for 25 wicker chairs for $1,800.00. I agree

to the additional terms specifically requiring an earlier shipment date of January 15, 2012.

Sincerely,

Ms. Lacey

Seller's Rejection of Modified Terms

Mr. David J. Thompson
5678 East Street
Austin, Texas 76543

December 5, 2011

Dear Mr. Thompson:

Your letter of December 1, 2011 is received as an acceptance of my letter dated November 15, 2011, relating to the purchase of 25 wicker chairs.

I regret that I cannot accept the additional terms that you propose, and therefore insist that the agreement operate exclusively on the basis of my original letter to you without modification.

Sincerely,

Ms. Lacey

Examine *Mace Industries, Inc. v. Paddock Pool Equipment Co.,* 339 S.E.2d 527 (S.C. Ct. App. 1986), which addressed the conditional acceptance issue and § 2-207(3) of the Code.

Line of Reasoning

Mace sent a quotation to Paddock for equipment. The quotation was presented in a form sales agreement containing the terms and conditions for the sale to Paddock. Some terms included timely payment, a delinquency charge, and a reimbursement for collection. The agreement also contained a limited warranty and disclaimed all other warranties. When Paddock received Mace's quotation, they responded with a purchase order referring to the quotation. The reverse side of the

purchase order also contained certain terms and conditions which did not include the collection, delinquency, or warranty limitations. Mace acknowledged receipt of Paddock's purchase order and objected to two conditions on the reverse of the purchase order. Both the purchase order and quotation contained a provision that the document constituted the entire agreement of the parties. A claim arose as to the terms and conditions of the purchase, specifically the applicability of the warranties. Did the limited warranty provision apply or the implied warranties of the U.C.C. The court discussed 2-207 of the U.C.C. and commented on the differences between the common law and the results. Thus the issue before the court was whether Paddock made its acceptance conditioned upon Mace's assent to the terms and conditions in its purchase order. If an acceptance is to be conditional, it must be communicated. This was not clear from Paddock's actions. Even though Paddock attempted to argue that Mace consented to the additional terms and conditions because of the language in his purchase order, the court was not convinced. Here, Paddock did not indicate his objection to the terms of Mace's purchase order. In fact, Paddock continued with the purchase, even though Mace rejected certain terms within their purchase order. Therefore, the court determined that under 2-207(2) "the additional terms of the purchase order are to be construed as proposals for additions to the contract." The court further stated that because "(1) both parties are merchants, (2) Mace's offer did not expressly limit acceptance to the terms of its offer, and (3) the additional terms did not materially alter the proposed contract between the parties. Therefore, regarding the main issue in controversy, we hold that the provision contained in the sales agreement concerning the limited warranties shall control."

Questions for Analysis

Review *Mace v. Paddock*. What actions could Paddock have taken to have a different result from the court? Why was the language in Paddock's purchase order ineffective?

Output and Requirements Contracts

Recall from Chapter 3 that contracts, which provide that a seller will sell to the buyer "all goods we produce," are known as *output contracts.* This type of contract was not favored under the common law, because of the indefiniteness of the amount the buyer was purchasing.

Contracts that allow a buyer to purchase "as much as we need" from a seller are known as *requirements contracts.* As with an output contract, the common law disfavors requirements contracts.

The U.C.C. changes all that. Section 2-306 suggests:

(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.
(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

Output and requirements contracts are acceptable under the U.C.C. as long as the parties deal in good faith and adhere to standards of reasonableness. Again, this is a major deviation from the common law approach to contracts.

The Duty of Good Faith: The U.C.C. Standard

Implicit in all sales contracts is the requirement that the parties act in "good faith" in the performance of their general obligations under the sales contract. This concept is so important that it is defined in the U.C.C. In Article 1-203 it states that "Every contract or duty within this Act imposes an obligation of good faith in its performance and enforcement." Good faith is further defined as honesty in fact. For a merchant, there is the added requirement of commercial reasonableness, which is defined in Article 2-103(1)(b) as observing reasonable commercial standards of fair dealing in the trade. You would think that because the U.C.C. sets such high standards that actions of parties to a sales contract would be meticulous. But of course that is not always the case. Part of the problem is that although, good faith is implicit in all contracts, the standard is not easily identified. As you can imagine, often the rules of interpretation will dictate the meaning of "good faith" and often the parties' actions will dictate the meaning. Judge Posner in *Market Street Associates v. Frey,* 941 F. 2d 588 (7th Cir. 1991) presented a lively opinion on the conundrum that is good faith. He observed in a bit of a tongue in cheek statement by writing about the definition of good faith that "cases are cryptic as to its meaning though emphatic about its existence, so we must cast our net wider. We do so mindful of Learned Hand's warning, that "such words as 'fraud,' 'good faith,' 'whim,' 'caprice,' 'arbitrary action,' and 'legal fraud' . . . obscure the issue. Indeed they do." (citations omitted) *Id*. at 593. Whatever the meaning, remember that the duty of "good faith" is implicit in every contract or at least its spirit. As you will often observe, it is easier to define what it is not rather than what it is.

Apart from the obvious meanings of not committing fraud, misrepresentation, or committing a crime, courts have struggled with defining exactly what good faith is. Thus, when analyzing a contract for good faith, look to the parties' course of dealings, the length of the relationship, and the commercial reasonableness of the transaction. This area is constantly developing, but exploiting a business relationship not only risks the consequences such as termination, but rendering a contract unconscionable.

12.5 UNCONSCIONABILITY IN SALES CONTRACTS

As previously discussed, contracts must be formed and performed in good faith. One area fraught with the indicia of bad faith is in the doctrine of unconscionability. Recall from previous chapters that contracts that are too one-sided or too harsh can be considered unconscionable as a matter of law. As with the common law, the U.C.C. provides a specific section on unconscionability. Section 2-302 sets out the available legal options:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

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(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

All states have guidelines for determining whether a contract is unconscionable. Most use § 2-302 as a guide, but others, such as California and Louisiana, use case law to determine what constitutes an unconscionable contract. When the issue of unconscionability is raised, the contract is usually between a merchant seller and a nonmerchant buyer (the consumer). Nonmerchant buyers are acknowledged to have less skill, experience, and bargaining power than merchants. Thus, the nonmerchant may be successful when alleging that a contract is invalid on grounds of unconscionability. However, because there is usually no great disparity in the bargaining power of two merchants, their contracts are not likely to be deemed unconscionable. There are two general types of unconscionability: procedural and substantive.

Cybercises

Determine how your jurisdiction deals with "unconscionability" in sales contracts. Does your jurisdiction rely solely on the U.C.C. or does it have other statutory laws which determine unconscionable conduct or language in a contractual transaction?

Procedural Unconscionability

Lack of meaningful choice is usually associated with procedural unconscionability. Here the process of negotiation and formation of the contract is examined. Procedural unconscionability usually consists of consumer ignorance balanced against the finesse of the skilled seller in a "take-it-or-leave-it" contract. In this situation, the consumer has no meaningful bargaining powers and can often be duped into signing an offensive contract.

In a procedural unconscionability case, educational and intelligence levels are considered by the courts. Courts evaluate a person's background to determine whether lack of skills and general knowledge contributed to the unconscionable contract. Consequently, two people can sign the same contract but, because of skills and education, procedural unconscionability may be found in one case but not another.

Substantive Unconscionability

Substantive unconscionability focuses on the terms set forth in the contract. Overly harsh terms that are not negotiable and lean heavily toward the seller's interest are substantively unconscionable. Courts must evaluate the terms of the contract to determine whether they are excessive and too lopsided. Courts have had difficulties in determining substantive unconscionability because there is no definitive test. They can consider the return of profit or the price charged by other sellers, but those standards are not dispositive. For example, a person, whose command of the English language is limited, purchases a refrigerator for $900. The refrigerator cost the seller $300. Add to that cost $300 in finance charges, and you probably have a good case of substantive unconscionability.

In addition to § 2-302, the Code suggests two other areas in which substantive unconscionability becomes an issue. Addressing liquidated damages clauses, § 2-718(1) states that "[a] term fixing unreasonably large liquidated damages is void as a penalty." Section 2-719(3) deals with consequential damages and provides:

> Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

When sellers attempt to unduly increase their available remedies and substantially decrease or erase a consumer buyer's remedies, unconscionability has been found. Examine *Frank's Maintenance & Engineering, Inc. v. C.A. Roberts Co.,* 86 Ill. App. 3d 980, 408 N.E.2d 403 (1980), which dealt with the distinction between procedural and substantive unconscionability and has been the basis of subsequent discussions in Illinois.

Line of Reasoning

The plaintiff, Frank's Maintenance & Engineering, Inc., manufactures motorcycle front fork tubes. On February 1, 1974 the plaintiff orally ordered some steel tubing from the defendant C. A. Roberts Co. (Roberts). Roberts sent a written acknowledgment. On the back of this acknowledgment were various conditions including the following paragraph 11:

> Seller shall not be liable for consequential damages, and except as provided in paragraph 10 hereof, Seller's liability for any and all losses and damages sustained by Buyer and others, rising out of or by reason of this contract, shall not exceed the sum of the transportation charges paid by Buyer, mill or warehouse price and extras, applicable to that portion of the products upon which liability is founded. Claims for defective products must be promptly made upon receipt thereof and Seller given ample opportunity to investigate; whereupon Seller may, at its option, replace those products proven defective or allow credit for an amount not exceeding the sum of the transportation charges, mill or warehouse price and extras, applicable thereto.

At issue was the applicability of the above provision. Although there were terms on the front of the form, the back was stamped over and basically illegible. In fact, the terms appear as though the words "No conditions of sale on reverse side" are stamped. These limitations were never discussed

between the parties. However, the steel which the plaintiff was sent was defective, containing cracks that rendered it useless for the plaintiff's needs. The plaintiff communicated the subquality of the steel to Roberts and revoked his contract. The plaintiff held the steel for Roberts, but they never responded to the issues. The plaintiff tried to sell the steel, but it was worthless because of the quality. The court then discussed the issue of unconscionability in the formation of the contract.

"Procedural unconscionability consists of some impropriety during the process of forming the contract depriving a party of a meaningful choice. Factors to be considered are all the circumstances surrounding the transaction including the manner in which the contract was entered into, whether each party had a reasonable opportunity to understand the terms of the contract, and whether important terms were hidden in a maze of fine print; both the conspicuousness of the clause and the negotiations relating to it are important, albeit not conclusive factors in determining the issue of unconscionability. To be a part of the bargain, a provision limiting the defendant's liability must, unless incorporated into the contract through prior course of dealings or trade usage, have been bargained for, brought to the purchaser's attention, or be conspicuous." The buyer's assent must be knowing and must understand what they are assuming.

On the other hand, "substantive unconscionability concerns the question whether the terms themselves are commercially reasonable." Limiting liability when a defect was latent is the type of provision courts tend to strike down. Thus, because the critical provisions were stamped over and unknown to the plaintiff and the defects in the steel latent, the contract was unconscionable. In this case, Roberts' action, or lack of action, was critical in the court's decision.

Questions for Analysis

Review *Frank's v. Roberts*. What are the distinguishing characteristics between procedural and substantive unconscionability? What facts would have changed the court's result and why? Are the results fair? Explain your answers.

12.6 WRITING REQUIREMENTS UNDER ARTICLE 2: THE STATUTE OF FRAUDS

As with the common law, Article 2 of the U.C.C. requires that, under certain circumstances, a contract be in writing to be enforceable; the contract must therefore satisfy the Statute of Frauds. The U.C.C., in § 2-201, provides that contracts for the sale of goods for over $500 must be in writing. The U.C.C. also requires that the contract be "signed by the party against whom enforcement is sought or by his authorized agent or broker." Again, the writing requirement has been relaxed under § 2-201(1), which states that:

> [A] writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

Consequently, lack of price or quantity terms may not defeat allegations that a contract was formed.

The Code has additional requirements for contracts between merchants in complying with the Statute of Frauds. When there is a communication by one party to another, unless the merchant objects to the communication in writing within 10 days after

receiving it, the merchant may be bound to a contract for failure to object even if there was no intent to contract. This places an important responsibility on a merchant to pay attention to the communications that are being transmitted.

The writing requirement can be circumvented in three instances, however. Section 2-201(3) indicates that a writing is not required (1) for specially manufactured goods; (2) when a party admits in a court that an oral contract existed; or (3) if the goods have been delivered and accepted or paid for and accepted. In these instances, the U.C.C. does not require that a writing exist in order to find an enforceable contract. Again, we see a relaxation of the restrictions imposed under the common law.

The U.C.C. version of the Statute of Frauds and the common law version have many similarities but differences which make the formation of a contract easier. *Delta Star, Inc. v. Michael's Carpet World,* 276 Va. 524, 666 S.E.2d 331 (2008) involves the application of the U.C.C. version of the Statute of Frauds.

Line of Reasoning

In *Delta Star, Inc. v. Michael's Carpet World,* Delta Star wanted to install flooring in the entryway of its offices. The CEO of Delta Star went to one of Michael's showrooms to view flooring options for his office, his assistant's office, and the entryway. The CEO requested pricing on three types of flooring. At the meeting, the CEO instructed Michael's salesperson Tommy Martin to only deal with his assistant, Donna Nash. Martin went to Delta Star to measure the areas and submitted proposals to Ms. Nash. Revised proposals and credit applications were exchanged between the parties by facsimile. A conditional sales contract was exchanged between the parties on May 31, 2006 with reference to a P.O. (purchase order) No. T-551 with a handwritten notation "per phone" where the customer signature would be. Delta Star sent the P.O. dated July 25, 2006, which contained a reference to carpeting the entryway for $832.22. The installation of the entryway was completed on August 2, 2006 and paid for. Nash told Martin to order the tile for the two offices and that the job must be completed by November. Martin ordered the tile. When the tile arrived, Nash told Martin to tile only her office and not her boss's office. Martin said he could not tile only Nash's office because he ordered for both offices. Michael's had never ordered this type of tile flooring before. It remained in their warehouse.

The case centers on whether the Statute of Frauds had been satisfied and whether there was a contract for both the offices. The trial and appeals court found that the documentation did not satisfy the Statute of Frauds. Michael's raised an exception to the Statute of Frauds that the goods ordered were "specially manufactured" for Delta and therefore not suitable for other customers. However, the Appeals Court did not find that the goods were specially manufactured. The facts indicated that the goods were available to all customers and that Michael's orders flooring for all its customers because they do not keep materials in inventory on hand. Delta simply ordered from samples without alteration.

The court then looked at the "confirmatory writing" to determine whether it fulfilled the requirements of the Statute of Frauds. The court did not agree with Michael's position. In finding for Delta, the court observed:

> A writing in confirmation of the contract presupposes that there exists an oral agreement between the parties and necessarily follows the formation of such an agreement. The proposals, however, by definition, cannot constitute confirmatory writings because a proposal is an offer presented for acceptance or rejection. In submitting its proposals,

> Michael's sought to form a contract, rather than to confirm a contract. Michael's invoice for the entryway flooring also cannot serve as confirmation of a contract for the purchase and installation of flooring in [the CEO's] office.

The court then considered that a contract was created because of the parties' course of dealings. The court found that it did not. Course of dealing is relevant to explain or supplement the terms of a parties agreement not establish the agreement itself.

Michael's raised the part performance exception to the Statute of Frauds as well. They argued that a single contract existed for all three areas and that installation and payment for the entryway was part performance thus taking it out of the Statute of Frauds. Again, the Appeals Court disagreed. The court stated the part performance defense only applied to the entryway flooring and not the CEO's office. The Court of Appeals ultimately found that the Statute of Frauds was not satisfied and found for Delta.

Questions for Analysis

Review the *Delta Star* decision. What actions or writings between the parties would have satisfied the Statute of Frauds? Should the court have considered the transaction to be one contract or three separate contracts? Would the result have been different?

State Your Case

Using the fact pattern from the beginning of the chapter, would the contract for the purchase and installation of the Mattin's carpet require it to be in writing? Explain your response.

Cybercises

Locate three examples of various purchase orders and review the contents. Compare and contrast the contents and determine whether they comply with your state's Statute of Frauds.

Parol Evidence Rule

The Code provides for a parol evidence rule under § 2-202. When an agreement is a final expression of the parties' intention, the parol evidence rule will apply, in that any prior oral statements made to alter or contradict the contract will be excluded. The rule does, however, allow for extrinsic evidence to explain, clarify, or supplement the parties' understanding of the contract. Section 2-202 states:

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
> (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

The Code thus provides that terms can be explained by course of dealing, usage of trade, and course of performance.

Course of Dealing

Prior actions and conduct have legal significance when determining whether a contract exists between the parties. Section 1-205(1) governs how the parties' course of dealing is interpreted:

> A course of dealing is a sequence of previous conduct between the parties to a particular transaction, which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

As the Code section suggests, the conduct is personal to the parties and may be different between different sellers and buyers.

Usage of Trade

usage of trade
Any practice or method of dealing having regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question

Commonly accepted industry standards and practices are the basis of **usage of trade**. The Code provides guidance in § 1-205(2):

> A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. If it is established that such a usage is embodied in a written trade code or similar writing, the interpretation of the writing is for the court.

Course of Performance

The repeated acts of performance by the parties to the contract are construed as a *course of performance.* This concept encompasses the parties' habits; that is, the parties' past performance with each other. The Code provides in § 2-208(1):

> Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

Strictly Speaking: Ethics and the Legal Professional

Relationships with clients are delicate. One day everything is fantastic, and the next day you are receiving an irate telephone call. We often spend more time at our jobs than any other place. Meeting people can be challenging when you are working all the time. Because of this fact, do not interpret this as a license to develop close personal relationships with clients. When preparing a case or working on a business deal, you may be spending countless hours of preparatory time with the client. We all know things can happen, but your legal responsibility is not to compromise the client's interests at any cost. Everything may be great in the beginning, but, if and when the relationship sours, the client's interest cannot be sacrificed. Again, there may not be a specific rule on this, but common sense tells us that this is simply a bad idea. Additionally, you do not want to be the center of an "in house" controversy over a client's displeasure in a firm's representation because of something personal. Thus, keep the lines clearly marked between the professional and personal relationships in the workplace.

12.7 A WORD ON ARTICLE 2A—LEASES

lease
A contract for the possession of real estate in consideration of payment of rent

Leasing of goods has been common in the United States for quite some time. However, in interpreting the parties' rights under **leases**, the courts often looked to Articles 2 and 9 of the U.C.C. This did not solve everyone's problems and, as a result, Article 2A was drafted by the NCCUSL beginning in 1985. After some adjustments and amendments, the official version that was adopted and approved by the commissioners is what we now recognize as the 1990 version. All states, except for Louisiana, have adopted Article 2A in its present or revised form, including the District of Columbia. Consequently, it is an important addition to understanding current commercial transactions.

It is important to note that a 2003 revised version has been introduced by the NCCUSL. However, as of the publication of this text, no state has formally adopted the 2003 version.

As with the previous articles under the Code, Article 2A is divided into sections. Exhibit 12-6 shows the contents of the Article. These sections govern the performance of the parties to a lease agreement and guide the courts in determining a person's rights or responsibilities under a lease.

EXHIBIT 12-6 Parts of U.C.C. Article 2A

Contents of Article 2A-Leases				
Part 1 General Provisions. **Explanation:** Includes the scope of Article 2A, definitions that apply in Article 2A and which laws govern such transactions.	**Part 2** Formation and Construction of Lease Contract. **Explanation:** General discussion of offer and acceptance. Included is a detailed explanation of warranties given in lease arrangements as well as some important risk-of-loss provisions.	**Part 3** Effect of the Lease Contract. **Explanation:** Deals with the effect of the lease on the performance and transfer of rights as well as any subsequent leases by the parties. Identifies the priority of rights when goods become fixtures or are seized.	**Part 4** Performance of Lease Contract, Repudiation, Substitution and Excuse. **Explanation:** Explains the legal ramifications when performance is either not given or is legally excused.	**Part 5** Default. **Explanation:** Divided into three subsections: General: deals with the general provisions regarding a defaulting party; Default by Lessor: sets forth a Lessee's rights and remedies upon lessor's default; Default by Lessee: deals with the rights and remedies of the lessor when lessee fails to perform.

Article 2A regulates transactions for the lease of goods between a lessor and a lessee. A *lease* is defined in § 2A-103 as a transfer of the right to possession and use of goods for a term in return for consideration. The big question under Article 2A is whether the transaction between the parties creates a "true lease": Is the lease between the parties in fact a security interest and not a lease? This answer determines whether Article 2A or Article 9 governs the transaction. This determination is made under § 1-201(37), which states that:

> [W]hether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and not subject to termination by the lessee, and
>
> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
> (d) the lessee has the option to become the owner of the goods for no additional consideration or nominal consideration upon compliance with the tease agreement.

This section provides guidance in determining which article is to govern, but much confusion and uneasiness still remain because the case law continues to develop in this area.

In addition to defining a true lease, Article 2A governs consumer leases and finance leases. This again gives some assistance to courts in interpreting the governing principles of leases.

In determining what rules apply to leases, it is important to review U.C.C. Article 2's sections on formation of a contract (which include offer and acceptance, course of performance, the parol evidence rule, and the Statute of Frauds). Virtually all provisions discussed in Article 2 have a corresponding provision in Article 2A specifically dealing with leases. However, there are some restrictions under Article 2A that are not found in Article 2. Specifically, the freedom of contract is restricted in dealing with consumer leases. Article 2A reduces the restrictions on warranties and, in effect, extends the statute of limitations on the filing of cases. Article 2 establishes a four-year statute of limitations on sale of goods. Although Article 2A does have a four-year statute of limitations, the statute begins to run on discovery of the defect rather than when the goods are provided. This is a major difference between Article 2A and Article 2.

The rights and remedies afforded to parties in a lease arrangement are similar to those in Article 2. In addition, parties can agree to provisions regarding remedies. The remedies provided a lessor and a lessee when default occurs are extensively treated in part 5 of Article 2A and are similar to those in Article 2.

Cybercises

Determine what the proposed amendments to Articles 2 and 2A entail. What are some of the changes proposed to your state's current version of these articles?

As with Article 2, Article 2A had proposed amendments in 2003. As of the publication of this text, no jurisdiction has adopted those amendments.

12.8 PRACTICAL APPLICATION

As a paralegal, you will probably be asked to draft standard bills of sale. When drafting a bill of sale, be sure to include the names of the seller and buyer, the date, the amount paid, and the description of the goods sold. Exhibit 12-7 illustrates a typical bill of sale.

EXHIBIT 12-7 Sample Bill of Sale

Bill of Sale

Know All Men by These Presents that Wayne Morrison, of 2200 Burkdale, Oklahoma City, Oklahoma, in consideration of Ten Thousand Dollars ($10,000.00) paid and delivered by Jonathan Ramos of 22 East 10th Street, Oklahoma City, Oklahoma, the receipt of which is hereby acknowledged, does hereby sell, assign, convey, transfer, and deliver to Jonathan Ramos the following goods:

650 pairs of roller blades

To have and to hold the same unto the said buyer and the heirs, executors, administrators, successors, and assigns of the said buyer forever.

Dated this the 21st day of November, 2011.

_____
Wayne Morrison

Often, a contract which forms the basis of the sale is part of the sales transaction. How detailed the contract must be depends entirely on the transaction and the parties' requirements. Exhibit 12-8 is an example of a general contract for the sale of goods.

EXHIBIT 12-8 Sample general contract for sale of goods

General Contract for Sale of Goods

Jason Jones of 223 10th Street, Boston, Massachusetts (seller), agrees to sell and Cynthia Day of 123 ABC Street, Boston, Massachusetts (buyer), agrees to buy [describe or identify goods] at $ [price] per ton to be delivered by Jason Jones to Cynthia Day on or before June 1, 2010. In consideration of the promises and of the mutual benefits to each party, it is further agreed as follows:

1. *Description.* The goods, which are the subject of this sale and which seller shall deliver to buyer and for which buyer shall pay shall conform to the following specifications: [insert terms].

2. *Warranty.* Seller warrants that the goods shall meet the specifications described herein. The foregoing warranty is exclusive and is in lieu of all other warranties, whether written, oral, or implied, including the warranty of merchantability and the warranty of fitness for a particular purpose.

3. *Delivery.* Delivery shall be on or before [date] and shall be to buyer at seller's place of business. Seller agrees to furnish the facilities and at its cost to load the goods on trucks furnished by buyer.

4. *Packaging.* Buyer shall give seller instructions for the packaging of the goods not less than 48 hours prior to the date of delivery, and the reasonable cost of such packaging shall be charged to buyer.

5. *Title.* Title shall remain with seller until delivery and actual receipt thereof by buyer.

6. *Risk of Loss.* Identification shall take place on the packaging of the goods, and the risk of loss shall pass on such identification.

7. *Price and Time of Payment.* The price of the goods shall be $[amount], and shall be paid at the time and place of delivery by bank draft or cashier's check or certified check.

8. *Inspection.* Inspection shall be made by buyer at the time and place of delivery.

9. *Claims.* Buyer's failure to give notice of any claim within [number] days from the date of delivery shall constitute an unqualified acceptance of the goods and a waiver by buyer of all claims with respect thereto.

10. *Remedies.* Buyer's exclusive remedy and seller's limit of liability for any and all losses or damages resulting from defective goods or from any other cause shall be for the purchase price of the particular delivery with respect to which losses or damages are claimed plus any transportation charges actually paid by buyer.

11. *Assignment.* Buyer may not assign its rights or delegate its performance hereunder without the prior written consent of seller, and any attempted assignment or delegation without such consent shall be void.

12. *Construction.* This contract is to be construed according to the laws of, and under the Uniform Commercial Code as adopted by, the State of Massachusetts. This document constitutes the full understanding of the parties, and no terms of this document shall be binding unless hereafter made in writing and signed by the party to be bound.

Signed and sealed in triplicate this 3rd day of May, 2011.

_____ _____

Buyer Seller

The paralegal may be given the task of drafting a lease or related lease documents that conform to Article 2A requirements. Sometimes, in the negotiation process, one party may make an offer in writing to lease. Exhibit 12-9 is a sample of such an offer.

EXHIBIT 12-9 Sample offer to lease personal property

Offer to Lease Personal Property

To: Janet Donally, 821 Main Street, Cedar Rapids, Iowa

D & J Leasing Co., offers to lease to you, Janet Donally, the following goods: Four (4) 486X Computers and Printers for monthly payments of Two Hundred Fifty Dollars ($250.00). The terms of this offer to lease are to be negotiated. This offer to lease is made pursuant to Article 2A of the Uniform Commercial Code.

This offer remains open until March 31, 2011. You may accept this offer by mailing a written notice of acceptance on or before the date indicated above. However, this offer may be accepted only on the terms set forth in this instrument.

The paralegal also may be asked to draft a personal property lease. There are a number of forms that can be followed, but Exhibit 12-10 is an example of a basic personal property lease. Some provisions to consider when drafting a lease are as follows. In some form, these provisions should be included in any lease.

- Applicable law
- Applicable judicial forum
- Modification of agreement—signed writing required
- Transferability of rights clause authorizing transfer or transferability of rights clause prohibiting transfer
- Disclaimer of implied warranties
- Renewal clause (automatic or optional renewal)

EXHIBIT 12-10 Sample personal property lease

Personal Property Lease

1. DESCRIPTION OF PARTIES AND PROPERTY LEASED. Discovery Computers Inc., of 1234 East Lake Road, City of Las Vegas, State of Nevada, addressed as lessor in this agreement, leases to Jon M. Vaughn, 5678 Lake Pine Drive, City of Las Vegas, State of Nevada, addressed as lessee in this agreement, and lessee hires from lessor, the following described personal property: [computer equipment to be installed at] 2345 Main Street, Las Vegas, Nevada.

2. TERMS OF LEASE. The term of this lease shall be 12 months, such term to commence on June 1, 2011, and to terminate on May 30, 2012, unless otherwise terminated as provided in this lease.

3. RENT. In consideration for leasing of the above-described property, lessee agrees to pay lessor as rent for such property the sum of Two Hundred Fifty Dollars and No Cents ($250.00) per month, the first payment of which rent is due on or before June 1, 2010, and each subsequent payment of which is payable on or before the first day of each month thereafter, during the entire term of the lease. Such payments shall be made at lessor's address as set out in § 1 if this lease.
4. MAINTENANCE AND REPAIR. Lessee shall exercise due care in the use and maintenance of the lessed property, keeping it in good repair and in a condition equivalent in all respects to that in which it was received by lessee, normal wear and tear excepted.
5. ASSIGNMENT OR SUBLEASE. Lessee will not assign this lease or sublet the leased property unless the written consent of lessor to such assignment or sublease is first obtained.
6. DEFAULT. If lessee shall be in default of any of the rental payments, when the payments shall become due and payable as provided in this agreement, or shall remove or attempt to remove the leased property from 2345 Main Street, Las Vegas, Nevada, without first obtaining the written consent of lessor, lessor shall, at his or her option, terminate this lease and lessee's right to possession of the leased property, and lessor shall then without demand on or notice to lessee take possession of such leased property.
7. INSPECTION BY LESSOR. Lessor shall at all times during lessee's business hours have the right to enter on the premises where the leased property is located for the purpose of inspecting the property.
8. INDEMNITY. Lessee will indemnify lessor against, and hold lessor harmless from, all claims, actions, proceedings, damages, and liabilities, including attorney fees, arising from or connected with lessee's possession, use, and return of the leased property.
9. APPLICABLE LAW. This lease and the construction of this lease will be governed by the laws of the State of Nevada.
10. NOTICES. Any notices to be given under this lease shall be given by mailing the notices to lessor at 1234 East Lake Road, City of Las Vegas, State of Nevada, and to lessee at 5678 Lake Pine Drive, City of Las Vegas, State of Nevada.

Dated_____.

_____
Discovery Computers, Inc., Lessor

_____
Jon M. Vaughn, Lessee

Typical contractual provisions relate to notice of renewal of the lease and notice of default. Usually these types of letters are in direct response to a lease's contractual provisions. Exhibit 12-11 illustrates each type of notice letter.

EXHIBIT 12-11 Sample lease renewal notices

Notice by Lessee of Intention to Renew Lease

You are notified pursuant to Section _____ of the lease executed on December 14, 2011, between Geyser, Inc., as lessor, and Hamilton Corporation, as lessee, that the undersigned, as lessee, elects to renew the lease for an additional period of two years (2) beginning January 14, 2012, on the termination of the lease, pursuant to the same terms and same rental as contained in the lease and pursuant to the terms of such lease.

Dated:_____

_____
Geyser, Inc., Lessor

_____
Hamilton Corporation, Lessee

Notice by Lessor of Termination of Lease Due to Default in Rental

Geyser, Inc.
14550 Dallas Parkway
Dallas, Texas 75240

October 31, 2011

Notice is given that under the lease agreement between Geyser, Inc. and Hamilton Corporation, dated December 14, 2010, whereby Geyser, Inc. leased from Hamilton Corporation hospital beds, the sum of Ten Thousand Five Hundred Dollars ($10,500.00), rent payment for the period of October 1, 2011 through November 30, 2011, is unpaid and in default.

Notice is given that Hamilton Corporation, pursuant to the terms of such agreement, elects to terminate the lease by reason of such default, and to take immediate possession of the personal property that is the subject of the lease.

You are hereby required to deliver to Hamilton Corporation all of the leased property, at the premises of Hamilton Corporation on receipt of this notice, in accordance with the terms of the lease agreement.

Sincerely,
Hamilton Corporation

SUMMARY

12.1 The Uniform Commercial Code is a statute that regulates commercial transactions. It has been adopted in some form in all 50 states and provides uniformity for parties entering into commercial transactions. The U.C.C. developed into eleven articles.

12.2 A sale transfers title from seller to buyer for a price. Article 2 relates to the sale of goods between merchants and nonmerchants. Sales between merchants are subject to higher standards of good faith and reasonableness than for nonmerchants. The sale between parties must be a sale of goods.

12.3 Rules of contract formation have been relaxed under the U.C.C. Contracts may be enforceable even if they are indefinite, lack terms, and are incomplete. The Code will allow nonconforming goods to be shipped as an accommodation, although the buyer's right to accept or reject the goods is unchanged. Additionally, consideration is not necessary to hold an offer open under the U.C.C.

12.4 The mirror image rule is completely modified under the Code. An offer and acceptance need not be exact. Even if terms are missing or left open, a contract may be formed between the parties. Further, delivery and price terms can be left open. New terms can be added to the offer if they are consistent with the contract. Output and requirements contracts are allowed under the U.C.C. and will not be held invalid for indefiniteness.

12.5 As with the common law, contracts cannot be unconscionable. Unconscionability falls into two categories: procedural and substantive. Procedural unconscionability is when the contract lacks meaningful choice. Substantive unconscionability focuses on the terms of the contract itself. Two important areas of substantive unconscionability focus on liquidated damage clauses and remedy provisions.

12.6 The U.C.C. has a Statute of Frauds and a parol evidence rule provision. Both of these rules have been relaxed under the U.C.C. Lack of a writing containing all the material terms will not defeat a contract. Under the parol evidence rule, course of dealing, usage of trade, and course of performance are used to interpret the conduct of the parties.

12.7 Because leasing of goods is a common method of doing business U.C.C. article, known as Article 2A, was developed to govern transactions between lessors and lessees. Article 2A has five parts. In addition, different types of leases are analyzed, as are remedies for breach of a lease.

KEY TERMS

Uniform Commercial Code
CISG
sale
goods
seller
buyer
merchant
accommodation
firm offer
usage of trade
lease

REVIEW QUESTIONS

1. Is the U.C.C. a successful statute? Why or why not?
2. How many articles are found in the U.C.C., and what are their titles?
3. How does Article 2 define *sale* and *good*?
4. Distinguish between a merchant and a nonmerchant.
5. List three main departures that the U.C.C. made from the common law of contracts.
6. How is the mirror image rule modified under the Code?
7. Distinguish a requirements contract from an output contract.
8. What is the difference between procedural and substantive unconscionability?
9. When can the Statute of Frauds be circumvented in a sale-of-goods transaction?
10. Identify the different sections under Article 2A and why Article 2A was developed.

EXERCISES

1. Michael Andrews wants to buy or lease a new computer with printer. He shops around and decides to purchase a computer and printer from his friend, Emily Browning. The price for the computer and printer are $800. Michael cannot afford to pay for the computer and printer in one payment, so Emily agrees that he can pay $200 a month for four months. After the second month, Michael defaults.

   a. Prepare the letter to Michael from Emily regarding the default.
   b. Does the U.C.C. apply to this transaction? Explain.
   c. What if Michael purchased the computer and printer from Computer Depot? Would the U.C.C. apply to the transaction? Explain.

2. Determine whether the U.C.C., Article 2, or common law contracts applies to the following transactions with an explanation supporting your response:

   a. Temps R Us employs Monica to work at their company.
   b. William and Beverly decide to purchase a pure bred golden retriever from the Pet Depot.
   c. Arnie purchases Mexican tile for his new kitchen in the amount of $3000. The installation for the tiles is $750.
   d. Air Conditioning service installs the central air conditioning unit Mrs. Marston purchased from New York Air Conditioners.
   e. Parker Jenson hires a Spanish artist to paint a portrait of his father.
   f. Parker Jenson purchases a portrait of his father from Spanish artist Salvador.

3. Which of the following transactions would be considered "a good" under the U.C.C. definition? (For this exercise, use your state U.C.C. statute. For states

that have not passed the U.C.C. either refer to your state's sales case or statutory law or choose another jurisdiction to answer this question.)

a. The Red Cross enters into a contract with General Community hospital to supply all its blood products to the hospital.
b. Mary Patton is in a car accident and receives a blood transfusion at General Community Hospital.
c. Addie has a weekly appointment with her hair stylist, Mr. Aaron. She decides to have her hair dyed light blonde. The hair dye irritates her scalp and causes her to see her dermatologist.
d. City of Hope sells water to meat packing facility.
e. Seesaw Acres contracts with Cost Savers, Inc. for 100 Christmas trees.
f. Sale of house and adjoining lot to the Blakelys from Storm Realty.
g. Hillary purchases computer software from Electronics R Us.
h. Hillary's software is defective and hires the Geek Patrol to examine the software.
i. Pools Unlimited sells the Toomeys a pool and equips and installs a sliding board and volleyball net.
j. Sale of gasoline by manufacturer to service station.

4. Gerard and Leann have always wanted a custom vehicle to drive on weekends. Gerard had heard of this company called Dream Vehicles, Inc., who convert ordinary vehicles into custom performance vehicles. They went to their local car dealership and purchased a Dodge Durango. Their dealership then delivered the Durango to Dream Vehicles to convert it into a Shelby SP 360—a high performance vehicle. Dream purchased most of the parts from High Performance Supplies and began working on the conversion. The conversion took approximately three months. The cost for the conversion was $24,500. On schedule, Dream Vehicles delivered the Shelby SP 360 to the dealership. The dealership paid Dream Vehicles. Excited about this new car, Gerard and Leann picked up the vehicle and drove it off the lot. About a mile from home, the car made a funny noise and just stopped. A mechanic inspected and examined the vehicle and determined that the parts were substandard and that the vehicle would never run unless it was rebuilt from scratch. Gerard and Leann were furious and wanted their money back for Dream's poor workmanship. Gerard and Leann sue Dream Vehicles for breach of contract. The court has requested a legal brief examining whether the U.C.C. or the common law of contracts applies. Your attorney has requested that you prepare the initial document to be submitted to the court.

5. Jennie owns a company that manufactures southwestern jewelry. Her company is Southwest Sterling. Jennie receives the following purchase order dated June 8, 2010 from Island Jewels:

   To: Southwest Sterling

   Want to purchase 100 sterling and turquoise necklaces and 100 pairs of matching earrings. Please provide pricing and delivery information.

   s/Island Jewels

Jennie responded as follows:

To: Island Jewels

Thank you for your inquiry. Can ship as per inquiry by July 20, 2010. Must prepay prior to shipping. The cost for the necklaces and earrings is $4,500, which includes shipping to your store. Please confirm.

s/Southwest Sterling

Island Jewels responded as follows:

Please ship. Will send funds immediately.

s/Island Jewels

Dated June 15, 2010

Island Jewels received the shipment on July 18, 2010. When they opened the earring boxes, the earrings did not match the necklaces. Under the U.C.C., did Southwest Sterling comply with Island Jewels purchase order? Was a contract formed under the U.C.C.?

6. Continuing with the facts from Exercise 5 except that the shipment arrived on July 31, 2010. In the shipment, Island Jewels noticed that there were only 75 necklaces. Included in the shipment were 25 bracelets. Southwest Sterling sent the following e-mail to Island Jewels on July 1, 2010.

   To: Island Jewels

   Can only ship 75 necklaces. Will add 25 bracelets. The bracelets are of high quality.

   s/Southwest Sterling

   (a) Island Jewels never responded to the e-mail. Was a contract created under the U.C.C.? Explain your answer.
   (b) Island Jewels claims they never received the e-mail. Was a contract created under the U.C.C.? Explain your answer.

7. Owen Pratt thinks it's a good time to purchase a new car. He goes to one of his local dealerships and finds a great deal on a new fuel efficient car. Because he does not have all the money to purchase the car, the dealership offers a financing arrangement with their financing company. Without reading all the details of the installment agreement, Owen signs the agreement and drives off in his new car. One year into the agreement, Owen defaults. He has lost his job due to the economy. The financing company calls Owen about his payments and Owen tells them the car is defective. The financing company tells him to take it up with a judge because they are coming for the car. Owen files a lawsuit against the dealership and financing company for breach of contract. The dealership and financing company file a Motion to Dismiss Owen's claims based on the fact that the installment contract has an arbitration clause in it which states:

   Arbitration: All claims arising out of or related to the purchase, sale or payment of the above vehicle shall be decided exclusively by arbitration in the state of New York. The laws of the state of New York shall apply to

this transaction and the unsuccessful party shall pay all fees related to the arbitration.

Owen never saw the arbitration clause and more importantly, he lives in Oregon. How is he going to fight a lawsuit in New York? Owen wants to challenge the arbitration clause. He has hired your law firm to fight the Motion to Dismiss. What are Owen's arguments in favor of striking down the arbitration clause? (You should review Oregon and New York law to support your position.)

8. Willis Reardon needs some new equipment to plow his vineyards in the Napa Valley. He contacts John's Farm Equipment to get some prices on tilling equipment. He finds a great field cultivator. He decides to buy the 2100 model with custom additions for his vineyard. He contacts John's Farm Equipment by telephone, and they orally agree to the specifications and the price. Willis tells the representative to begin building the cultivator. Delivery is set for 60 days from their conversation, which was October 17, 2010. When the cultivator is delivered, Willis notices that some of the special features that he ordered are not included. He contacts the representative who states that he delivered what Willis had ordered. The only documentation that Willis has is an invoice, which states:

```
                JOHN'S FARM EQUIPMENT, INC.
The best service and equipment for over 90 years
                  PURCHASE ORDER INVOICE
To: Willis Readon
One Field Cultivator (Special order)
Design requirements attached                    $15,000

                                   Delivery       $400

                                   Total       $15,400*
*Full purchase price required on all special orders
```


John's Farm Equipment claims that they complied with the contract for the field cultivator. Willis claims that the contract is enforceable under the U.C.C.'s Statute of Frauds provision. Who will succeed? Detail your response.

9. Plus Point Corporation offers to sell Wellness Health Center 500 home blood pressure machines at $50 a machine. Plus Point states in its offer that "in the event you accept this offer, please fax your acceptance to the undersigned by October 15, 2010." Wellness Centers accepted the offer on October 14, 2010 by e-mailing the acceptance to the Vice President of Sales who faxed him the offer.

   a. Under the U.C.C., was a contract formed?
   b. If Plus Point had not specified a mode of acceptance, would your response change? Explain your response.

10. Mango Melee is a company which imports and exports fruit from all over the world. Their principal place of business is in Miami, Florida with many satellite offices within the United States and its territories. One of its customers, Organic Markets, wants to purchase 200 crates of mangos. Organic specified it wanted "grafted" mangos only. No other variety is acceptable. Mango Melee agrees to the order, but states that they can only supply 150 crates every two weeks. Organic agrees to this term. The first delivery arrives on May 25, 2010. Organic inspects the shipment and notices that some of the mangos are smaller than others. When they taste some of the mangos, they have a stringy texture, which is not consistent with a grafted mango. The smaller varieties are sweet and Organic does not object and accepts the first shipment. The second shipment arrives two weeks later, again with different types of mango varieties. When the third shipment arrives, Organic objects; the mangos supplied are not grafted and Organic returns the shipment to Mango Melee. Organic refuses to pay for all three shipments. Was a contract created under the U.C.C.? If Mango Melee sues Organic, will a court allow parol evidence? What importance are the party's course of dealing and performance to the contract activities?

CASE ASSIGNMENTS

1. Midland Grain Producers is a long-standing client of the firm. They have never prepared a formal contract for the sale of their grain to manufacturers, but they believe it is time that they had a formal contract. They are not sure what they need but offer the following as some of the required terms:

   a. Parties with address and place of incorporation.
   b. No term is for more than one year.
   c. Cannot assign the contract.
   d. Price to be determined 10 days prior to actual purchase.
   e. Inspection within 48 hours of receipt of product—nonnegotiable provision.
   f. No personal checks or corporate checks.
   g. Arbitration is exclusive remedy with the arbitration to take place only in Missouri.
   h. Missouri law applicable.

   Other than the above suggestions, Midland Grain is willing to discuss the contents of the document. Draft a sales contract for Midland Grain.

2. Based upon the document you prepared from the facts in 1, Midland Grain negotiated a contract with Bread and Rye Manufacturers who produce all types of bread for sale to grocery stores. Bread and Rye received your contract but objected to the term that an inspection must be completed within 48 hours of receipt of the grain. Their sales representative faxed Midland a letter stating that they would need 5 days to inspect the grain. Midland never responded

to the letter. On March 15, 2010 Midland Grain delivered Bread and Rye's shipment. On March 19, 2010 Midland Grain received a letter from Bread and Rye that the grain was old and rejected the goods. Midland Grain responded by stating that the contract included a term that the inspection must occur within 48 hours of receipt of the shipment. Bread and Rye responds by stating that they never agreed to the provision and sends back the grain; they want their money returned in full immediately. Midland Grain refuses. Which provision governs the transaction, Midland Grain's or Bread and Rye's? Prepare a memorandum to your supervising attorney advising her as to the likelihood of Midland Grain's success in defending a lawsuit.

Chapter 13

Performance under Article 2: Seller and Buyer Duties

Just Suppose . . .

You are a big fan of the television show "Dancing with the Stars."—the dancing, the drama, and, of course, that mirror ball trophy. In a nail biter, Maks and Mel B won the competition. (Okay, wishful thinking!) As the winners, Maks and Mel B must do a number of post-show publicity appearances, which makes it impossible for either star to bring home that mirror ball trophy. The show decides to send the trophy through the mail to the homes of both Maks and Mel B. Both trophies arrive in perfect condition. Mel B hears about a charity event and decides to auction the trophy. The proceeds of the event will be used to help a pediatric AIDS foundation. Mel's assistant packs the mirror ball trophy for shipment to Events Auction House. The trophy brings in $7,000. The Auction House prepares the mirror ball trophy for shipment to the buyer, who lives in Sun Valley, Utah. Events assigned the shipping to one of its new employees, Dillon. He packs the trophy in bubble wrap, but unfortunately it arrives at the buyer's residence in a thousand pieces. The buyer cannot believe his eyes when he opens the package. He wants his money back, but the auction house refuses—something about the fact that the buyer was responsible for the shipping. Now, the buyer hires your firm to examine all options. Hopefully, the buyer can get his money back or a replacement.

Situations such as this arise when there are no specific instructions as to the responsibilities of the parties in shipment. This chapter will focus on the seller's and buyer's general obligations and how to best preserve the interests of each. In these circumstances, who bears the responsibility is critical to determining the rights and responsibilities of the parties to the contract.

Outline

13.1 GENERAL OBLIGATIONS

When a contract for the sale of goods has been created between a buyer and a seller, the parties have certain basic duties. One of those duties we discussed in the previous chapter is good faith. In addition to the duty of good faith, section 2-301 of the Uniform Commercial Code (the Code) sets out the general obligations of the parties to a sale-of-goods contract:

> The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

Thus, the seller simply has to deliver goods that conform to the terms of the contract and deliver those goods in accordance with the agreement or in accordance with the Code; the buyer has the responsibility to pay for those goods upon delivery. Once these acts have occurred, the sales transaction is complete.

There are variations on this simple rule that goods must be tendered and payment must be made under the U.C.C. This chapter explores the U.C.C. provisions for when the seller's and buyer's duties are not specifically stated.

13.2 SELLER'S DUTIES AND OBLIGATIONS

The basic duties of a seller in a sales contract are to tender and deliver goods to the buyer. One question that may arise is whether a proper tender of the goods has been made. The U.C.C. states, in § 2-503, that:

> [T]ender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery.

Section 2-503 also specifies the manner, time, and place for the tender of goods. The Code specifically states that tender must be made at a reasonable hour and that the buyer must furnish facilities to accept the goods in the contract.

There are variations under § 2-503, which affect when the goods are to be shipped by means of a common carrier, when the goods are in the hands of a bailee, and when the goods are being delivered through a document of title. Therefore, when the seller delivers conforming goods, no matter what the method of delivery, the buyer must accept the goods and pay for them.

Delivery by Common Carrier

common carrier
A person or company engaged in the business of transporting persons or property from place to place, for compensation

Although delivery to a **common carrier** is a frequent requirement in sales transactions, additional considerations arise between the parties. First, the seller must deliver the goods to the common carrier, such as a ship, truck, or train. There will usually be documents that instruct the carrier as to the method of shipment and liability of the parties while the goods are in transit. (This becomes important with respect to the title issues discussed in

Chapter 14.) Second, the goods must be properly loaded and transported by the common carrier. A concern of the seller is that the goods arrive at the buyer undamaged. This can be a problem, because once the goods are placed on the carrier, the seller loses control over the goods. Third, once the goods arrive, the buyer must accept them and pay for them. If the goods reach the buyer unharmed, the sales contract is completed when all parties perform their obligations. But, as will be seen later in this chapter, complications may arise.

Delivery to a Bailee

bailee
The person to whom property is entrusted in a bailment

bailor
The person who entrusts property to another in a bailment

document of title
A document evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods to which it pertains

Goods can be delivered to a third party known as a **bailee**. The bailee holds the goods on behalf of the **bailor** until instructions are given as to disposition of the goods. Normally, the instructions for delivery are found in a **document of title**, which tells the bailee who owns the goods and to whom title is to be transferred upon delivery. Section 2-503(4) (a) and (b) provide guidance in a bailment situation:

> (4) Where goods are in the possession of a bailee and are to be delivered without being moved
>
> (a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but
>
> (b) tender to the buyer of a non-negotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

In a sense, the transfer is done on paper, without physical delivery of the goods to the buyer. This is a common method of delivery in the commercial world (see Exhibit 13-1).

EXHIBIT 13-1 Delivery by bailment

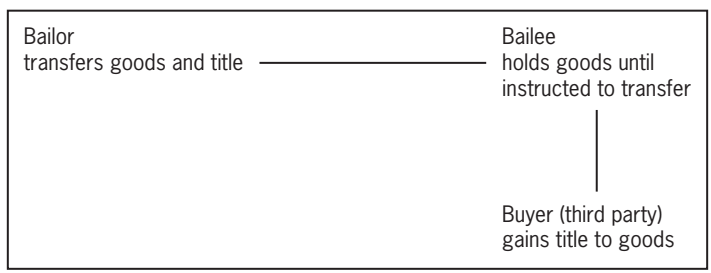

Exhibit 13-2 shows some provisions to use when goods are delivered to a bailee.

EXHIBIT 13-2 Sample delivery clauses for bailments

Tender of Delivery When Goods in Possession of Bailee to Be Delivered Without Being Moved—Negotiable Document

At the time of executing this contract, the goods are located in the [name of warehouse] at [address]. Seller shall deliver the documents necessary for buyer to obtain the goods from the warehouseman to the buyer at [address]. Delivery of documents shall satisfy seller's obligations hereunder.

OR

The goods which are the subject of the agreement are presently in the possession of [identify warehouseman] at [address]. Delivery will be made by negotiable documents covering the goods by seller to buyer.

Tender of Delivery When Goods in Possession of Bailee to Be Delivered Without Being Moved—Procure Acknowledgment

The goods which are the subject of this agreement are presently in the possession of [identify carrier or warehouseman]. Delivery will be made by seller to buyer when seller obtains and delivers to buyer an acknowledgment from the bailee of the buyer's right to possession of the goods.

Delivery by Document of Title

When a document of title is used to effectuate delivery, the inquiry goes beyond Article 2. A document of title can be a bill of lading, a warehouse receipt, or any other document that transfers ownership. Article 7 of the Code, entitled "Warehouse Receipts, Bills of Lading, and other Documents of Title," governs documents of title and sets out the rights of the parties handling documents of title. Consequently, Article 2 and Article 7 may have to be reviewed together if documents of title are used as a means of delivery of goods.

Delivery of the Goods: No Delivery Place

When a contract does not specifically state a place for delivery, § 2-308(a) sets forth how delivery should be made. Delivery is proper at the seller's place of business or, if there is no place of business, at the seller's residence. This suggests that the buyer has a responsibility to pick up the goods and that the seller has only to notify the buyer that the goods are ready and provide a reasonable time to pick them up. This is logical. Think about when you purchase a television or DVD player; you the buyer, go to the seller's place of business to pick up the product and in effect, there is a tender of delivery.

However, § 2-308(b) suggests that the proper place of delivery for identified goods, when the goods are at a location other than the seller's residence or place of business, is where the goods are located. The Code is specific in its guidance when a place for delivery is not identified. Familiarity with these Code sections is important in determining whether proper tender of delivery has occurred between the parties.

13.3 SHIPMENT CONTRACTS: PARTIES' RIGHTS AND RESPONSIBILITIES

When the goods which are the subject of the contract have to be transported, the U.C.C. provides direction as to the proper means of delivery. Any contract under which the goods must be shipped to the buyer is either a shipment contract or a destination contract. In a *shipment contract,* the seller contracts with a carrier for shipment of the goods and releases those goods to the carrier. When the goods are surrendered to the carrier, the buyer technically owns the goods. Under a shipment contract, tender of performance occurs when the goods are surrendered to the carrier. Thus, the buyer is thereafter responsible for the goods as the owner. Unless otherwise stated, contracts involving transportation of goods are presumed to be shipment contracts.

In contrast, under a *destination contract,* the seller tenders the goods to the carrier, but the buyer neither becomes responsible for the goods nor has ownership of the goods until the carrier tenders the goods directly to the buyer. However, the buyer agrees to accept delivery when the goods arrive. Tender is not complete until the goods reach the buyer's destination. If the parties have not agreed to the type of delivery contract, the Code provides that a shipment contract, rather than a destination contract, will be implied.

A seller is required to perform certain obligations to accomplish proper tender of the goods. Under § 2-504, a seller must:

(a) put the goods in the possession of such a carrier and make such a contract for the transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case: and
(b) obtain and promptly deliver or tender in due form any documents necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade: and
(c) promptly notify the buyer of the shipment.

These provisions must be carefully met, or the seller may be found not to have properly tendered delivery. Lack of proper tender of delivery may allow the buyer to reject the goods, which the seller undoubtedly does not desire.

Note, however, that a destination contract is very specific as to the method of transport. It not only requires shipment from a particular place but also delivery at a particular destination. For example, a seller located in Boston contracts to sell and deliver goods to a buyer in New York at the buyer's warehouse in New York. The delivery is not complete until the goods are delivered to the buyer's warehouse, after notice to the buyer that the goods have been shipped and delivery is forthcoming.

The Code, as well as custom and usage, determines the type of contract between the parties through the use of certain *mercantile terms.* These terms are important in determining who has responsibility for the shipment and when ownership rights pass to the buyer.

F.O.B.
Free on board

F.O.B. The term **F.O.B.** means "free on board." In the shipping of goods, "F.O.B. place of origin" or "F.O.B. place of destination" are used to determine title, liability, and shipping costs. Therefore, understanding the term F.O.B. is essential to determining the seller's and

buyer's responsibilities under the contract. For example, assume that the seller's place of business is St. Louis and the seller is shipping goods from St. Louis to Miami, F.O.B. St. Louis. That means that once the seller has loaded the goods on the carrier, the buyer becomes responsible for the goods. "F.O.B. place of origin" indicates a shipment contract.

If however, the seller was in St. Louis, the buyer was in Miami, and the contract was F.O.B. Miami, the seller would be responsible for the goods until they reached their destination. Thus, "F.O.B. place of destination" creates a destination contract.

F.A.S.
Free along side

F.A.S. The term **F.A.S.** means "free along side" and is used primarily when goods are shipped on a seagoing vessel. When the term F.A.S. is used, the price quoted will include all costs and shipping expenses to get the goods to the buyer's place of business or named destination. Consequently, if the seller is in Miami and the buyer is in New York, a contract stating "F.A.S. Miami" means that the buyer is responsible for the goods the moment they are loaded on the ship. Once the seller transports the goods to the ship at the port of departure, the seller has technically delivered the goods and is relieved of further responsibility. The buyer is responsible for the goods in transit from the point of departure, at Miami, to New York.

Sometimes sellers will interchange the term F.A.S. with F.O.B. The results and responsibilities are the same. If there is any question as to when a party's responsibility begins and ends, ask. Do not allow lack of experience to cause undue costs to a client or customer. Provisions that might be included when the contract calls for F.O.B. or F.A.S. shipment are in Exhibit 13-3.

EXHIBIT 13-3 Sample clauses for F.O.B. or F.A.S. shipment

Provision of Sales Agreement—F.O.B. and F.A.S. as price terms

The terms F.O.B. and F.A.S. as used in this agreement are price terms only and impose no duty on seller apart from guaranteeing the price at which the goods are to be sold.

Provision of Sales Agreement—F.O.B. and F.A.S. as delivery terms modified as to risk

Any F.O.B. or F.A.S. term used in this agreement shall be construed as a delivery term, but seller shall have the risk of loss until the goods covered by this agreement have been delivered to the facility of buyer and are approved after inspection by buyer.

Provision of Sales Agreement—F.O.B. and F.A.S. as delivery terms modified as to expenses

Any F.O.B. or F.A.S. term used in this agreement shall be construed as a delivery term, but expenses incurred by seller in moving the goods from the place of business of seller, and in loading, shipping, or delivering the goods, shall be charged to buyer.

C.I.F.
Cost, insurance, and freight

C & F
Cost and freight

C.I.F. and C & F. The terms **C.I.F.** and **C & F** are related shipment terms. C.I.F. means cost, insurance, and freight, whereas C & F means only cost and freight. The price of the goods includes the freight costs and insurance costs under a C.I.F. contract. C.I.F. and C & F are normally used in conjunction with a shipment contract, where the seller's responsibilities cease when the goods are loaded onto the carrier. Exhibit 13-4 shows some common C.I.F. and C & F provisions in shipment contracts.

EXHIBIT 13-4 Sample clauses for C.I.F. or C & F shipment

Provision of Sales Agreement—Insurance requirements

On shipment of goods by [type of carrier] to [address], seller shall purchase for the account of and at the expense of buyer sufficient insurance to cover the costs of the goods to buyer plus _____ percent [_____%] of such costs. The insurance policy shall be a [form of policy]. In the discretion of seller or at the request of buyer, seller shall obtain additional insurance for the account of buyer to cover the following risks: [set out specific risks].

Provision of Sales Agreement—Expansion of C.I.F. and C & F terms

In addition to the duties imposed on the parties to this agreement by [cite applicable Uniform Commercial Code section] in effect in [state] relating to C.I.F. and C & F terms, buyer shall perform the following additional duties: [state duties].

Mercantile Terms—Clause postponing until tender of goods in F.O.B. of F.A.S. vessel shipment

Buyer shall not be required to make payment for any goods shipped F.O.B. vessel or F.A.S. vessel until tender of documents after arrival of the goods at destination.

ex-ship
A term that refers to goods that are shipped by sea

Ex-Ship. The term **ex-ship** refers to a contract under which the goods are shipped by sea. Like an F.O.B. destination contract to the buyer's place of business, ex-ship indicates a destination contract where the seller pays all costs and expenses, including unloading the goods at the buyer's named destination. The seller is not relieved of any responsibility until the goods reach the specified destination and are unloaded. Some ex-ship provisions used in shipment contracts are shown in Exhibit 13-5.

EXHIBIT 13-5 Sample ex-ship clauses

Provision of Sales Agreement—Delivery "Ex-Ship"

Seller is required under this contract to deliver the goods ex-ship from the carrying vessel at [destination], in a manner and at a place that is appropriate. The risk of loss shall not pass to buyer until the goods leave the ship's tackle or are otherwise properly delivered, and seller shall furnish buyer with a direction that puts the carrier under a duty to deliver the goods. Seller must discharge all liens arising out of the carriage.

Provision of Sales Agreement—Delivery "Ex-Ship," option of buyer when goods subject to lien

In the event the goods on the ship are subject to any lien, buyer shall have the option to discharge the lien and receive the goods, or may refuse to accept the goods and treat the agreement as a breach by seller. Payment by buyer in discharge of any liens shall be chargeable to seller. In no case shall the payment of the amount of any liens be deemed a waiver by buyer of any right to damages for the breach by seller.

Mercantile Terms—Clause relating to meaning of term requiring delivery "ex-ship"

Under an "ex-ship" term in this agreement, seller is required to ship the goods on the [name of ship] operated by [name the operator of the ship] and the goods must be discharged at the destination port at [name the exact location at the destination port where the goods are to be unloaded].

No Arrival, No Sale. When goods are placed in transit and arrive damaged, destroyed, or not at all, the seller may be responsible. In a **no arrival, no sale** contract, the seller bears the risk of transit. Critical to a no arrival, no sale contract is determining who is responsible for the damaged or destroyed goods. If the seller can show proper performance under the contract, the seller may be absolved from liability. However, if it can be shown that the seller caused the damage, the seller will be responsible. Exhibit 13-6 shows sample contracts used in shipping goods.

no arrival, no sale
A term in a contract for sale of goods; if the goods do not arrive at their destination, title does not pass to the buyer and there is no liability for the purchase price

EXHIBIT 13-6 Sample no arrival, no sale clauses

Provision of Sales Agreement—No arrival, no sale, buyer to determine nonconformity

This agreement shall be subject to no arrival, no sale terms, but on arrival buyer shall be the sole judge of whether the goods have so deteriorated as to no longer conform to the agreement.

Provision of Sales Agreement—No arrival, no sale, avoidance for deterioration of goods

This agreement shall be subject to no arrival, no sale terms, but on arrival buyer may treat any deterioration of the goods as entitling buyer to the rights resulting from a casualty to identified goods without regard to whether there has been sufficient deterioration so that the goods no longer conform to this agreement.

State Your Case

Using the facts from the introduction, how could the buyer have protected himself in the shipment of the "mirror ball trophy" and what instructions should the buyer have given the auction house to accomplish this goal?

Strictly Speaking: Ethics and the Legal Professional

We all like presents. A gift of flowers or chocolates is always a nice gesture no matter where it comes from, especially when it is a "thank you" for a job well done. In today's world of heightened awareness of accepting gifts from clients or business associates, it is a good practice to decline any gift from a client or business associate of the firm. It may not be wrong ethically, but it just looks bad. You never want to give the impression to anyone that you can be influenced by a client or business associate of the firm. Often times, firms and businesses have a policy that gifts of more than $25.00 should not be accepted, which includes the occasional business lunch. For many highly regulated industries, such as healthcare, accepting gifts from vendors may create the appearance of impropriety or even a conflict of interest. The U.S. government has a policy on accepting gifts, or more to the point, not accepting gifts as well. Of course, check with your supervising attorney as to the policy of the office, but its best to keep the gifts of gratitude to a minimum to avoid any internal or legal entanglements. Another area where gifts have become an issue is when a client includes the attorney or paralegal in a will. Here, the attorney or paralegal is named in the will to receive a bequest from the client. This can occur under many sets of facts, but the rules of professional responsibility prohibit gifts of this nature and may border on self-dealing or undue influence. The end result is not to accept any gift from a client regardless of circumstances.

13.4 BUYER'S DUTIES AND RESPONSIBILITIES

After the goods have been tendered by the seller, the buyer's responsibilities begin. Section 2-606 sets out the rules for the buyer's acceptance of goods. According to § 2-606(1):

(1) Acceptance of the goods occurs when the buyer
   (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity; or
   (b) fails to make an effective rejection [§ 2-602(1)] but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
   (c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of a commercial unit is acceptance of the entire unit.

Common sense suggests that, prior to making payment for goods, the buyer should have the opportunity to inspect the goods to determine whether they conform or are an improper tender. Consequently, prior to acceptance of the goods, a buyer has the right of inspection to determine if the goods conform to the contract.

Right to Inspect

Section 2-513 provides for the buyer's inspection rights as to goods tendered:

(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.
(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.
(3) Unless otherwise agreed and subject to the provisions of this Article . . . , the buyer is not entitled to inspect the goods before payment of the price when the contract provides:
    (a) for delivery "C.O.D." or on other like terms; or
    (b) for payments against documents of title, except where such payment is due only after the goods are to become available for inspection.
(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

Oddly enough, under the Code the expenses for inspection are borne by the buyer and not the seller. The reasoning is that the buyer will be more conscientious about the inspection when he or she is paying for it. However, the Code further states that if the inspection shows that the goods do not conform and thus are rejected by the buyer, then the seller is responsible for the cost of that inspection. In this situation, the buyer has not paid for the goods prior to the inspection.

Exceptions to the payment-after-inspection rule are set out in § 2-513(3). When the contract calls for delivery against documents, or if the delivery is C.O.D. (cash on delivery), inspection follows delivery. In this circumstance, the payment is tendered prior to inspection. This does not waive a buyer's right to inspection, nor does it waive the buyer's right to reject the goods if they are nonconforming, but because of the terms of the shipment contract, payment must be tendered prior to any inspection.

The inspection must occur at the time the goods are delivered. If the buyer fails to exercise its right to inspect, the buyer will not have a later opportunity to inspect the goods and reject them. The Code is very specific that, unless a reasonable inspection is made when delivery is tendered, the buyer waives any rights to any future inspections.

Once the opportunity has come and gone, the assumption is that the goods are conforming and that the buyer has accepted them and will pay for them. Exhibit 13-7 shows a Notice of Inspection Demand by a buyer.

EXHIBIT 13-7 Sample notice of inspection demand by buyer

Notice by Buyer to Seller—Demand for inspection

To: Elliott Pate Freeman
Imports International
431 Chestnut Street
Philadelphia, Pennsylvania 01234

Dear Mr. Freeman:

Please be advised that we have received your notification that the goods sold pursuant to our "no arrival, no sale" contract dated April 20, 2010, regarding the 80 lawn chairs and 20 tables, have not yet arrived or arrived in partially deteriorated state.

Pursuant to Section 2-324 and 2-613 of the U.C.C., we hereby demand that you allow us to inspect the goods within a reasonable time so that we may exercise our option either to void the contract or to accept the [late or partially deteriorated] goods with due allowances.

Please advise us of a reasonable date and time at which we can inspect the goods.

_____
Edna Parrish

There is an exception to the inspection rule, however. When the inspection does not reveal a hidden defect, and it would be unreasonable to expect a buyer to find the defect at the time of inspection, the Code allows rejection of the goods at a later date. In this instance, the buyer must notify the seller of the hidden defect and make a determination as to how the parties will proceed, as the goods are now nonconforming. When the goods are nonconforming, the seller can offer to remedy the defect by shipping conforming goods. This is known as the *opportunity to cure.*

There is a caveat to the seller's right to cure. Under § 2-508(1), the Code suggests that when goods are nonconforming, the seller may cure *if* the time for performance has not passed. This means that the right to cure exists only within the specified time period

allotted in the original contract. Unless the buyer permits, the Code does not provide an extension of time for cure.

However, when a seller ships nonconforming goods that the seller had reasonable grounds to believe the buyer would accept, and the buyer rejects those nonconforming goods, the Code provides a reasonable time period to substitute conforming goods without creating a breach of contract. This exception is based on the prior dealings of the parties in that nonconforming goods had been shipped in the past and accepted. Because the seller is working under a prior course of dealings between the parties, the Code relaxes the strict standard that performance must occur within the time specified under the contract. Some provisions to limit the acceptance of nonconforming goods appear in Exhibit 13-8.

EXHIBIT 13-8 Sample provisions to limit acceptance of nonconforming goods

Provision of Offer for Sales Agreement—Acceptance by shipment of nonconforming goods excluded

This order may be accepted only by shipment of goods that conform to the specifications provided in the offer. The shipment of nonconforming goods shall be considered a rejection of the offer.

Provision of Offer for Sales Agreement—Acceptance by shipment of nonconforming goods excluded—Instruction not to ship goods for accommodation if goods cannot be supplied as ordered

This offer to purchase [quantity] [type of goods] may be accepted in writing addressed to [name] at [complete mailing address] or by prompt shipment of the specified goods by seller. In the latter event, the goods as specified must be shipped to [specify complete shipping address and any other terms for shipment].

In the event you elect to accept this offer to purchase by prompt shipment of the goods specified, you are instructed that you must not ship any goods for accommodation if you cannot supply the goods as ordered. Any such shipment will not be considered acceptance of the offer to purchase, and any nonconforming goods so shipped will be totally at your risk and cost and will be refused by the offeror.

Provision of Offer for Sales Agreement—Efforts of buyer to correct defects not considered acceptance

Efforts of the buyer to correct any of the goods delivered in a defective or nonworking condition shall not constitute an acceptance of such goods where commercially reasonable in extent and cost, so that the buyer may revoke acceptance and reject the goods when the attempt to correct such defect has proved unsuccessful.

Corinthian Pharmaceutical Systems, Inc. v. Lederle Laboratories, 724 F. Supp. 605 (S.D. Ind. 1989), deals with the issue of a seller shipping nonconforming goods. The court went into great detail regarding offers and acceptance under the Code.

Line of Reasoning

Lederle Laboratories is a pharmaceutical manufacturer and distributor of drugs, including the DTP vaccine. Plaintiff Corinthian Pharmaceutical, which also manufactures a number of drugs, is a distributor and supplier of drugs. The parties regularly did business with each other. The heart of this case is an order placed by Corinthian for 1,000 vials of the DTP vaccine. Lederle has a price list that states that any orders are subject to its acceptance and that prices shown are subject to change without notice. More importantly, any new pricing takes effect immediately and any current or back orders will be invoiced at the price in effect at the time of shipment. Corinthian's normal order was 100 vials of DTP. Any order it made with Lederle always contained a standard terms and conditions of sale set forth on its invoice. The language was repeated on the back of the form with the following: "[s]eller specifically rejects any different or additional terms and conditions and neither seller's performance nor receipt of payment shall constitute an acceptance of them." The reverse side reiterated the point that prices were subject to change. Lederle was instituting a substantial price increase of which, (somehow), Corinthian got wind. The price was going to jump from $51.00 to $171.00. Of course, Corinthian ordered a substantial amount of the vaccine—1,000 vials, the day before the new price was to take effect. Using a telephonic ordering system, Corinthian ordered and confirmed the price of $64.32 per vial—twice. Lederle sent Corinthian 50 vials only with the standard conditions. A letter with the new pricing was sent to all Lederle customers. In the letter, the buyer was told that the prices were in effect at the time of shipment and was given the right to cancel any order that was going to be invoiced at the new price. Corinthian wanted specific performance of its contract and Lederle countered by referring to the terms and conditions in its invoices. The question is at what price did Lederle agree to sell Corinthian the vaccines? Of course, the U.C.C. applies to the transaction. The court discussed the basic concepts of offer, invitation and proposal and how these concepts relate to an acceptance in the sales context. The fact is that the price lists were not offers. They were mere quotations, especially given the specific language in Lederle's pricing. Moreover, the orders were always subject to Lederle's acceptance. When Corinthian ordered the 1,000 vials over the telephone, the court considered this an offer to Lederle, which it had to accept.

Second, neither Lederle's internal price memorandum nor its letter to customers dated May 20, 1986, can be construed as an offer to sell 1,000 vials at the lower price. There is no evidence that Lederle intended Corinthian to receive the internal price memorandum, nor is there anything in the record to support the conclusion that the May 20, 1986, letter was an offer to sell 1,000 vials to Corinthian at the lower price. If anything, the evidence shows that Corinthian was not supposed to receive this letter until after the price increase had taken place. Moreover, the letter, just like the price lists, was a mere quotation (i.e., an invitation to submit an offer) sent to all customers. Thus, as a matter of law, the first offer was made by Corinthian when it phoned in and subsequently confirmed its order for 1,000 vials at the lower price. The next question, then, is whether Lederle ever accepted that offer. Under § 2-206, an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances. Lederle did not communicate or perform any act that would constitute acceptance of Corinthian's offer or order. The telephone ordering process is a "ministerial act," which does not constitute acceptance. The next question is whether the shipment of the 50 vials was an acceptance. The court found that it was not; it was an accommodation. Section 2-206(b) of the Code speaks to this issue:

> [A]n order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt

or current shipment of conforming or non-conforming goods, *but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.*

Here, Lederle shipped a nonconforming amount only as an accommodation and was not accepting Corinthian's offer to purchase 1,000 vials at $64.32. In fact, Lederle wrote Corinthian stating that the remainder of the order would be priced at $171.00 and it had the option to cancel the order if it so desired. Therefore, the shipment was nonconforming, an accommodation and not an acceptance under section 2-206. At best, the Lederle response was a counteroffer. But most importantly, the terms of Lederle's invoices always conditioned any acceptance upon the buyer's assent to its terms.

Questions for Analysis

Review the *Corinthian Pharmaceutical* case. How did the court address the issue of the seller's nonconformity? Would the result have changed if the terms and conditions were posted on Lederle's Web site? Was Corinthian acting in good faith in making the order for 1,000 vials? Explain your responses.

The Code further requires that if there are commercial units in the shipment, shipment of a commercial unit is acceptance of the entire commercial unit. Consequently, the buyer cannot accept or reject part of a shipment.

Once the rights of inspection have passed, or the seller's opportunity to cure has passed, the buyer has a duty to accept and pay for the tendered goods.

13.5 PAYMENT

After the prerequisites of acceptance, such as inspections and any other contingencies in the contract, have been completed, the buyer has a duty to pay the seller. Ordinarily, the duty to pay arises after acceptance of the goods and after an opportunity to inspect, but this is not always so. There are instances when payment will be made prior to acceptance, but this does not impair a buyer's rights to reject nonconforming goods.

The manner of payment is normally that which the parties have used in the past. This can be accomplished by check, a letter of credit, or against a document of title.

Payment by Check

draft
An order in writing by one person on another (commonly a bank) to pay a specified sum of money to a third person on demand or at a stated future time

Payment by a check or a **draft** is common. Upon the buyer's tender of the check to the seller and the seller's presentment of the check to the bank, all obligations of payment are fulfilled. If the check is not paid by the bank (dishonored), however, the buyer's obligations are not discharged and the seller can exercise any available remedies.

When a party's credit rights have been questioned, the seller may demand cash at the time of the delivery. In this situation, the Code allows a reasonable extension of time after the delivery to obtain the cash.

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Letters of Credit

letter of credit
A written promise, generally by a bank, that it will honor drafts made upon it by a specified customer so long as the conditions described in the letter are complied with

irrevocable
The act of not withdrawing; not revocable

revocable
The ability to cancel or withdraw

A typical method of payment in a sales transaction is by **letter of credit**. Governed by Article 5 of the U.C.C., a letter of credit is a written negotiable instrument that authorizes one party (normally a bank) to advance money or give credit to another person (usually the customer) in accordance with the terms and conditions of the transaction. Upon the advice of the customer, the bank will honor demands for payment for the goods, which are the subject of the letter of credit. Letters of credit can be irrevocable or revocable. An **irrevocable** letter of credit is a guarantee by the bank that the credit will not be withdrawn or canceled, whereas a **revocable** letter of credit allows the bank to cancel or withdraw the credit, normally upon notice to its customer. The process of buying goods under a letter of credit generally works as follows:

1. Buyer approaches bank for credit to purchase goods.
2. Assuming buyer has good credit, bank agrees to issue the credit to buyer to purchase the goods. Seller is the beneficiary (receiver of the money) of the letter of credit.
3. Letter of credit is issued by bank.
4. Buyer agrees to repay bank for extension of credit.
5. Bank notifies seller of letter of credit.
6. Seller ships goods with appropriate invoices and supporting documents.
7. Goods arrive.
8. After inspection, goods determined to be conforming.
9. Bank pays seller for goods shipped based on letter of credit.

Payment against a Document of Title

Payment can also be made against a document of title. Documents such as bills of lading, warehouse receipts, and other similar documents are used to transfer ownership of goods.

This is a method of payment by the holder of the document. If the document is negotiable, it is akin to the payment of money through a check, and the holder has the right to pay under the document of title. When the goods have been accepted and payment has been tendered, for all practical purposes the contract for the sale of goods is complete. At this stage, there are no further obligations between the parties.

New Electronic Methods of Payment

Within the last decade or so, e-commerce and Internet retailing has reached new heights, revolutionizing how we do business. The normal or standard methods of payment, such as checks or credit cards, may be things of the past with companies such as PayPal forging the way for new mediums in the ever-expanding world of the Internet. The questions are: what is PayPal, what does it do, and how does it affect sales and e-commerce? PayPal was started in 1998 to bridge a gap in how Internet business is conducted—payment. Rather than using the traditional credit card, PayPal allows for a secure means of electronic payments. Basically, PayPal is an online form of banking that allows you to purchase or sell goods using the account. You can deposit money in the account and debit it for an online purchase, or you can link PayPal to your credit card or bank account. You can do just about anything you can imagine with the account. There are two types of accounts—personal and business. One of the special features of PayPal is that it does not transmit personal financial information over the Internet as a bank or credit card company would do. If you have problems or complaints with PayPal, this may or may not be connected to the vendor who is using PayPal. PayPal is expanding each day. In fact, in 2009 eBay bought PayPal and now uses it as their exclusive method of payment. Of course, there are other electronic methods of payment, but what is important to recognize is that the world of contracts and sales is changing because of technology, and we must all keep up with the changes for both our professional requirements as well as the client's.

13.6 SPECIAL TYPES OF SALES UNDER ARTICLE 2

The standard methods of selling goods between parties have undergone some changes lately. In an effort to acknowledge these changing methods of doing business, the Code has recognized conditional sales known as "sale on approval" and "sale or return." Some believe that these new styles of sales are a passing fad, but often they are simply a new way of acquiring business and revenue. Article 2 also covers auction sales, discussed later in this section.

Sale on Approval

A *sale on approval* occurs when a buyer purchases goods from a seller with the understanding that the buyer can return the goods without any recourse. Under this type of sale, the buyer is given a reasonable time to try out the goods and determine if the goods conform to its needs. Such a sale is at the seller's risk. Until the buyer actually accepts the

goods, by signifying acceptance, not returning them, or using them in an unreasonable manner, the buyer does not take ownership or assume any risk of loss if the goods are returned. Suppose that you purchase a knife from one of those television advertisers that state "10-day free trial for use of the product and can be returned for a complete refund." You use the knife for a week and determine, for whatever reason, that you do not want it. You send it back and request a refund of the purchase price. The company is obligated to return your money because it was a sale on approval. Check Exhibit 13-9 for some contract language regarding sales on approval.

EXHIBIT 13-9 Sample sale on approval clauses

Provision of Sales Agreement—Sale on approval

The transaction between the parties to this agreement is a sale on approval.

Provision of Sales Agreement—Sale on approval—After trial period

Seller guarantees buyer complete satisfaction, and will allow buyer to determine whether the goods fulfill all descriptions, guarantees, and expectations of buyer.

Buyer shall have a 10-day trial period in which to determine whether the goods are entirely satisfactory, the trial period to run at the option of seller either from the date of receipt of the goods by buyer or from a date two weeks after arrival of the goods at the place designated as the point to which shipment is to be made. The goods must prove entirely satisfactory to buyer, or the buyer shall repackage the goods in the same condition as received, ordinary wear and tear excepted, and return to seller F.O.B. carrier at [designated delivery point].

When the goods are returned as directed above, billed to any point designated by seller, are received at that point, and on immediate examination are shown to be in good condition, ordinary wear and tear excepted, seller shall immediately return to buyer all money and any notes transferred for the goods to seller by buyer. The return of the goods and the return to buyer of all notes and money transferred to seller shall cancel and void this agreement, and shall terminate any and all liability of either party to the other.

Provision of Sales Agreement—Sale on approval—Right to return goods if unsatisfied

Seller guarantees that the goods, delivered to buyer will be entirely satisfactory to buyer, and buyer shall be the sole judge of such satisfaction. Buyer shall be allowed ten days from the time buyer receives the goods at the buyer's place of business to ascertain whether the goods are satisfactory. If for any reason buyer is not entirely satisfied with the goods, the buyer shall write seller for the shipping instructions for return of the goods, and seller shall furnish buyer with shipping instructions within five days. On return of the goods, seller shall return to buyer within ten days the purchase price of the goods without question.

A case that dealt with the issue of sale on approval and the definition of destination contracts was *Wilson v. Brawn of California*,132 Cal.App.4th 549, 33 Cal. Rptr. 3d 769 (Cal. App. 1 Dist., 2005).

Line of Reasoning

Most of us have ordered something through the mail. *Wilson v. Brawn of California* discusses the relationship between the seller and the consumer buyer. The results may be surprising. Brawn sells clothing over the Internet. When a buyer purchased clothing, Brawn packaged it and forwarded it for shipping via common carrier to the addressee. As part of the fees, Brawn charged $1.48 for insurance. Apparently, the fee was associated with the insurance costs it had for damaged or lost items while in transit. When items were lost or damaged in shipment, Brawn did replace the item. Brawn rarely sold goods to customers who did not pay the fee. On February 5, 2002, Wilson, a customer and on behalf of other customers, challenged the fee as deceptive. The basis for the challenge is that under the deceptive business practice act in California, Brawn was required to pay, as a seller, for any insurance as a matter of law. Wilson argued Brawn bore the risk of loss for goods in transit. The trial court agreed with Wilson. Brawn appealed. The appeals court basically stated, "not so fast."

Applying the U.C.C., the court analyzed the risk of loss issues when goods are in transit. First, the court discussed the distinction between a shipment contract and a destination contract. In a shipment contract, the risk of loss passes when the goods are delivered to the common carrier. This is the norm. A destination contract does not pass the risk of loss to the buyer until received at the particular destination. Unless agreed to by the parties, this is the exception. Most contracts are considered shipment contracts. As the court indicated, simply placing a label on a package with "ship to" information does not make the contract a destination contract. Thus, a consumer's request to ship to a residence does not convert the contract into a destination contract. It is only a shipping instruction, according to the court. Furthermore, the court stressed that it is common for the risk of loss to shift to the buyer when the seller delivers the goods to the common carrier. When insurance is included as part of the shipment costs, this is a C.I.F. This means that the price includes the cost of the goods, freight charge, *and* insurance. Under the comments to the U.C.C., it is clear that C.I.F. is a shipment contract and not a destination contract where risk of loss is borne by the buyer. The court concluded that by Brawn breaking out the cost of insurance it was a further indication that the contract was a shipment and not a destination contract.

The court next considered the issue of sale on approval. In a "sale on approval" normally the seller bears the risk of loss while goods are in transit. The basis for Wilson's position is U.C.C. sections 2-326 and 327. Section 2-326 states:

> Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is (a) A 'sale on approval' if the goods are delivered primarily for use, and (b) A 'sale or return' if the goods are delivered primarily for resale.

However, section 2-327 provides a caveat. Unless the parties "otherwise agree," under a sale on approval, "the risk of loss and the title do not pass to the buyer until acceptance." The key is the term "otherwise agree." Here, Brawn provided express terms which the buyer had to agree to for the sale to continue. Brawn was within its right to create its terms and conditions for purchase. Therefore, the risk of loss did pass to the buyer when placed on the carrier under the terms of a "sale on approval" contract.

However, and this is important, the court was not convinced that this was a "sale on approval" at all. In a detailed analysis of different types of sales, the court observed that

> [b]oth a 'sale on approval' and a 'sale or return' should be distinguished from other types of transactions with which they frequently have been confused. A 'sale on approval,' sometimes also called a sale 'on trial' or 'on satisfaction,' deals with a contract under which the seller undertakes a particular business risk in order to satisfy its prospective buyer with the appearance or performance of the goods that are sold. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them.

Additionally, payment is not due until accepted and tested by the buyer. This was not the case here. Brawn's customers paid for their purchases before shipment and before inspection even though they were entitled to a refund if the goods were later returned. The court did not want to restrict its opinion to say that a buyer cannot ever pay for the goods before shipment. The court simply stated that the ability to return items for a full refund in a simple sale was a benefit to the customer, which did not convert the transaction to a sale on approval. The court reversed the lower court's decision.

Questions for Analysis

Review Wilson v. Brawn. Was this decision a good one for consumers? What were the critical facts that distinguished this case from a "sale on approval?" What facts would have changed the result for the plaintiffs?

State Your Case

Legal Docs, Inc. wants to purchase a new copier. The cost of the copier is $5,000. Legal Docs is concerned as to whether the copier will handle its volume. What language could Legal Docs offer in the contract to protect itself? What type of sale should Legal Docs require? How should the copier be shipped to Legal Docs? Explain your answers.

Sale or Return

When a party purchases goods for resale and can return the unsold goods to the seller without any legal ramifications, this is known as a *sale or return*. In this instance, the buyer assumes the risk of breakage or theft and thus must pay the seller for any items broken or stolen. However, if the buyer determines that the goods cannot be sold, the buyer can return the goods to the seller without any legal consequences. A sale or return is similar to a **consignment**, which occurs when a party accepts goods and does not pay for them. If the goods do not sell, the party can return them without recourse. A consignment sale is really a sale or return contract. Exhibit 13-10 provides some language for drafting a sale or return provision.

consignment
Transaction where buyer accepts goods conditioned upon a future sale

EXHIBIT 13-10 Sample sale or return provisions

Provision of Sales Agreement—Sale or return

The transaction between the parties to this agreement is a sale or return.

Provision of Sales Agreement—Sale or return

Buyer shall have the right to return the goods sold under this agreement to seller at any time within five days after receipt of the goods for the following reasons: defective or damaged goods. Any return of goods by buyer under this provision shall be at the expense of buyer.

Buyer shall be deemed to have accepted the goods if seller has not received the goods within the five-day period.

Provision of Sales Agreement—Sale or return—Goods subject to inspection and approval by buyer with right to return after inspection

All goods ordered shall be subject to final inspection and approval at the facility of buyer. Any goods that do not conform to the order of buyer or that contain defective material or workmanship may be rejected by buyer regardless of date of payment of the goods. Buyer may hold any goods rejected for cause pending instructions from seller, or buyer may return the goods at seller's expense.

Auction Sales

Sales of goods may be by *auction*. In an auction, a person known as an *auctioneer* offers goods for sale to members of the public, who make offers known as ***bids*** on the goods. Ordinarily, the person who bids the highest is entitled to the goods once the auctioneer acknowledges the sale, usually by calling out the word "sold."

Auction sales are conducted *with reserve* or *without reserve*. These terms are critical, as the auctioneers can have leverage in accepting or rejecting bids. When an auction is conducted with reserve, the auctioneers can withdraw an item for sale at their discretion. This usually occurs when an item is not receiving high enough bids and the auctioneers have been instructed to withdraw the item if the minimum bid is not reached. When an auction is conducted without reserve, once the bidding begins, the auctioneer cannot withdraw the item, no matter how low the bid. Section 2-328 governs auction sales.

13.7 PRACTICAL APPLICATION

The paralegal may be asked to draft a number of documents when a sale of goods is involved. On occasion, the paralegal may also have to draft a consignment sale contract. A complete consignment contract is shown in Exhibit 13-11. This contract incorporates many of the provisions discussed in this chapter.

EXHIBIT 13-11 Sample consignment contract

Contract for Sale of Goods—Sale on Consignment

Agreement made on August 31, 2011, between Jonathan Day, of 1234 Dee Street. Chicago, Illinois, referred to as consignor, and Mary Ann Porter, of 5678 Bell Street, Chicago, Illinois, referred to as consignee.

In consideration of their mutual covenants, the parties agree as follows:

1. Delivery of Merchandise. Consignor agrees to deliver, from time to time, such goods, wares, and merchandise as it, in its judgment, sees fit, and consignee agrees to accept possession of such goods, wares, and merchandise on the terms and conditions set forth in this agreement.

2. Acceptance of Merchandise; Title. Consignee agrees to accept possession of the goods, wares, and merchandise from consignor, and to hold and care for the same as the property of consignor, it being agreed that the title to the merchandise, or its proceeds, is always vested in consignor, and such merchandise shall be at all times subject to and under the direction and control of consignor. The title to the merchandise shall pass directly from consignor to such person or persons to whom the same shall be sold in the manner and on the terms contained in this agreement.

3. Insurance of Merchandise. Consignee agrees to keep the merchandise fully insured for the benefit of and in the name of consignor in fire insurance companies approved by consignor.

4. Sale of Merchandise by Consignee; Proceeds. Consignee agrees to sell such merchandise to such persons as it shall judge to be of good credit and business standing, and to collect for and in behalf of consignor all bills and accounts for the merchandise so sold, and to immediately pay to consignor any amount collected as mentioned above immediately on collection, minus, however, the difference between the price at which the merchandise so collected for has been invoiced to consignee and the price at which the merchandise has been sold as mentioned above by consignee.

5. Consignee's Guarantee of Payment. Consignee hereby guarantees the payment of all bills and accounts for merchandise, possession of which is delivered under this agreement, and hereby agrees, in case any merchandise delivered under the provisions of this agreement by consignor to consignee is not accounted for to consignee under the provisions of Section Four of this agreement, to pay to consignor the invoiced price of the merchandise, and on such payment title to the merchandise, or to the proceeds thereof, so paid for shall pass to consignee and shall be exempted from the provisions of this agreement.

6. Trade Discounts. The invoices sent by consignor to consignee are subject to the usual trade discounts of [enumerate].

7. Restrictions on Merchandising by Consignee. Consignee agrees that except in [enumerate exception], it will not, during the continuance of this agreement, engage in the merchandising, in any manner, of any [name of product], except as provided in this agreement.

8. Duration: Return of Merchandise on Termination. This agreement shall continue for _____ years from the date of its execution, until [date]. If, for any reason, this agreement terminates, all of the merchandise, possession of which is held by consignee

under this agreement, shall at the termination be immediately returned to the possession of consignor.

9. Further Documentation. Consignee agrees to execute any and all other documents that consignor shall deem advisable in order to carry out the purpose of this agreement.

10. Effect of Breach. Any breach on the part of consignee of any of the agreements contained in this consignment agreement shall, at the option of consignor, because for its termination.

In witness whereof, the parties have executed this agreement at the offices of [firm] the day and year first above written.

_____

Jonathan Day

_____

Mary Ann Porter

SUMMARY

13.1 The basic duties under a sales contract are for the seller to tender the goods and for the buyer to accept and pay for them. With few exceptions, once these acts of the parties have occurred, the transaction is complete.

13.2 Tender of delivery occurs when the seller holds conforming goods for the buyer's delivery after ratification. Variations of this rule apply when the goods are delivered to a common carrier, a bailee, or through a document of title. When the place for delivery is not specified in the contract, delivery at a seller's place of business is proper. When one of these methods of delivery is used, the Code sets out the procedures.

13.3 Determining the type of shipment contract is important. Under the shipment contract, the buyer is responsible for the goods when placed with the carrier, whereas in a destination contract, the buyer is responsible when the goods are received. Certain terms are used to designate the parties' duties and obligations: F.O.B., F.A.S., C.I.F., C & F, ex-ship, and no arrival, no sale.

13.4 Upon receipt of the goods, the buyer has the opportunity to inspect them to make sure they conform to the terms of the contract. Under certain circumstances, if the goods do not conform, the seller may have an opportunity to cure. Unless the goods are C.O.D. or delivered against documents, payment is not tendered until after inspection.

13.5 After all inspections are complete, the buyer's duty to pay arises. Payment is proper by check, letter of credit, or against a document of title. A letter of credit may be revocable or irrevocable.

13.6 There are other types of sales than the "standard" sale of goods in the U.C.C. Sales terms may be sale on approval, sale or return, or auction sales. An auction sale may be conducted with reserve or without reserve.

KEY TERMS

common Carrier	F.A.S.	draft
bailee	C.I.F.	letter of credit
bailor	C & F	irrevocable
document of title	ex-ship	revocable
F.O.B.	no arrival, no sale	consignment

REVIEW QUESTIONS

1. What are the general obligations of the seller and the buyer in a sales contract?
2. When is a proper tender completed in a sales transaction?
3. How is a proper delivery to a common carrier consummated?
4. What is the distinction between a shipment contract and a destination contract?
5. Define the terms *F.O.B., F.A.S., C.I.F,* and *C & F.*
6. When goods are properly tendered, what are the buyer's duties under a sales contract?
7. When does the opportunity to cure arise in a sales contract?
8. What various methods of payment may a buyer use in paying for goods?
9. What is a sale on approval?
10. What is the difference between an action conducted "with reserve" or "without reserve"?

EXERCISES

1. Determine the type of shipment contract involved in the following transactions.
   a. The seller of custom exercise equipment manufactures the equipment in a plant in Atlanta, Georgia. The buyer's business is in Columbia, South Carolina. The terms of shipment by the seller are F.O.B point of manufacture. What type of contract has been created and who is responsible for the goods? Explain your response.
   b. Same facts as above but the shipment terms are F.O.B Atlanta. What type of contract has been created and who is responsible for the goods? Explain your response.
   c. Mercy Memorial Hospital is located in Hollywood, Florida. They have just purchased 50 portable dialysis machines to use in their hospital. The manufacturer of the machines is in San Diego, California. Mercy wants the goods to be delivered directly to the hospital. The shipment terms are F.O.B Hollywood. What type of contract was created and will the goods be delivered to the hospital? Explain your response.
   d. Wholesale Produce purchases a container of lettuce from Growers Co-Op located in Vineland, New Jersey. Wholesale Produce is located in Ocean City, Maryland. The seller ships the container C & F Philadelphia. What

type of contract is created between the seller and buyer? What if the shipment is destroyed prior to arriving in Philadelphia, who has responsibility for the shipment? Explain your response.

2. Jonas Wines is owned by Albert and Malin Jonas who purchased two containers of Chardonnay and Pinot Noir from a new winery in Washington State. They pay for the wines and are excited when they finally arrive at their stores in Louisville, Kentucky. The shipment arrives on September 21, 2010, and since they are about to leave on a much needed holiday, they do not open the containers until they get back from their European holiday on October 10, 2010. When they open one of the bottles of Chardonnay, it tastes sour. They try 10 other bottles, which have the same problem. They call the winery and tell them they are shipping back the wine and want their money returned. The winery refuses saying that they did not promptly notify them of the problem. Does Jonas Wines have a case against the winery? Explain your answer.

3. Using the same facts as stated in Exercise 2, the winery offers to replace the wine. Does Jonas Wines have to accept the winery's offer? Why or why not?

4. Brooks and his friend Chris decided to purchase a motorhome together. They specifically wanted a motorhome with two air conditioning units located on the roof. When the motorhome arrived, there was only one rooftop air conditioner. The seller, World RV Sales offered to fix the motorhome by putting on the second unit, but there would be a hole in the roof. Brooks and Chris rejected this solution. Brooks and Chris initially made a $5,000 deposit on the motorhome with the remainder of $45,000 to be paid upon delivery. Could World RV's offer be considered a "conforming delivery" or "substitute" which Brooks and Chris would have to accept? Discuss the issues involved.

5. Seabreeze Bistro is always looking for the freshest seafood for its restaurant. Seabreeze is located in Marin, California. Seabreeze's manager contacts Seattle Seafood to order some salmon. The salmon is located in Seattle Seafood's warehouse. Seabreeze places an order for 100 pounds of salmon on October 2 for delivery on October 14. What would the delivery terms be if none is expressed between the parties?

6. Evan has started a new business called Just Desserts. He has all kinds of desserts, such as chocolate chocolate chip cookies, deep-dish fudge brownie cake, and lemon lime chiffon cake. He needs to find a wholesaler of flour. Asking around, he finds that Baking Products for You, Inc. is the best supplier in his area. He wants to make sure he protects himself but is not sure how the process works. He knows you are studying to become a paralegal and just wants to ask some general questions. One question he has is, what are his best options to ensure proper and safe shipment of the flour to his place of business? What shipment terms would be best suited to protect Evan's interest and why?

7. Harlan Designs has ordered silk fabric from New York Imports, Inc. Both companies are located in New York City. The design house was very specific in that it wanted raw silk in red, turquoise, royal blue, and emerald green. Nothing else would do. The silk arrives on May 3. When Designs opens the shipment they

are appalled. The green is more of a hunter green and the blue is navy and not royal blue. The red has too much orange in it. What are Harlan's options regarding the shipment? What are New York Imports options?

8. Beth wants to buy 50 plain wood picture frames for her business. She paints and specially decorates the frames for sale in her business. Frameland Manufacturers receives the order for the 50 frames. The terms of the delivery are C.O.D. Beth is concerned about this because what if she does not like the frames or what if they are damaged. In a short memorandum, explain Beth's rights under a delivery, which is C.O.D.

9. June is the busiest month for weddings. As a florist, Extravagant Flowers, Inc. always searches for the freshest flowers. Extravagant Flowers orders a shipment of "birds of paradise," an exotic flower from Caribbean Importers located in San Juan, Puerto Rico. Extravagant receives confirmation that Caribbean Importers shipped the flowers on June 12 with delivery in Miami on June 16. The shipment never arrives in Miami. Is Extravagant Flowers responsible to pay Caribbean Importers for the birds of paradise? Would your response change if Caribbean Importers contacted Extravagant and indicated that a hurricane in the Atlantic destroyed the shipment? (Focus only on the shipping issues.)

10. Charleston Galleries specializes in finding new and up-and-coming artists. They discovered this artist who called himself, "Tuley" who mainly works in glass. The Gallery wanted to offer some of his work, but could not pay for them outright. Tuley offers to send 10 pieces on consignment. After three months in the gallery, only five pieces sold. Charleston Galleries now wants to send back the five pieces that did not sell. When Tuley opens the package, two of the glass pieces are cracked. Charleston Galleries says that the pieces were perfect when they were packed. How should Charleston Galleries have shipped the pieces to best protect their interests? Does Charleston Galleries have to pay for the damaged pieces of art? Explain your answers.

CASE ASSIGNMENTS

1. A famous auction house is one of your firm's client's. They have a rare Chinese soapstone figurine to offer, which dates back to the Ming Dynasty. Since this is an unusual situation, the auction house wants to be sure that the prospective buyers know the terms and conditions of the sale. Prepare the terms and conditions of sale document that the auction house would send to the public and any prospective buyers. Be creative.

2. Barbara Elias collects ancient artifacts from the Inca and Mayan eras. She hears of a find in Mexico. Barbara contacts the seller, the Mexican Institute of Ancient American Artifacts, who is willing to let Barbara examine and inspect the artifacts prior to a final purchase. They want a deposit of $300,000 since the artifacts are worth nearly a million dollars. Barbara contacts your firm to draft a contract for her protection. She is not sure what she needs, except for the fact that, if the artifacts are not as she anticipates, she wants to able to return them and get her deposit back. Prepare a contract of sale that would suit Barbara's needs.

Chapter 14

Title, Risk of Loss, and Warranties

Outline

Just Suppose . . .

You receive a hysterical call from your best friend Amy. She is crying so hard that all you heard her say, you think, is that some grass was in her canned green beans. Well, that's not good you think, but to be so upset over a piece of grass is a bit much even for Amy. As Amy calms down a bit, she keeps screaming that a grasshopper was in her canned green beans. A grasshopper—that can't be! So you tell Amy that you will be right over and not to throw out anything. Ten minutes later you arrive at Amy's house where she immediately rushes you into her kitchen. She keeps pointing to the pan on the stove and crying. You thought it was because Amy was 8 months pregnant, but sure enough covered in butter, onions, and beans is a grasshopper. Apparently, Amy did not notice the grasshopper when she opened the beans and as she tasted her dish she bit down on something crunchy, which she realized was odd. She spit out the beans and saw part of the grasshopper in her kitchen sink. Amy began hyperventilating. You decide that you need to bring her to the emergency room, but before that you save the cans of beans and the mixture from the pot on the stove. You are not an expert but you know that there is a lawsuit in this situation somewhere!

Of course, the above facts introduce the concepts of warranties in sales, specifically in food. You have heard stories of situations like Amy and now you are about to understand what steps Amy should take in pursuing a claim. Our chapter deals with warranties and title issues in a sales transaction.

14.1 GENERAL RULES OF PASSAGE OF TITLE AND RISK OF LOSS

title
The right of ownership with respect to property, real or personal

Determining who owns goods involved in a transaction is important to the law of sales, because with ownership comes certain rights and obligations. In any analysis under Article 2 of the Uniform Commercial Code, one of the first questions to ask is who has title to the goods. **Title** is equivalent to legal ownership. The person who owns the goods has legal ownership and, therefore, title to the goods. In most sales transactions, the seller retains title to the goods until they are sold to the buyer.

Coupled with title is *risk of loss*, which refers to the financial responsibility for goods that are damaged, lost, or destroyed. Whether the risk of loss is on the buyer or the seller is determined by the type of contract the seller and the buyer have entered. Is the contract a shipment contract or a destination contract? When is the buyer's acceptance effective? What was the parties' agreement with regard to risk of loss? The answers to these questions determine who bears the risk of loss.

Because title and risk of loss are closely related, one of the biggest issues under sales is when the title passes. When does ownership transfer from the seller to the buyer, and when does the buyer assume the obligations of ownership of the goods, including risk of loss? To determine when title passes, the goods first must be identified; then the goods must be delivered to the buyer for title to pass, together with the assumption of risk of loss.

Passage of Title: Shipment Contracts

Under a *shipment contract*, the buyer and the seller agree to place the goods with a carrier for delivery to the buyer. Recall from Chapter 13 that the buyer's responsibility begins when the goods are placed on the carrier. In a shipment contract, at the moment the goods are delivered to the carrier, title—and all its consequences—vest in the buyer. Thus, both title to the goods and the risk of loss pass to the buyer when the goods are placed on the carrier at the seller's origin. From that moment on, the seller is free from any responsibility regarding shipment of the goods, and the buyer assumes title and risk of loss and thus all responsibility for the goods. For example, if a contract is F.O.B. Dallas, Texas, and the goods are being shipped to San Juan**,** Puerto Rico, the title to the goods is at the buyer's place of shipment, or where the shipment originates, not the final destination. Thus, title passes to the buyer in Dallas and not San Juan. The risk of loss also passes to the buyer in Dallas and not San Juan. Consequently, title and risk of loss pass simultaneously in a shipment contract.

Passage of Title: Destination Contracts

In a *destination contract,* the title and risk of loss pass to the buyer when the goods arrive at the destination on which the seller and buyer have agreed. In this type of contract, title does not pass, nor is the risk of loss assumed by the buyer, until the buyer has received the goods at the agreed destination. If a carrier is used, the seller pays for all costs of transportation and takes all responsibility for shipment of the goods to the destination. Recall that destination contracts also use the term *F.O.B.*; to distinguish a shipment contract from a destination contract, though, check the place of destination—that agreement will determine the parties' responsibilities.

Using the previous example, if the contract is F.O.B. San Juan and the goods originate and are loaded in Dallas, title and risk of loss pass when the goods are delivered in San Juan. To pass title and the risk of loss to the buyer, the goods must arrive at the destination, with notice of the arrival to the buyer and a reasonable time period for pickup of the goods. Only then do title and risk of loss pass to the buyer.

Strictly Speaking: Ethics and the Legal Professional

This chapter deals with how title is transferred and under what conditions in a sales transaction. Following with that theme but in a completely different context is the use of your "title" as a paralegal in the professional setting. The term "paralegal" and "legal assistant" are used interchangeably within the legal profession. However, in some jurisdictions, such as California, the term paralegal may only be used by those who have qualified in some way to use that title. For example, California has an extensive definition defined in its Business and Professional Code, which focuses on education, training, or work experience. In other states, the term paralegal has also been defined statutorily and its misuse carries a fine. From an ethics standpoint, when you are signing your name with your title, be sure you know the rules in your jurisdiction for the correct term to refer to yourself. Also, using the term certified has different connotations. In some instances, it represents that you have passed a national test administered by the National Association of Legal Assistants. Additionally, some states such as Texas, Florida, North Carolina and Ohio may have legal certifications that have connotations as well. Basically, do not hold yourself out to the public as something you are not—just like any other professional. If you are not what you say you are, there may be legal ramifications to the "misrepresentation." Know what your title is and what its legal significance means as it represents important characteristics of your professional responsibilities.

Passage of Title: Other Considerations

No Delivery Requirement in Contract

When the parties to the sales contract do not require shipment or delivery of the goods to a destination other than the seller's place of business, title to the goods passes when the contract is made with the buyer. In this situation, delivery occurs when the buyer picks up the goods at the seller's place of business. Risk of loss is a different problem altogether. If the seller is a merchant, the risk of loss passes upon receipt of the goods by the buyer. If the seller is a nonmerchant, the risk of loss passes when the seller tenders the goods to the buyer.

document of title Any document evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods to which it pertains

Documents of Title

In some instances, goods are not delivered directly to the buyer, but are delivered through transfer of a **document of title**. When the goods are not to be delivered to any specified destination, nor moved to the buyer's place of business or a designated delivery place, title and risk of loss pass when the seller gives a document of title to the buyer. Provisions to consider for a sales contract when title and risk of loss are at issue are found in Exhibit 14-1.

EXHIBIT 14-1 Sample clauses on title and risk of loss

On Identification of Goods to Agreement

Title to the [type of goods] sold under this agreement shall pass to buyer at the time that seller identifies the goods subject to this agreement.

At Time and Place of Shipment of Goods

Title to the [type of goods] sold under this agreement shall not pass to buyer at the time the goods are identified in the agreement, but shall pass only at the time of and place from which shipment of the goods is made by seller to buyer.

On Execution of Sales Agreement

Title to the [type of goods] sold under this agreement shall pass to buyer at the time of execution of this sales agreement.

By Agreement of the Parties

The parties can contractually agree to other title and risk of loss arrangements. If they do so, title and risk of loss will pass at the agreed time and place.

Sale on Approval

When goods are sold "on approval," title and risk of loss do not pass to the buyer until the goods are accepted. To have title and risk of loss pass, the buyer must consent to the sale, either orally or in writing, or use the goods in a reckless manner. A sale on approval presents some unique problems, and Exhibit 14-2 offers some suggestions on contract language.

EXHIBIT 14-2 Sample sale on approval clauses

Seller to Retain Title until Goods Approved by Buyer

The following goods are sent by seller to buyer for examination, but are to remain the property of seller and are to be returned to seller on demand: [describe goods and quantity]. The sale shall take effect from the date of approval by buyer, and until then the goods are to be held subject to the order of seller.

Risk of Loss and Title Passing to Buyer Immediately

The risk of loss and title to the goods shall pass to buyer immediately upon execution of this agreement.

Acceptance of Part of Goods Not Acceptance of Entire Quantity

The acceptance by buyer of a specifically designated quantity of the total goods ordered, or the acceptance of a single installment, shall operate as an acceptance of that specific quantity or installment only, and shall not operate as an acceptance of the balance of the goods to be delivered or not specifically accepted. Each partial quantity or installment shall be subject to separate acceptance by buyer.

Revesting of Title

When a buyer rejects goods that have been delivered by the seller, title reverts to the seller and is said to *revest*. Revesting of title shifts title, and often the risk of loss, from the buyer back to the seller. Thus, the seller retains all its previously held rights and interests in the goods. Under the U.C.C., a buyer does not have to rightfully reject goods for title to revest in the seller, nor does the rejection have to be justified for the title to revest in the seller. Section 2-401(4) states:

> A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale."

Nonconforming goods contracts present a different problem. If nonconforming goods are shipped and rejected, title and risk of loss remain with the seller. A unique problem arises when insurance is involved. When goods are shipped and accepted by the buyer, but later rejected because of a defect, assumption of the risk of loss depends on insurance coverage. If the buyer is insured, the risk of loss remains with the buyer. If not, the risk of loss reverts to the seller. The following example is a provision to use in an agreement when revesting of title is required.

Revesting of Title in Seller:

Title to the [type of goods] sold under this agreement shall revest in seller if buyer shall either reject the goods or refuse to accept the goods.

14.2 VOID AND VOIDABLE TITLE

valid title
Legal or lawful ownership

In a sales transaction, the seller can transfer only the same quality title as the seller retains. If the selling individual or entity has **valid title** and is the rightful owner of the goods, upon sale, the seller can pass good and valid title to the buyer, and the buyer will then enjoy all the rights and title that have been transferred from the seller.

void title
Title without legal effect; a nullity

Sometimes, however, a party that does not have valid title attempts to sell goods to a buyer. The person who does not have valid title to goods is said to have **void title**; any transfer from a seller who has void title transfers only void (and therefore worthless) title to that buyer. This situation may arise when a person attempts to transfer stolen goods to an unsuspecting buyer. Even if the buyer purchases the goods in good faith, not knowing that the goods are stolen, the original owner of the goods retains the right to repossess the goods. Thus, any transfer of the goods from a party when void title is involved transfers only void title. A buyer who purchases goods with a void title will never have clear title to the goods, but will always hold the goods subject to the superior rights of the original and rightful owner.

For example, a friend offers you a 1994 Camaro for $5,000. You jump on this good deal, of course. Unbeknownst to you, the Camaro was stolen from a man in Philadelphia by an international auto theft ring. If they track the stolen Camaro back to you, the authorities could (and would) take the car back from you without returning your $5,000, even though you had no idea that the car was stolen. Your only recourse is to locate your "friend."

When a person obtains *voidable title* to goods, title can legally transfer from that person to another person. In fact, the rights possessed by the person who has voidable title are better than those of the original owner. Voidable title situations usually arise when a person has gained access to goods through fraud, misrepresentation, mistake, undue influence, or duress. Titles transferred by minors and persons who are mentally incompetent are also voidable. If persons purchase goods without knowledge that the title was voidable, they have valid title to the goods. What is critical to transforming voidable title into valid title is that the person purchasing the goods be a good faith purchaser for value (money) who has no knowledge of any prior transaction that would harm the title.

The person who acquired the goods through improper means can attempt to reclaim the goods prior to sale to a good faith purchaser. *Charles Evans BMW, Inc. v. Williams*, 196 Ga. App. 230, 395 S.E.2d 650 (1990), deals with the voidable title issue.

Line of Reasoning

This is a tale of a sale made by an impostor who got away with the goods! Williams sold his car to someone named Hodge who gave him a cashier's check as payment. Williams signed over the certificate of title to Hodge along with the car. The next day, Hodge, holding himself to be Williams, sold the car to Charles Evans BMW, Inc. who in turn gave him a check in Williams' name. Somehow Hodge was able to present identification bearing Williams' name and was able to cash the check from the BMW dealer. After the dealer purchased the car, Williams was notified that Hodge's check was a forgery. When the dealer became aware of Hodge's scam, it had already sold the car to another purchaser. Now the police got involved who told the dealer to get back the car and title; the dealer refunded the purchase price to the buyer. However, the dealer did keep the certificate of title and sued Williams. The court set forth its analysis that:

> Under the U.C.C. § 2–403(1) "[a] purchaser of goods acquires all title which his transferor had or had power to transfer . . . A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been *delivered under a transaction of purchase* the purchaser has such power even though: (a) The transferor was deceived as to the identity of the purchaser, or (b) The delivery was in exchange for a check which is later dishonored: or . . . (d) The delivery was procured through fraud punishable as larcenous under the criminal law." (emphasis supplied.)

The court emphasized that Williams delivered his car, albeit under criminal fraud, under a transaction of purchase. Williams conveyed voidable title to Hodge as opposed to void title. Hodge in turn conveyed good title to a good faith purchased for value.

The court continued by citing § 2–403(1), which empowers a purchaser with a voidable title to confer good title upon a good faith purchaser for value where the good[s] were procured through fraud punishable as larcenous under the criminal law. Unfortunately for Williams, he voluntarily relinquished possession of his car to Hodge. In an interesting quote, the court observed "[a] thief who wrongfully takes goods is not a purchaser . . . but a swindler who fraudulently induces the victim to voluntarily deliver them is a purchaser." Therefore, the dealer acquired good title to the car from Hodge. The dealer acted in good faith even as Hodge continued his well planned scam. Thus, the dealer had all rights of title for the car.

Questions for Analysis

Review the Williams case. What type of title did Williams transfer? Are there any facts that would have changed the result so that the title was void when it was transferred from Williams to Hodge?

State Your Case

Carley, a buyer, purchases a diamond watch from Jewelers International. She pays by check. The check is dishonored for insufficient funds. Prior to the seller finding out about the dishonored check, Carley sells her diamond watch to Anita. What type of title does Carley have to the diamond watch? What type of title does Anita have to the watch? Can Jewelry International bring an action against both Anita and Carley for the return of the watch? Explain your answers.

Entrustment of Goods

An entrustment presents unique problems in the sale of goods. An *entrustment* occurs when a person (the entruster) gives goods to a merchant who normally deals in those types of goods. This often happens when you take an appliance for repairs or have a computer cleaned at a repair shop. In this situation, the merchant takes possession of the goods with the understanding that the entruster will get them back. However, sometimes the merchant attempts to sell the goods without the entruster's knowledge. Although the merchant does not have title to the goods, if he transfers the goods to a good faith purchaser, the good faith purchaser receives valid title to the goods even to the exclusion of the original owner. In this situation, the entruster would have a cause of action against the merchant for money damages; unfortunately, though, that does not bring the goods back to the original owner.

14.3 SPECIAL PROBLEMS IN RISK OF LOSS SITUATIONS

insurable interest An interest from whose existence the owner derives a benefit and whose nonexistence will cause him or her to suffer a loss

To protect goods or property, it is likely that a person will take out insurance on those goods or property. An **insurable interest** is the value placed on property by the insured. A seller retains an insurable interest in a good until title passes, and can have a continuous insurable interest if the risk of loss has not passed. Buyers can have an insurable interest the moment the goods to a contract are identified.

Sending nonconforming goods presents a different problem relating to insurable interests. When the seller sends nonconforming goods to the buyer, the risk of loss remains with the seller. Because a nonconforming shipment is considered a breach by the seller, the buyer will not assume responsibility for it. U.C.C. § 2-510 suggests that if a buyer later discovers a defect in the goods and revokes the acceptance, the risk of loss remains with the buyer, but there is a caveat: the buyer's exposure to loss is limited to the buyer's insurance coverage. Any loss that exceeds the insurance is borne by the seller.

14.4 WARRANTIES AND SALES

Once title passes to the buyer, the buyer owns the goods and seemingly has no recourse against a seller who tenders a good that does not conform to the standards promised. This is not the case, however. Once the good leaves the seller's hands, the seller warrants that the good will be in a certain condition and form suitable for the use for which the product was intended and for which the buyer purchased it. A promise or guarantee that the product or good is of a certain type, quality, and condition is known as a **warranty**. Warranties are implicit in the sale of any product and are normally categorized as either express or implied warranties.

warranty
A promise, either express or implied by law, with respect to the quality, fitness or merchantability of an article of sale

Express Warranties

When goods are sold, certain guarantees, known as warranties, come with the goods. An **express warranty** may be an oral or written statement that makes certain representations about the quality of the product. Under the U.C.C., there are three basic types of express warranties. Section 2-313(1) provides that express warranties by the seller are created as follows:

express warranty
A warranty created by the seller in a contract for sale of goods, in which the seller, orally or in writing, makes representations regarding the quality or condition of the goods

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

If the seller makes any of these representations, an express warranty is created.

Statement of Fact or Promise to Buyer

Any specific fact that a seller states about a good is considered an express warranty. Ordinarily, any statement upon which the buyer relies becomes part of the basis of the bargain and is an express warranty. The statement itself is considered a representation or a guarantee of the product.

The issue that frequently arises in express warranty cases is whether the statement was a fact or an opinion, which the law refers to as **puffing**. Puffing is the "big talk" a salesperson often gives to get a customer interested in a product. An example of puffing is a salesperson's saying, "This boat is the greatest boat this side of the Mississippi." Most of us would know that is sales talk. But if the salesperson says to you, "This boat comes with a two-year free maintenance guarantee," that is a statement of fact or promise to you, the buyer. The distinction that has to be made is whether the seller is stating a specific fact or merely giving an opinion. Sellers who are attempting to convince a buyer to purchase their goods often use language to encourage or entice the buyer into

puffing
Exaggerating or "talking up" of a product based on opinion

purchasing the goods. Courts are called upon to make the distinction as to whether a seller is communicating a fact upon which the buyer relies (in which case an express warranty is created), or whether puffing or mere opinion was being communicated to the seller. This has been a difficult area of law for the courts, as there are no specific guidelines for determining the distinction between fact and opinion. Case law will guide the determination of whether a salesperson's words are fact or opinion.

The U.C.C. does not require that certain language or words be used to create an express warranty. It is the representation or the intent to make a warranty that creates the express warranty, not the language.

Description of the Goods

A description of the goods by a merchant or salesperson can also create an express warranty. If the description of the good induces a buyer to purchase the good, the buyer can claim an express warranty for that product. Assume that Martha sees an advertisement for a microwave that has a turntable in it. She orders the microwave. When it arrives, Martha finds a glass plate inside the oven, but no revolving turntable. Martha would have an action against the seller for breach of express warranty, because the microwave was not as represented in the advertisement, either as pictured or as described. Language that can be used in sales contracts for an express warranty based on description of the goods is provided in Exhibit 14-3.

Cybercises

Locate three examples of express warranties for products that you commonly use.

EXHIBIT 14-3 Sample express warranties

Declaration of Warranty—Specifications

The specifications set forth in Section _____ of this agreement constitute express warranties by seller that the goods covered by this agreement shall conform to those specifications.

Declaration of Warranty—Based on Description

Seller warrants that the goods when delivered shall conform to the description in Section _____ of this agreement.

Sample or Model

A common sales technique is to show a buyer a sample or model of the product offered. When a buyer is shown a sample or model, it becomes part of the purchase contract and thus an express warranty. Implicit in the showing of the sample or model is that any good sold and delivered to the buyer will be of the same type and quality as the sample or model. If this is not so, the buyer will have an action against the seller for breach of an express warranty. Provisions to consider when the express warranty is based upon a sample or model are found in Exhibit 14-4.

EXHIBIT 14-4 Express warranties based on sample or model

Declaration of Warranty—Based on Sample or Model

Seller warrants that the goods when delivered shall conform to the [sample or model] that was [exhibited or demonstrated] to buyer on February 1, 2011, by Shay Sullivan, the sales representative of seller, at 1234 19th Street, New York, New York.

Identity of Sample or Model Used as Basis of Warranty

This sale has been made on the basis of a [sample or model] of the goods that is marked for identification purposes in the following manner: _____. The [sample or model] is in the possession of William Payne Johnson, of 1258 85th Street, New York, New York.

Effect of Damage or Destruction of Sample or Model Used as Basis of Warranty

If the [sample or model] identified in Section _____ of this agreement is damaged or destroyed in any manner or by any cause, the party to this agreement not responsible for the damage or destruction shall have the option of canceling this agreement.

Implied Warranties

implied warranty
A warranty by the seller, inferred by law (whether or not the seller intended to create the warranty), as to the quality or condition of the goods sold

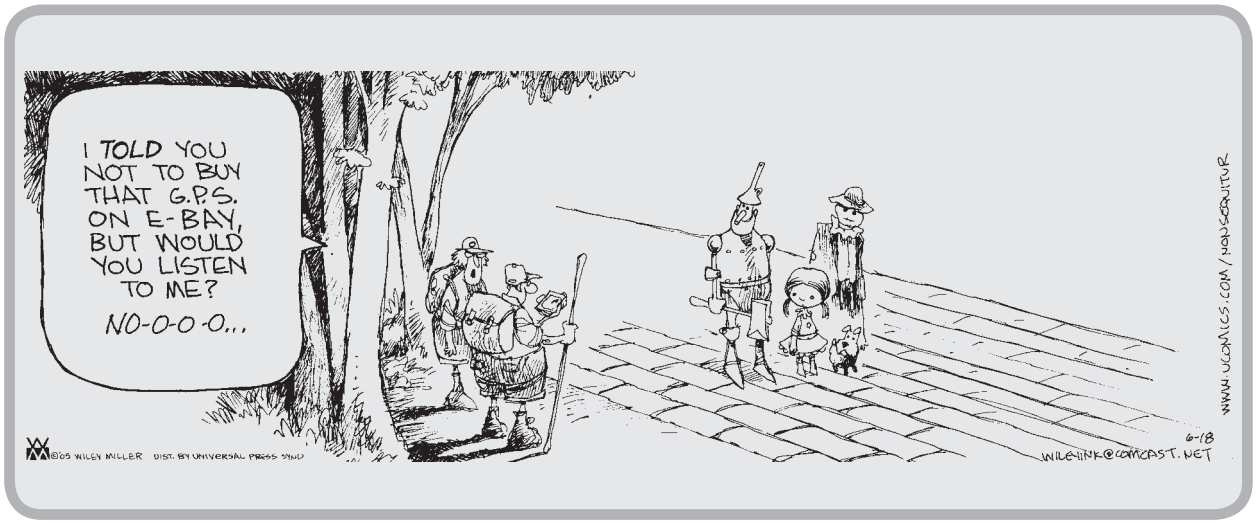
In addition to imposing standards for express warranties upon sellers, the U.C.C. also imposes standards for implied warranties. An **implied warranty** is a warranty imposed by law that is *implicit* (understood, but not expressed) as the basis of the bargain. Implied warranties set out certain standard business dealings and are designed to protect the consumer or buyer. The U.C.C. cites four basic types of implied warranties: (1) warranty of title, (2) warranty against infringement, (3) warranty of merchantability, and (4) warranty of fitness for a particular purpose. The type of contractual arrangement of the parties will control which warranties, if any, are implied in the contract.

Warranty of Title

warranty of title
A warranty by the seller, implied by law, that it has ownership to the goods

In any sale of a good, a **warranty of title** is deemed to exist. Warranty of title ensures that the goods purchased are free of any liens or encumbrances of which the seller has knowledge. Unless excluded by the seller, the warranty of title guarantees that the transfer of the goods from the seller to the buyer is proper. The seller warrants to hold the buyer harmless from any possible title issues or claims from third parties that might affect the buyer's ownership interest in the good. U.C.C. § 2-312 provides:

(1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that
   (a) the title conveyed shall be good, and its transfer rightful; and
   (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.



(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed, a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

To establish a case for breach of the warranty of title, the buyer must show that: (1) the title acquired was not valid; or (2) the transfer of title was improper; or (3) the goods transferred are subject to another's rights of which the buyer had no knowledge. For examples of provisions that could be considered in drafting warranty-of-title language, review Exhibit 14-5.

EXHIBIT 14-5 Sample warranty of title language

Warranty of Title

Seller warrants and represents that seller has absolute and good title to and full right to dispose of the [type of goods], and that there are no liens, claims, or encumbrances of any kind against the goods.

Right of Agent to Transfer Title

Seller warrants that Bud Johnson of 8900 Walnut Street, Dallas, Dallas County, Texas, is the owner of the goods covered by this agreement, and that seller is the authorized agent of the owner and has authority to transfer the title to the goods to buyer.

Right of Pledge to Transfer Title

Seller is a pledgee of the goods covered by this agreement, which goods were pledged with seller on March 17, 2010, by Collin Casperson, of 1813 West Buckingham Drive, Ft. Lauderdale, Florida, as pledgor. On March 17, 2011, and at all times thereafter, pledgor was in default under the terms of the agreement of pledge and this sale is made by seller as pledgee under that agreement of pledge and is made in accordance with the rights of seller under that agreement. Seller warrants that the sale by seller is authorized and rightful with respect to pledgor.

Warranty of title was an issue in *Jefferson v. Jones*, 408 A.2d 1036 (Md. 1979). The results are surprising.

Line of Reasoning

Warranty of title issues can have interesting results for "innocent" purchases. Case in point is *Midway Auto Sales v. Clarkson,* 29 S.W. 3d 788 (Ct. App. Ark. 2000). Midway Auto Sales acquired a 1986 Corvette from Clarkson. Clarkson had acquired the Corvette from a Larry Bowen who purchased the car from Jimmy Haddock who purchased the car from someone in Oklahoma on an open title. It appears that the Corvette had a shady history while located in Oklahoma—it was stolen. Oddly enough, Bowen checked the title in Oklahoma, which reported that the car was free of encumbrances. The car was not registered, however. Then Bowen sold the car to Clarkson from an open title from Oklahoma for $5,500. Clarkson then sold the car to Midway for $6,000. After Midway took possession, the police confiscated the car, because it was stolen. It was returned to its original owner. The focus of the case was whether Clarkson had breached the warranty of title. The court distinguished a car acquired by fraud and one from theft. Fraud is different from theft. Citing to the U.C.C., the court stated

> (1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though:
>
> ....
>
> (b) The delivery was in exchange for a check which is later dishonored; or
>
> ....
>
> (d) The delivery was procured through fraud punishable as larcenous under the criminal law.

The court went on to discuss the difference between void and voidable title. In general, a thief cannot pass anything but void title; on the other hand voidable title can be passed to "buyers who commit fraud, or are otherwise guilty of naughty acts (bounced checks), but who conform to the appearance of a voluntary transaction." More commonly, voidable title is created in a more common occurrence: the "rubber check." Even when Bert Buyer pays Sam Seller with a check that returns to Sam marked "NSF," a good faith purchaser from Bert takes good title.

The court then concluded that Mr. Haddock obtained voidable title from the original seller. Unless the sale was avoided by the original seller, any purchaser from that point had good title to transfer to a prospective buyer. Therefore, Clarkson had good title to transfer to Midway. The question then becomes: what happens to Midway? The issue the court discussed was good faith. Were Bowen and Clarkson good faith purchasers? All the actions of both parties indicate that they acted in good faith regarding the transaction. Clarkson did pass good title to Midway. There was no breach of the warranty of title. Essentially, Midway was out of luck!

Questions for Analysis

Review *Midway Auto Sales v. Clarkson*. There was a concurring opinion is this case. What was the reasoning behind the concurring opinion? Are there any facts which would have changed the result for Midway? How can Midway cover its purchase price?

patent
The exclusive right granted by the federal government to a person who invents or discovers a device or process that is new and useful

copyright
The right of an author, granted by federal statute, to exclusively control the reproduction, distribution, and sale of literary, artistic, or intellectual productions for the period of the copyright's existence

Warranty of Infringement

The warranty of infringement relates to **patent**, **copyright**, and **trademark** rights. This warranty applies only to a merchant who is selling goods which are part of the normal stock or inventory of the merchant. Although the warranty of infringement has not received much attention over the past years, new applications are being tested in the courts. Much attention has been given to unofficial ("bootleg") copies of compact discs (CDs), cassette tapes, and videos. Individuals who make unauthorized copies and attempt to sell them to the unsuspecting public as the real thing, are engaged in *pirating*—a practice that has cost the entertainment industry untold millions of dollars over the years. Those who make and sell the unauthorized copies violate the warranty against infringement. Illustrations of contractual provisions that may be used in a contract for warranty against infringement appear in Exhibit 14-6.

EXHIBIT 14-6

Sample warranties against infringement

Warranty of Seller against Patent and Trademark Infringement

Seller warrants that the goods shall be delivered free of the rightful claim of any person arising from patent or trademark infringement.

Warranty of Seller against Patent and Trademark Infringement—Indemnification of Buyer

Seller shall indemnify buyer or the customers of buyer against any liability arising from claims of patent or trademark infringement on account of any composition, process, invention, article, or appliance used or furnished by seller in the performance of this agreement, including, but not limited to, patents or processes for the manufacturing, sale, and delivery of the goods. Seller shall defend any actions brought against buyer for

trademark
A mark, design, title, logo, or motto used in the sale or advertising of products to identify them and distinguish them from the products of others

any such claim, and shall bear all the costs, expenses, and attorney fees of buyer in the defense of any action, and seller shall pay any judgment that may be awarded against buyer. Seller shall have the right to participate in or take over the defense of any such claim or action.

Exclusion of Warranty against Infringement by Seller

Seller makes no warranty, and no warranty shall be deemed to exist, that buyer holds the goods free of the claim of any third person that may arise from patent or trademark infringement.

Cybercises

Go to your favorite music downloading sites and review the types of warranties given by the retailers. What types of warranties are given by the sellers?

Warranty of Merchantability

From a buyer's perspective, the implied warranty of merchantability is perhaps the most valuable. This warranty attaches when there is a sale of a good by a merchant, manufacturer, wholesaler, or retailer. Implicit in the sale of the product is that the product will be free from defects and fit for the purpose for which it was intended. For example, when foreign objects such as worms or mice are found in a food product, needless to say, the product will be deemed unmerchantable. The six elements of warranty of merchantability are set forth in U.C.C. § 2-314(2):

Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and
(b) in the case of fungible goods, are of fair average quality within the description; and
(c) are fit for the ordinary purposes for which such goods are used; and
(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
(e) are adequately contained, packaged, and labeled as the agreement may require; and
(f) conform to the promises or affirmations of fact made on the container or label if any.

When a product fails to conform to the standards in § 2-314(2), a breach of warranty may be found.

Food Products

The warranty of merchantability has been challenged in court in many food cases, which range from chemical contamination to foods containing foreign objects. Because of the volume of disputes about food, the courts have developed two general approaches to these cases: the foreign-natural test and the reasonable expectation test.

Under the *foreign-natural test*, substances that are considered natural to a product do not violate the warranty of merchantability. For example, an unshelled nut in a can of mixed nuts is natural to the product; a fish bone found in fish chowder is natural to the

product. These examples are from actual cases in which courts decided issues of warranty of merchantability. Review *Mitchell v. B.B. Services Co., Inc.,* 582 S.E. 2d (Ct. of App. Ga. 2003), which may give you second thoughts about eating hamburgers!

Line of Reasoning

In *Mitchell v. B.B. Services Co., Inc.,* 582 S.E. 2d (Ct. of App. Ga. 2003), the question for the court was the expectations of a consumer when bone fragment was found in a hamburger from Wendy's. Ronnie Mitchell purchased a hamburger from Wendy's. He bit into the burger and felt something hard strike his tooth. He stopped eating and removed the food from his mouth. What he found was a "bone color" particle. He retrieved additional pieces, which were the size of pencil lead—one-eighth to one tenth of an inch. Mitchell reported the incident to the manager of the Wendy's. The central point of Mitchell's claim is that the bit of bone constituted a "defect" in the product rendering it unmerchantable—a breach of implied warranty. Wendy's attempted to argue that the bone was a natural part of the hamburger meat and thus could not be a defect. Many prior cases took the position that certain substances are "natural" to a product and the seller was not responsible for a breach of implied warranty. This court, however, focused on a North Carolina case whose facts were identical to those of Mitchell. In *Goodman v.Wenco Foods,* 333 N.C. 1, 423 S.E.2d 444 (1992), the same thing occurred when a customer bit down on a small bone while eating a hamburger at Wendy's. Although the *Goodman* case focused on both negligence and warranty issues, where the negligence claim was dismissed, the North Carolina Supreme Court reviewed the implied warranty of merchantability as a viable cause of action. Four elements needed to be proven for a breach of implied warranty:

(1) that the goods were subject to the warranty;
(2) that the goods were defective;
(3) that the injury was caused by the defective goods; and
(4) that damages were incurred as a result.

The *Goodman* case broke with past precedent in North Carolina, which stated that a substance "natural" to the product would not constitute a breach of the implied warranty. The court opined:

> We think the modern and better view is that there may be recovery, notwithstanding the injury-causing substance's naturalness to the food, if because of the way in which the food was processed or the nature, size or quantity of the substance, or both, a consumer should not reasonably have anticipated the substance's presence.

The *Goodman* court cited five other states that followed this reasoning. In the past, a consumer would not be able to recover if a "natural" substance to the product was found in the food. The court stating that the issue was not whether the substance was natural to the product, but whether it was likely that the consumer would take precautions in eating the food if an unnatural substance could be found in a food—such as a fish bone. The *Goodman* court then concluded

> that the fact that a foreign substance is "natural" to the food consumed is not a bar to recovery, provided that the substance is of such a size, quality or quantity,

> or the food has been so processed, or both, that the substance's presence should not reasonably have been anticipated by the consumer. A triangular, one-half-inch, inflexible bone shaving is indubitably "inherent" in or "natural" to a cut of beef, but whether it is so "natural" to hamburger as to put a consumer on his guard . . . .

The *Goodman* court summed up the change in direction by stating that they could not fathom a person eating a hamburger, piece by piece, checking for bone. "When one eats a hamburger he does not nibble his way along hunting for bones because he is not "reasonably expecting one in his food" The Georgia court followed the North Carolina court departing from the position that bone was natural to a hamburger. Mitchell should not have had to anticipate the bone in the hamburger thereby making the beef defective.

Questions for Analysis

Review *Mitchell v. BB Services.* Had Mitchell bought chicken tenders and found a bone in that product, would the court have applied the same reasoning? What if Mitchell bought a bag of peanuts where he bit down on a shell from the bag, would the result be the same?

State Your Case

Tony was on his first trip to the northeast. On his trip, he stopped by a restaurant, the Fish Place, which was known for its fish and clam chowders. Wanting to taste some local cuisine, Tony orders a big bowl of fish chowder. He eats the chowder, slurping and enjoying every bite. About half way through his meal, he places a bite in his mouth and bites down. He hears a crack and spits out the chowder. In his napkin is a big fish bone and a crown from his tooth. The excitement of the chowder is gone. He's in pain. He contacts his attorney (who he keeps on retainer) and tells her that he wants to sue the Fish Place. Will Tony be successful in bringing a breach of implied warranty case against the Fish Place?

Under the *reasonable expectations* test, the court inquires as to what a reasonable person would expect to find in the product. Undoubtedly, one does not expect to find bits of glass or an insect in food, or a syringe in soda. Having such foreign objects in a food product is unreasonable.

Cars and Trucks Another area in which the warranty of merchantability has been challenged is in the use and manufacture of cars and trucks. This issue received national attention when the Ford Pinto's merchantability came into question (several Pintos exploded on impact due to the gas tank design). More recently, a truck design was litigated (because of the placement of side gasoline tanks, when hit, the trucks often exploded). In each case, one of the bases for challenge was warranty of merchantability.

Cigarettes Courts have had the difficult task of determining whether cigarettes are merchantable because they cause cancer. To date, the courts have taken the

"no-worse-than-anybody else" approach. Unless contaminated by some foreign substance, a cigarette is merchantable, because the product as intended is free from defects, even though it may cause cancer. Many disagree with that analysis, and the case law is sure to develop rapidly in this area as new cases are decided.

Warranty of Fitness for a Particular Purpose

Sometimes a seller knows that the buyer is relying on the seller's expertise and judgment in the purchase of goods. When this occurs, the warranty of fitness for a particular purpose comes into play. Under U.C.C. § 2-315:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified an implied warranty that the goods shall be fit for such purpose.

The critical question is whether the product is fit for a particular purpose, not whether the product is fit for an ordinary purpose. Fitness for a particular purpose is more specific and defined than fitness for ordinary purpose, which is considered a merchantability issue. When a buyer communicates to a seller the particular needs of that buyer, and relies on the skill and judgment of the seller, the warranty of fitness for a particular purpose is breached if the product fails to meet those specific needs and expectations. However, the respective expertise of the parties will be considered in determining whether the buyer relied on the seller's skill and knowledge of the product. *Evilsizor v. Bencraft & Sons General Contractors*, 806 N.E. 2d 614 (Ct. of App. Ohio 2004) illustrates this point.

Line of Reasoning

An interesting case of reliance on one's expertise is illustrated in *Evilsizor v. Bencraft & Sons General Contractors,* 806 N.E. 2d 614 (Ct. of App. Ohio 2004). The facts are straight forward. Gladys Evilsizor hired Bencraft to paint her house. She signed a written contract where Bencraft agreed to paint her house for $3,300 using Sherwin-Williams 20 year warranty paint and labor. A warranty was included in the contract which stated: "All of our work is guaranteed for one year, and the paint is guaranteed by Sherwin Williams for twenty years." Gladys paid for the work in July, 2001. In March, 2003 Gladys noticed that the paint was cracking and peeling. She contacted Bencraft who failed to fix the problem. She contacted another contractor at a cost of $2260. The problem was Bencraft's use of the latex-based paint over an existing layer of oil-base paint. There are two main issues: (1) whether the one year warranty in the written contract for the work precludes Gladys lawsuit (2) whether the common law or U.C.C. applies to the transaction.

The court observed that the case involved both services and the furnishing of goods. Since this was a consumer who relied on Bencraft's expertise in choosing the paint, the court applied principles from the U.C.C. to the transaction. In applying the U.C.C., the court found that

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or

> judgment to select or furnish suitable goods, there is unless excluded or modified under [the Code] an implied warranty that the goods shall be fit for such purpose.

In finding that the U.C.C. applied, the court used the predominant purpose test and observed that the service was not so predominant as to exclude the application of the U.C.C., thus the court did focus on the fact that Gladys was relying on Bencraft's expertise and skill in choosing the paint and that the paint was fit for its particular purpose. Bencraft knew the purpose of the contract and the fact that Gladys was relying on Bencraft's judgment to select and furnish paint suitable for the task at hand. Bencraft's actions created an implied warranty of fitness for the particular purpose. The written agreement did not make any express disclaimers of warranty and the one year warranty did not displace the implied warranties that Gladys had by law. The chipping and peeling of the paint was a direct result of Bencraft's painting over the oil based paint with the latex paint creating an adhesion problem. Glady's loss was caused by the unsuitability of the paint which Bencraft has chosen, furnished and purchased. Thus, the facts support a breach of warranty claim and damages from hiring another contractor.

Questions for Analysis

Review *Evilsizor v. Bencraft*. Under what set of facts or circumstances would the common law of contracts be applied rather than the U.C.C.? Had the common law been applied, would the result of the court have changed?

State Your Case

Granite Book Publishers wanted to buy a new telephone system for their business. They had outgrown their old system. Ballentine Business Machines specializes in many kinds of business products from copiers to telephones. Granite hired Ballentine to assist in choosing a telephone system. Ballentine sent a representative, Walter P. Calley. Calley told Granite that the best system was the T3 Line of phones. All his best clients have the system. He also stated that the system rarely had problems. The system will last forever. Based on Walter's representations, Granite purchased the system. After the system was installed, Granite had problems transferring calls, conferencing clients, and a host of other problems. Granite wanted its old system back! Now, Granite wants Ballentine to take the system out. Ballentine refuses. Does Granite have a claim for breach of express warranty and implied warranties on the telephone system?

TECH CHECK

Warranties on the Internet—are they available?

Perhaps the old adage "buyer beware" is having a rebirth with the Internet. Warranties that normally are given and honored in a "brick-and-mortar" type store may not be honored if purchased on the Internet. Retailers use language such as "will honor warranties when purchased by an authorized online dealer." This

language may or may not be enforceable, but if you or a client happens to purchase a product and find out that the site you purchased the product from was not sanctioned by the dealer, you may be without the warranty. Additionally, many retailers exclude such sites as e-Bay from their warranty protections because of not being an "authorized dealer." This does place an additional burden on the consumer who believes they are purchasing goods with all the requisite warranties attached. The Internet has introduced new challenges for both retailers and buyers. Another issue with online retailers, even the big ones, is where do you turn when a product is defective—the place of purchase, right? Wrong. Now, many sites appear to be under the umbrella of a big retailer only to find out that it is more like an "affiliation" with the larger more known retailer. You have a problem, so you contact customer service who in turn sends an e-mail stating that they are not responsible and that you should contact some retailer unknown to you. Then this retailer tells you that they only sell the products, but any problems must be addressed directly to the manufacturer. The anonymous nature of the Internet has created warranty issues that consumers never anticipated or expected. The importance of this concept is knowing the terms of the contract and hoping that the issue of "unconscionablity" and warranty disclaimers is only a theoretical lesson as opposed to a real one. Thus, pay attention to contracting on the Internet and know the limitations of the sites you visit as a consumer or professional.

Cybercises

Using the Internet, locate three full and limited warranties for products. Compare the language and identify the differences and whether the warranties comply with the Magnuson-Moss Act.

14.5 GENERAL WARRANTY OF PROTECTION: MAGNUSON-MOSS ACT

Buyers and consumers have had many problems with companies attempting to disclaim warranties without the buyers' knowledge and attempting to circumvent their responsibilities under contracts. Buyers and consumers were left with little protection under the law and were literally helpless. However, in 1975, Congress passed the "Consumer Protection Warranty Act," also known as the Magnuson-Moss Act (15 U.S.C. § 45 *et seq.*), which created new protections for consumers against sellers.

No longer could sellers hide warranties in the fine print or exclude warranties of which the buyer had no knowledge. The Act required that sellers or manufacturers provide presale warranty information; it also set forth procedures to assist consumers in having their claims heard.

According to the Act, when goods are sold for more than $10:

1. The warranty has to be available prior to the purchase.
2. The warranty must be presented in easily understood English.
3. The warranty must state whether it is full or limited.

Unless these basic statutory requirements are followed, the seller may be subject to certain civil penalties.

One of the Act's most notable requirements is that the seller/manufacturer must designate whether a warranty is full or limited. The Act provides four basic requirements for a **full warranty**:

full warranty
A warranty that is not confined to specified defects and that covers labor as well as materials

1. Defects will be remedied within a reasonable period of time.
2. Any exclusions or limitations of consequential damages must be conspicuously set forth.
3. An implied warranty cannot be limited as to time.
4. If a product is defective and the defects cannot be remedied, the buyer has the right to a refund or a replacement item.

In addition, a full warranty must state its duration. For example, if the warranty is for 90 days, it must state in a conspicuous manner "Ninety-Day Warranty." Most products today have full warranties. For example, a hair dryer is usually sold with a printed warranty setting out in specific language the rights and responsibilities of both the seller and the buyer.

limited warranty
A warranty that is limited in duration or confined to specified defects

A **limited warranty** is any warranty that does not fulfill all the requirements of a full warranty. In a sense, a limited warranty is created by exclusion. Many of the requirements for creating a full warranty are not met in a limited warranty; thus, the rights of the party who is purchasing the item are limited. Exhibit 14-7 shows a sample combined full warranty and limited warranty.

EXHIBIT 14-7 Sample combined full and limited warranty

AUTOMATIC WASHER WARRANTY

Full One-Year Warranty

For one (1) year from the date of original retail purchase, any part which fails in normal home use will be repaired or replaced free of charge. This warranty applies when the appliance is located in the United States or Canada. Appliances located elsewhere are covered by the limited warranty, including parts which fail during the first year.

Limited Parts Warranty

After the first year from the date of original retail purchase, through the time periods listed below, the designated parts which fail in normal home use will be repaired or replaced free of charge for the part itself, with the owner paying all other costs, including labor.

Second Year—all parts; **Third through Fifth Year**—all parts of the transmission assembly (as illustrated).

Additional Limited Warranty against Rust

Should an exterior cabinet, including the top and lid, rust during the five year period starting from the date of retail purchase, repair or replacement will be made free of charge during the first year. After the first and through the fifth year, repair or replacement will be made free of charge for the part itself, with the owner paying all other costs, including labor.

How and Where to Receive Warranty Service

Call or write the authorized dealer from whom the appliance was purchased or the authorized service firm designated by it.

If the owner moves from the selling dealer's servicing area after purchase, call or write any authorized dealer or authorized service firm in or near the new location.

Should the owner not receive satisfactory warranty service from one of the above, call or write Service Department.

This Warranty gives you specific legal rights, and you may also have other rights which vary from state to state.

14.6 THE RIGHT TO EXCLUDE WARRANTIES

Sellers may exclude warranties on the products they sell, but the exclusion must be readily apparent so that the consumer or buyer is not misled when purchasing the product. U.C.C. § 2-316(1) discusses when express warranties can be excluded. In part, this section states that:

> Words or conduct relevant to the creation of an express warranty in words or conduct intending to negate or limit warranty shall be construed whenever reasonable as consistent with each other.

If the warranty and the exclusion are inconsistent with each other, the warranty will supersede the exclusion. Thus, the warranty will be interpreted in favor of the buyer.

The Code provides specific methods of excluding implied warranties, which must be strictly met. Section 2-316(2) states how certain implied warranties can be excluded:

> To exclude or modify the implied warranty of merchantability or any part of it, the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranties of fitness, the exclusion must be a writing and conspicuous.
>
> Language which excludes all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

conspicuous
Clearly visible: easily seen

Notice that under § 2-316(2), all the exclusions of implied warranties must be written and **conspicuous**. This means that the language must either be underlined, or in boldface print, or in capital letters, so that the buyer can easily see that the exclusion exists. Language that does not comply with the requirements of § 2-316(2) will not exclude the implied warranty.

Further, § 2-316(3) provides a method of exclusion for implied warranties of quality:

> (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which

in common understanding calls the buyers' attention to the exclusion of warranties and makes plain there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods, there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) An implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

The key to warranty exclusion is notice to the buyer. Be sure the notice is clear, unambiguous, and easily understood. Exhibit14-8 provides examples of warranty exclusions.

EXHIBIT 14-8 Sample warranty exclusions

Exclusion of Warranties of Merchantability and Fitness for Any Purpose

SELLER MAKES NO WARRANTY OF MERCHANTABILITY OF THE GOODS OR OF THE FITNESS OF THE GOODS FOR ANY PURPOSE.

Exclusion of Warranties of Merchantability and Fitness for Any Purpose

Except for the warranty of title, NO WARRANTY OF MERCHANTABILITY FITNESS, OR OTHER WARRANTY (WHETHER EXPRESSED, OR IMPLIED, OR STATUTORY) IS MADE BY SELLER, except that seller warrants the goods to be free from defects in materials and workmanship in normal use and service.

Exclusion of Warranty of Fitness for Any Purpose

THE GOODS SUBJECT TO THIS CONTRACT ARE NOT WARRANTED AS SUITABLE FOR ANY PURPOSE PARTICULAR TO BUYER. THE SUITABILITY OF GOODS FOR ANY PURPOSE PARTICULAR TO BUYER IS FOR BUYER. IN BUYER'S SOLE JUDGMENT, TO DETERMINE. SELLER ASSUMES NO RESPONSIBILITY FOR THE SELECTION OR FURNISHING OF GOODS SUITABLE TO THE INDIVIDUAL NEEDS AND PURPOSES OF ANY PARTICULAR BUYER.

14.7 PERSONS COVERED UNDER WARRANTIES

privity
An identity of interest between persons, so that the legal interest of one person is measured by the same legal right as the other

Under § 2-318, the U.C.C. extends warranties to the persons who benefit from the product and who may use the product. This suggests that **privity**, a direct contractual relationship between the buyer and seller, is unnecessary. If a person uses a product and is injured by it, the injured party has a cause of action against the appropriate parties. Privity is not an issue.

The Code presents three alternatives (see Exhibit 14-9) for state adoption on the issue of who is included in a warranty. A number of states have adopted one of these various alternatives; others have created their own versions to deal with the extended warranty problem. Check Exhibit 14-10 to determine individual state policy.

EXHIBIT 14-9 U.C.C. warranty alternatives (§ 2-318)

Alternative A:	Seller's warranty, whether express or implied, extends to any natural person who is in the family or household of the buyer or who is a guest in his home, if it is reasonable to expect that such person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty. Seller may not exclude or limit the operation of this section.
Alternative B:	Seller's warranty, whether express or implied, extends to any natural person who may reasonably be expected to use, consume, or be affected by the goods who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.
Alternative C:	A seller's warranty, whether express or implied, extends to any person who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends.

EXHIBIT 14-10 State adoption of warranty language

Alternate A	Alternate B	Alternate C
Alaska	Alabama	Hawaii
Arizona	Colorado	Iowa
Arkansas	Delaware	Minnesota
Connecticut	Kansas	North Dakota
District of Columbia	South Dakota	Utah
Florida	Vermont	
Georgia	Wyoming	
Idaho		
Illinois		
Indiana		
Kentucky		
Maryland		
Michigan		
Mississippi		
Missouri		
Montana		
Nebraska		
Nevada		
New Jersey		
New Mexico		

Alternate A	Alternate B	Alternate C
North Carolina Ohio Oklahoma Oregon Pennsylvania South Carolina Tennessee Washington West Virginia Wisconsin		

Own Version	None
Maine Massachusetts New Hampshire New York Rhode Island Texas Virginia	California Louisiana

14.8 REMEDIES FOR BREACH OF WARRANTY

A prerequisite for any action involving a breach of warranty is the plaintiff's notice to the seller of the defect in the product. The notice must occur within a reasonable time period after discovery of the defect or after the defect should have been discovered. Unless notice has been properly given, recovery for damages will be difficult. Exhibit 14-11 is an example of a notice letter for breach of warranty.

EXHIBIT 14-11 Sample notice letter for breach of warranty

May 15, 2011

Mr. Conrad Holmes
1234 Elm Street
Dallas, Texas 76543

Dear Mr. Holmes:

Please take notice that on July 15, 2011, the warranty of merchantability given by you in our agreement of July 10, 2011,

for the sale of 45 vacuum cleaners was breached by you in that within fifteen (15) days of receiving the goods, seven (7) customers have brought back their vacuums because of defective motors.

The warranty is based on Section ___ of our agreement, which provided as follows: [set forth agreement].

Unless you remedy this problem within ten (10) days of receipt of this letter, I will take the appropriate legal action.

Your prompt attention to this matter is advised.

Very truly yours,

Andrew Davids

Cybercises

Find three examples of a remedy provision located in products that you use. Identify the differences in the provisions and whether the language complies with your jurisdiction's U.C.C.

The damage provisions for breach of warranty situations are found in § 2-714(1) and (2), which state:

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607), he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

Notice that incidental and consequential damages are recoverable in a breach of warranty case.

However, contract law is not the only method of recovery for breach of warranty or a defective product. Tort law now allows consumers to file actions against sellers, manufacturers, suppliers, and retailers when a product causes injury. When a consumer is injured by a product, products liability law offers remedies based upon **negligence** or **strict liability**.

negligence The failure to do something that a reasonable person would do in the same circumstances, or the doing of something a reasonable person would not do

strict liability Liability for an injury whether or not there is fault or negligence; absolute liability

Negligence

A common method of recovery for an injury suffered from the purchase of a product is a negligence action. Under present legal theories, an injured party can sue the manufacturer, supplier, and/or retailer for damages caused by a product held out for sale to the public. Based upon public policy arguments, entities that put unsafe products in the stream of commerce are held responsible for injuries resulting from defective products. For a consumer to be successful in a negligence action, it must be shown that:

1. The consumer's injuries were proximately caused by normal use of the product.
2. The manufacturer, supplier, or retailer owed a duty of care to the consumer.

3. That duty of care was breached.
4. The consumer suffered damages.

If all four elements can be proven, a consumer could recover damages for injuries caused by the product.

A negligence case may require knowledge of the unsafe nature of the product by the manufacturer, supplier, or retailer as a necessary element. Sometimes proving such knowledge can be difficult. Consequently, another theory of recovery, known as strict liability, has developed.

Strict Liability

The strict liability theory of recovery for injury makes it easier for consumers to recover for injuries suffered. Under strict liability, the seller must engage in the selling of the product and the defect in the product that caused the injury must be shown to be unreasonably dangerous. Further, no privity of contract is required. The guide for strict liability cases has been *Restatement (Second) of Torts* § 402(A), which states:

(1) One who sells any product in a defective condition unreasonably dangerous to the user or customer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property if:
   (a) the seller is engaged in the business of selling such a product, and
   (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although
   (a) the seller has exercised all possible care in the preparation and sale of his product, and
   (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

Many states have adopted 402A in either their case law or by statute.

Strict liability in tort law has given consumers the means to recover for unsafe products. In fact, recovery under tort theories, rather than contract theories, may be less restrictive for the consumer. Normally, no notice to the seller is required when an injury or defect occurs. Further, contractual disclaimers and exclusions are usually ineffective because the theory of recovery is based in tort law, not contract law.

Parties sustaining injuries due to a defective product usually sue on both tort theories, thus maximizing the legal options available. *Toney v. Kawasaki Heavy Industries, Ltd.*, 763 F. Supp. 1356 (S.D. Miss. 1991) provides some insight into tort law when negligence and strict liability issues are raised in product liability cases.

Line of Reasoning

This case focuses on the buyer's duty to act responsibly when using a product. Toney purchased a used Kawasaki KZ 750 motorcycle from Henry Banks. It was manufactured by Kawasaki. One day after the purchase from Banks, Toney was in an accident on the open highway where he was severely injured.

Eventually, his leg was amputated because of the injuries. Toney sued Kawasaki for a defective product and breach of warranties. The Mississippi court set forth the elements of recovery for strict liability, which are

> (1) the defendant placed a product on the market that was in a defective condition and unreasonably dangerous for its intended use; (2) the plaintiff was using the product in a manner that was reasonably foreseeable; and (3) the defective condition was the proximate cause of the injury to the plaintiff.

In establishing the elements for strict liability, the plaintiff must show that the product was dangerous beyond what is contemplated by an ordinary consumer who commonly would use it. If the danger is "open and obvious" a claim for strict liability will not apply. Under the "open and obvious" standard a manufacturer does not have a duty to warn a consumer either.

The main issue in this case was whether the motorcycle should have been equipped with leg guards or other leg protection. The court found that the dangers associated with using motorcycles are "open and obvious" and would be "patently obvious" to a consumer who uses one. The court also looked at the breach of warranty claims. Here, Toney alleges that the motorcycle was unsafe in its present condition. The court stated that Toney must prove "among other elements, that the goods were unfit for their normal use at the time of sale and that plaintiff incurred injuries that were proximately caused by the defective nature of the goods." As with strict liability, a manufacturer cannot be liable for a breach of warranty when a condition is "open and obvious" to the product. As the court stressed:

> an express warranty does not survive acceptance with knowledge of the defects. It has been stated that neither a general nor an implied warranty covers external and visible defects which are plain and obvious to the purchaser upon mere inspection with the eye.

Therefore, the court found Toney's claim unfounded because the defects that he alleged—lack of leg protection—were an "open and obvious" danger. Therefore, there could be no breach of warranty.

Questions for Analysis

Review *Toney v. Kawasaki*. Under what set of facts would the court have found a breach of warranty claim? Would the court's decision have changed if the product was a jet ski? A riding lawn mower?

14.9 PRACTICAL APPLICATION

Throughout this chapter, there are examples of provisions to assist in drafting tasks. Remember that all states have adopted U.C.C. Article 2 (Sales) in some form. As a result, you can often locate applicable sales and warranty provisions in state statutes. Many states provide forms which guide the attorney or paralegal who is searching for appropriate language. Consequently, consult state statutes as well as formbooks when presented with a drafting task. Exhibit 14-12 shows two contracts that address the warranty, title, and risk of loss issues.

EXHIBIT 14-12 Sample sales contracts

Contract for Manufacture and Sale of Machinery

This Agreement of Sale made this 10th day of September, 2011, between Machines R Us, Seller, of 1234 Beach Drive, West Palm Beach, Florida, and Simpson Electronics, Buyer, of 5678 Ocean Drive, West Palm Beach, Florida.

1. Subject Matter of Contract. Subject to the terms and conditions hereof, Seller agrees to manufacture and sell to Buyer the following described machinery; [specify machinery and set forth specifications, such as "specifications attached" or "Seller's standard specifications are set forth in its catalog of certain date"], hereafter called "Machinery."

2. Payment. Buyer agrees to pay therefore as follows: One-fourth down within five days after execution of contract; one-half within ten days after Seller notifies Buyer of opportunity to inspect and Seller's intent to make delivery at expiration of ten days from notice; one-fourth upon delivery, installation, and readiness for commercial operations upon Buyer's designated premises. If Seller should regard its prospect of receiving the last payment as insecure, it may demand payment prior to delivery.

3. Delivery Schedule. Seller shall commence to manufacture within two weeks following receipt of Buyer's initial deposit. Subject to the provisions of paragraph 5, Seller will complete such manufacturing and make the Machinery available for inspection at Seller's plant not later than September 31, 2011. In the event that Buyer's inspection discloses defects or need for adjustments, Seller shall have a reasonable time to correct such defects and make such adjustments as are necessary. Buyer shall thereafter have an opportunity to make a final shipment inspection. Seller shall within five days of inspection cause the Machinery to be appropriately packaged and shipped to the designation specified by Buyer. Seller shall pay all expenses of packaging and preparations for shipment and Buyer shall pay all costs of shipment, including insurance on both Seller's and Buyer's respective interests therein.

4. Installation. Within ten business days after receipt of notice of arrival at Buyer's destination, Seller shall cause such machinery to be assembled and installed at Buyer's plant. Seller will furnish one master mechanic for such purpose and pay his wages, and Buyer shall pay all other costs of assembly and installation, including the master mechanic's reasonable travel to and living expenses while at Buyer's plant, and the cost of any other laborers or workers needed by the master mechanic for assistance in such assembly and installation.

5. Excuse for Nonperformance. Seller's obligations hereunder are accepted subject to strikes, labor troubles (including strikes or labor troubles affecting any suppliers of Seller), floods, fires, accidents, delays, shortage of cars, contingencies of transportation, and other causes of like or different character beyond the control of Seller. Impossibility of performance by reason of any legislative, executive, or judicial act of any governmental authority shall excuse performance or delay in performance of this agreement.

6. Warranties and Limitations Thereof. Seller warrants that the machinery shall be delivered free of the rightful claim of any third person by way of patent infringement, and if Buyer receives notice of any claim of such infringement, it shall, within ten days, notify Seller of such claim. If Buyer fails to forward such notice to Seller, it shall be deemed to have released Seller from this warranty as to such claim.

There are NO WARRANTIES OF MERCHANTABILITY and NO WARRANTIES WHICH EXTEND BEYOND THE DESCRIPTION ON THE FACE HEREOF.

Seller further agrees that it will replace without charge any part which proves defective in material or workmanship within the first 2,000 hours of operation or a period of one year from date of delivery to Buyer, whichever shall occur first.

7. Entire Contract. The parties agree that this constitutes the entire agreement and there are no further items or provisions, oral or otherwise. Buyer agrees that it has not relied upon any representations of Seller as to prospective performance of the Machinery, but has relied upon its own inspection and investigation of the subject matter.

8. Inspection of Machinery by Seller. Buyer agrees to permit Seller, its agents or employees, or any independent experts or their agents or employees to inspect such Machinery and observe its performance at reasonable times and after reasonable notice. Buyer further agrees to permit Seller, its agents or employees, and its independent manufacturer's agents to show such machines while in operation to persons who are prospective purchasers of comparable machinery and notwithstanding that such prospective purchasers are competitors or potential competitors of Buyer.

In Witness Whereof, Seller and Buyer have signed their names and caused their corporate seals to be affixed as of the day, month, and year aforesaid.

Misti Rainey
By: _____
President of Machines R Us

Attest:
_____
Corporate Seal

Karen Simpson
By: _____
President of Simpson Electronics

Attest:
_____
Corporate Seal

General Form of Contract to Sell in Future

This Contract made this 27th day of September, 2011, between Misti Rainey, Seller, of 1234 Beach Drive, West Palm Beach, Florida, and Karen Simpson, Buyer, of 5678 Ocean Drive, West Palm Beach, Florida.

WITNESSETH

1. Description of Goods. Seller agrees to sell and Buyer agrees to buy on the 10th day of October, 2011, the following described goods: [specifically describe goods]. Until such date, the goods shall remain the property of Seller and Seller shall be free to make normal use of such goods in and about the operation of its business.

2. Delivery. Seller shall deliver the said goods to Buyer at 5678 Ocean Drive, West Palm Beach, Florida, on or before the 10th day of October, 2011.

3. Price. Buyer shall pay to Seller on day of delivery the sum of Twenty-Eight Thousand Dollars ($28,000.00), with appropriate adjustments, if any, under paragraph 4 hereof.

4. Condition of Goods: Buyer has inspected such goods and agrees to purchase such goods AS IS, including normal wear and tear to date of delivery. Except as expressly set forth herein, there are NO WARRANTIES OF MERCHANTABILITY OR OF FITNESS OR OTHERWISE. Seller does warrant that on date of delivery, the goods will be in equally good condition as of the date of this Contract, excepting only normal wear and tear occurring after such date. Until delivery, all risk of loss shall be on Seller. In the event of damage, destruction, or deterioration to or of such goods (other than normal wear and tear), there shall be an appropriate adjustment in the purchase price to reflect any diminution in value as a result thereof.

SUMMARY

14.1 Determining ownership to goods is important. Title is equivalent to legal ownership. Risk of loss, often associated with title, refers to the assumption of financial responsibility when goods are damaged, lost, or destroyed.

14.2 In a shipment contract, title and risk of loss pass when the goods are placed on a carrier. In a destination contract, title and risk of loss do not pass until the buyer receives the goods at the agreed destination. When delivery is not required, title and risk of loss pass when the contract is made. In addition, if a buyer rejects goods, title may revest in the seller.

14.3 Void title is not a valid title. If persons with a void title attempt to transfer title, they transfer only a void title. Voidable title is different. If a person who has voidable title transfers title to a good faith purchaser, the transferred title is valid.

14.4 An insurable interest is the value placed on the property by the insured. Depending on the circumstances, a seller usually retains an insurable interest up to the point when title passes, and the buyer has an insurable interest when the goods are identified.

14.5 Warranties can be either express or implied. An express warranty may be oral or written. An express warranty can be created (1) by a statement of fact or promise to the buyer, (2) through description of the goods, or (3) through a sample or model.

Implied warranties are imposed by law. They are implicit in the bargain. The implied warranties are the warranty of title, warranty against infringement, warranty of merchantability, and warranty of fitness for a particular purpose.

14.6 The Magnuson-Moss Act establishes general warranty protection for consumers. The Act establishes two types of warranties: full and limited. A full warranty must comply with certain statutory requirements, whereas a limited warranty is created by exclusion.

14.7 Sellers may exclude warranties. To be effective, the exclusion should be in writing, mention merchantability, and be conspicuous.

14.8 Persons need not be in privity with the seller to be included under warranty provisions. The Code provides statutory remedies when a warranty has been breached. However, contract law is not the only avenue a consumer has for recovery. A consumer may also sue in tort law under theories of negligence and strict liability.

KEY TERMS

title
document of title
valid title
void title
insurable interest
warranty
express warranty
puffing
implied warranty
warranty of title
patent
copyright
trademark
full warranty
limited warranty
conspicuous
privity
negligence
strict liability

REVIEW QUESTIONS

1. Define the concepts of title and risk of loss.
2. When do title and risk of loss pass in a shipment contract? In a destination contract?
3. Under what circumstances will title revest in the seller?
4. Distinguish between void and voidable title and give one example of each.
5. When does risk of loss pass when a good is insured? What special problems are presented when the buyer revokes an acceptance?
6. What is an express warranty and under what circumstances is it created?
7. Identify the four types of implied warranties.
8. Distinguish between a full warranty and a limited warranty.
9. How can warranties be properly excluded under the law?
10. What remedies are available when warranties have been breached?

EXERCISES

1. Review some warranties given for products you have bought such as a hair dryer, can opener, washer and dryer, computer or printer. Using the Code, determine if the warranties comply with the requirements set forth in the U.C.C.
2. Using the examples in this chapter, draft an enforceable warranty clause that excludes the warranty of merchantability and is sold without guaranteeing title.
3. Ms. Charlene Thomas has purchased a car from ABC Motors. She drives it home and for a week the car is fine. After one week, the engine goes dead and the radiator begins to leak. The contract she signed excludes the warranty of fitness for a particular purpose. Prepare a notice letter setting forth the reasons why the exclusion is ineffective and demanding the return of the car and all monies tendered to the car dealer.

4. Tildon Electronics is a distributor of the Wii and its related games. Davis Electronics Wholesale is a retailer of all types of electronics. Davis Electronics wants to purchase 550 Wii games along with 1,000 compatible games. Tildon receives the order from Davis Electronics and faxes back a confirmation of the order which totaled $215,000. Tildon requires a 30 percent deposit when the order is confirmed, 30 percent when shipped, and 40 percent when delivered. Davis Electronics paid the 30 percent down payment. A sales representative went to the warehouse and segregated the Davis Electronics order and placed a big sign indicating that it was for Davis Electronics. Overnight there was an electrical fire and everything in the warehouse was destroyed. Tildon is relieved because they know that Davis Electronics made its down payment for its order. The Wii and related games were owned by Davis Electronics. Did title pass to Davis Electronics? Explain your response.

5. Based upon your state's law, determine whether the following are destination or shipment contracts:

   a. All windows to be shipped properly crated/packaged/boxed suitable for cross-country motor freight transit and delivered *to* New York City.
   b. All windows to be shipped properly crated/packaged/boxed suitable for cross-country motor freight transit and delivered *at* New York City.
   c. All windows to be delivered properly crated/packaged/boxed suitable for cross-country motor freight transit to seller's port.
   d. Seller shall deliver all windows properly crated/packaged/boxed F.O.B New York City.
   e. Seller shall ship windows as specified by buyer to buyers place of business in New York City.

6. Thomas and Marilyn Hernandez recently installed an in-ground pool in their backyard. During the summer months the temperature was quite comfortable, but as fall approached, the pool was becoming too cold to use, even in Florida. Thomas contacted Sun and Fun Pools where he purchased a pool heater. The heater and installation costs $5,000. Sun and Fun delivered the heater by leaving it in the middle of the Hernandez' driveway. They did not install the heater when it was delivered. Marilyn was worried about the security of the heater since someone could steal it. She contacted Sun and Fun, and they told her not to worry. They would be there in a few days. When Thomas left for work the next morning, the driveway was bare—no pool heater. He immediately called Sun and Fun and the police. Sun and Fun claims that the Thomas' are responsible for the purchase and installation price of the heater. Was the pool heater "delivered" and who was responsible for the risk of loss at the time the pool heater disappeared?

7. Henry Danno needed some lumber to complete the addition he had been working on for his house. He went to Lumberyard Central to purchase the additional lumber for his renovation. Henry backed his truck up to the warehouse entrance. Henry just slid the lumber in the back of his truck without tying it down or securing the lumber. At the entrance of the loading area was a sign, which stated:

   WE WILL BE GLAD TO HELP YOU LOAD

   YOUR MATERIALS. HOWEVER, BEFORE

LEAVING THE YARD, BE SURE TO TIE

YOUR LOAD AND ALL MATERIALS SECURELY.

LUMBERYARD CENTRAL IS NOT RESPONSIBLE

FOR THE SAFE TRANSPORT OF YOUR PURCHASE.

Henry did not pay attention to the sign and drove off. While driving and attempting to navigate a turn, the lumber fell out of the truck. Henry got out of his truck and tried to retrieve the lumber when a car hit the lumber forcing Henry to the ground. He injured his knee. Henry sued Lumberyard Central for his injuries. One of the claims in Henry's lawsuit was that Lumberyard retained the risk of loss until Henry reached his destination—his home. Does Henry have a valid argument under the U.C.C.? Detail your explanation.

8. Penny Wilson decided to treat herself and purchase a garnet and tanzanite ring from Jewelry Closeouts, a seller of discounted and discontinued jewelry. She paid for her purchase by check. Before the check cleared, Penny decided to sell the ring on E-bay for twice the amount she paid. The new buyer paid Penny promptly. Penny uses all the money to pay some of her outstanding bills. The day after Penny received her money, she received a call from Jewelry Closeouts telling her that her check was returned for insufficient funds. Jewelry Closeouts wants the ring back. Does Penny have valid, voidable, or void title to the ring? Explain your answer.

9. Molly, an avid horse rider, decided to purchase a horse from her friend Huck James. The horse she was purchasing was a beautiful mare the color of dark chocolate named Midnight's Folly. Molly had observed Huck ride Midnight a number of times, so when it was time to purchase her, Molly did not ride him or have a veterinarian examine him. Huck sold him "as is" and guaranteed that the horse was sound. A day after Molly purchased Midnight, she rode him and determined that the horse was lame. She took him to a vet where it was determined that the horse was lame and had arthritis. Molly went to Huck demanding her money back and returned the horse. Answer the following questions:

    a. Is this a transaction under the U.C.C.?
    b. Did Huck make any express or implied warranties to Molly?
    c. Were the warranties made by Huck to Molly effective? Explain your answer.

10. Mel and Zachary were avid World War II memorabilia collectors. They usually purchased metals and swords. Knowing that they like WWII memorabilia, Barney, the owner of Antiques for the Ages, called Mel and told him that he had come into possession of an authentic rifle dating back to the civil war. Although it was not from WWII, Barney thought Mel or Zachary might be interested. When Mel contacted Zach about the rifle, they decided it was something they could not pass up. They contacted Barney for the price and within two hours were at the store with the purchase price of $7,500. Two weeks later, Mel received a call from the Santa Fe police asking about the rifle. They gave the officer a description. According to the officer, the rifle had been stolen from Carney Lee over two months ago. The police demand the rifle's return to its owner.

How it ended up in Barney's shop is a mystery. Mel and Zach are not happy. They call Barney and demand their money back. Answer the following questions based upon these facts.

a. What kind of title did Barney have to the rifle?
b. What kind of title did Mel and Zachary have to the rifle?
c. Are Mel and Zachary entitled to the return of their purchase price?
d. Does Carney Lee have a lawsuit against Barney or Mel and Zachary?
e. Were the police within their rights to demand the rifle from Mel and Zachary?

Give a detailed explanation of your answers.

CASE ASSIGNMENTS

1. A new client is scheduled for an initial interview tomorrow. All you know is that the client has just purchased a new boat, and it apparently has a number of defects. Prepare a list of possible questions that you would ask the client regarding this case.

2. After the meeting you have learned that the client, Donald R. Moss, is the owner of a software business. He has just purchased a new boat to take out to the lake on weekends. He purchased the boat from ClearLake Boats, an authorized representative of Seamaster Boats. Donald purchased the new boat at a cost of $74,000. When it was delivered to his dock, he noticed that some items, such as the windshield wipers, cushions from the outside deck, and the anchor, were missing. He also noticed that the tachometer, refrigerator, floor drains, and outside railings were either damaged or improperly installed. Donald contacted ClearLake, but they claim that they are not responsible for the repairs—Seamaster is. ClearLake points to two warranty provisions, which state:

   > Purchaser agrees that all terms and conditions, including those of the reverse side of this Contract are part of this Contract and that ALL EXPRESS WARANTIES and implied warranties of merchantability and fitness for a particular purpose are EXCLUDED from this transaction and DO NOT APPLY to the goods sold.
   >
   > Any warranty on any new unit is made by the MANUFACTURER ONLY and not by the seller who disclaims all warranties, either express or implied including any implied warranty of merchantability or fitness for a particular purpose. *Any work required must be at manufacturer's place of business. Any shipping or transportation shall be borne by buyer.*

   The costs for the repairs will be around $3,000 but the shipping costs to the manufacturer's site will be at least $5,000. Donald wants to know whether the warranties are any good. Are the warranties cited by ClearLake Boats and Seamaster valid? Is the requirement that the buyer pay for shipping of warranty work unconscionable? Your supervisor wants a thorough analysis of Donald's situation on her desk in two days. They want to file a legal action. (As part of your response, if there is additional information that you require before a lawsuit can be filed, identify the information that you need to make a complete evaluation of the situation.)

Chapter 15

Seller and Buyer Remedies

Outline

Just Suppose . . .

Your supervising attorney has received a box of documents from one of his clients, Il Italia, a shoe importer located in New York City. Apparently, Italia has a contract with Designer Outlets and Warehouse for the purchase of its line of Italian shoes. Italia received a shipment of shoes from its supplier in Milan two days ago. Italia now wants to ship the shoes to Designer Outlets as per their contract, except that Designer Outlets is going out of business. They refuse to pay for the shoes and accept delivery. Italia now has 50,000 pairs of shoes and no buyer. Il Italia is concerned because if they do not sell the shoes soon, they could either go out of business, like Designer Outlets, or file for bankruptcy—neither is a good option. Your attorney wants you to locate the original contract between the parties and any correspondence relating to the latest shipment. She wants to be sure of the facts and what options Il Italia has against Designer Outlets.

The facts in the introduction present a common problem between sellers and buyers: determining the facts to assess the available remedies each may have against the other. Oftentimes the details of a sales transaction are mired in the practices of the parties who are less concerned with the details of a transaction and more concerned with making the sale and delivering the goods. As we will see throughout this chapter, the remedies available to sellers and buyers are many, with some hinging on timing and others on performance. Remember that the Uniform Commercial Code (the Code) offers many different remedies than the common law of contracts; pay close attention to the available options each of the parties has under a myriad of situations.

15.1 OVERVIEW OF THE AVAILABLE REMEDIES

When one of the parties to a commercial sales contract fails to perform, certain remedies are available to the injured party under Part 7 of the Uniform Commercial Code. The two sections in the U.C.C. concerning available remedies are § 2-703 for the seller and § 2-711 for the buyer. These sections should be interpreted in conjunction with other provisions in the Code, but each is a good starting point for determining the available remedies.

Because different remedies are available when a seller has been injured than when a buyer has been injured, one of the first questions to be addressed is who is seeking the remedy. The next question is whether the injury occurred prior to acceptance or after acceptance of the goods.

15.2 REMEDIES AVAILABLE TO SELLER

The general remedies available to a seller are set out in § 2-703 of the U.C.C., which states:

> Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or a whole, then with respect to any goods directly affected and, if the breach is of the whole contract, then also with respect to the whole undelivered balance, the aggrieved seller may
>
> (a) withhold delivery of such goods;
> (b) stop delivery by any bailee as hereinafter provided [§ 2-705];
> (c) proceed under the next section respecting goods still unidentified to the contract;
> (d) resale and recover damages as herein provided (2-706);
> (e) recover damages for nonacceptance or in a proper case the price (2-709);
> (f) cancel.

Understanding which remedy may be appropriate is important. Often a variety of remedies will be available to the seller upon a breach, and the appropriate remedy is a matter of choice for the injured party.

Withhold Delivery of Goods

When a buyer breaches a sales contract, the seller has the right to withhold delivery of the goods under § 2-703 of the Code. When the seller learns in advance of the buyer's intention to breach, the seller is not under an obligation to perform under the contract.

Furthermore, § 2-702(1) addresses a common problem—that of the insolvent buyer. Section 2-702(1) states:

> (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705).

This provision allows the seller to refuse delivery to the buyer unless paid in cash at the time of delivery. Some provisions to include in a contract when insolvency is an issue

are illustrated in Exhibit 15-1. In addition, the paralegal may be asked to draft a notice letter (see Exhibit 15-2) to the buyer when an insolvency is discovered.

EXHIBIT 15-1 Sample clauses treating insolvency

(1) "Insolvent" for the purpose of this agreement means being unable to pay one's debts in the ordinary course of business.

(2) In the event of bankruptcy or insolvency of buyer, or in the event any proceeding is brought by or against buyer under the bankruptcy or insolvency laws, seller shall be entitled to cancel any order then outstanding and shall receive reimbursement for the reasonable and proper cancellation charges accrued by seller.

(3) In the event of insolvency as defined by the Uniform Commercial Code in effect in [state], any act of bankruptcy, whether voluntary or involuntary, or any insolvency proceeding instituted by or against buyer, seller may refuse delivery of the goods covered by this sales agreement except for cash, including payment for all goods theretofore delivered under the agreement, and seller may stop delivery of goods in transit.

EXHIBIT 15-2 Sample notice letters to insolvent buyer

Lamps Unlimited
7321 Grove Street
Sonoma, California 12345

Dear Walter:

I have learned from reliable sources that you are now insolvent within the meaning of U.C.C. Section 2-702. I accordingly suspend the credit term under our agreement dated January 4, 2011, for the sale of lampshades and will not make deliveries to you except on payment by cash or cashier's check received by me in advance of shipment to you of any goods.

I hope that your difficulties are only temporary, and I will be pleased to return to a credit basis as soon as your solvency is restored.

Very truly yours,

Arthur Howell

[OR]

Lamps Unlimited
7321 Grove Street
Sonoma, California 12345

Dear Walter:

I have learned from reliable sources that you are now insolvent within the meaning of U.C.C. Section 2-702. For this reason, I must notify you that I shall refuse to deliver the goods pursuant to our sales agreement dated January 4, 2011, except for cash or cashier's check, including payment for all goods previously delivered to you.

To date you owe me the amount of Two Thousand Three Hundred Twenty One Dollars and Eighty Six Cents ($2,321.86) for deliveries already made. The balance of the purchase price is due on delivery.

I therefore ask you to pay for the goods on September 3, 2011, the date of delivery, in cash or cashier's check made payable to Arthur Howell, Inc. in the amount of Two Thousand One Hundred Dollars and No Cents ($2,100,00).

I hope that your difficulties are only temporary, and I will be pleased to return to a credit basis as soon as your solvency is restored.

Very truly yours,

Arthur Howell

[OR]

Lamps Unlimited
7321 Grove Street
Sonoma, California 12345

Dear Walter:

Pursuant to U.C.C. Section 2-702, I revoke the credit term of our agreement dated January 4, 2010, with respect to the goods delivered to you on September 3, 2011, consisting of lamp-

shades, I demand immediate return of the goods to me because of your insolvency.

I also call to your attention the financial statement you furnished to me on August 11, 2011, which misrepresents that you are solvent when in fact you are not.

Very truly yours,

Arthur Howell

Stoppage of Delivery in Transit

stoppage in transit
A right that a seller of goods on credit has to retake them while they are in the possession of a carrier or other intermediary, upon discovering that the buyer is insolvent

Section 2-705 of the Code also provides another method of withholding delivery, known as **stoppage in transit**. Under this method, the seller may stop delivery of the goods when the buyer is insolvent or repudiates the contract. Section 2-705(1) provides:

(1) The seller may stop delivery of goods in the possession of a carrier or another bailee when he discovers the buyer to be insolvent (Section 2-702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

There is a caveat about using this remedy. The goods must be in the possession of a third party, such as a common carrier, and must not have reached the final destination.

When communicating to the common carrier that the buyer is insolvent, the seller can instruct the carrier not to continue delivery. Unfortunately, this may put a burden on the seller, as the responsibility for any costs incurred by the carrier for not completing the contract, or any damages suffered in the event that the stoppage was improper, must be borne by the seller. Use care when choosing this remedy, if the seller elects stoppage in transit. Exhibit 15-3 provides a sample letter to follow.

EXHIBIT 15-3 Sample stoppage in transit letter

Mr. Oscar H. White
486 Industrial Park, #301
St. Paul. Minnesota 23456

Dear Mr. White:

Demand is hereby made pursuant to U.C.C. Section 2-705(1) that delivery of goods at present in your possession be stopped

and held by you at the disposition of the undersigned seller for delivery in accordance with subsequent instructions of the undersigned.

This STOP ORDER is made with reference to the following goods: 80 twin mattresses. The goods were consigned by B.K. Beds, Inc. of 821 Stately Drive, St. Paul, Minnesota, as consignor, to Beds Limited, of 246 Main Street, St. Paul, Minnesota, as consignee, on November 1, 2011, for which goods you issued a negotiable warehouse receipt No. 4861 dated November 1, 2011.

The undersigned seller is in rightful possession of the above-described negotiable document of title and herewith surrenders it to assure prompt execution of this stop order and warrants that this stop order is made in accordance with Section 2-705, in that the buyer is insolvent as defined in U.C.C. Section 1-201 (23).

The undersigned agrees (1) to pay all charges for storage and shipment of the goods: (2) to reimburse you for any expenses, costs and attorney fees that may be incurred by you by reason of this stop order; and (3) to indemnify and hold you harmless against any claims or demands that may be made against you by any person in connection with the execution of this stop order.

Dated and dispatched on:_____.

Very truly yours,

Abe Standsfield

Note that § 2-705 also provides that a seller may stop the delivery of goods when a buyer breaches the contract prior to delivery, if the delivery is by carload, truckload, planeload, or larger shipments of express freight. This situation presents some problems if delivery has been by a document of title and the buyer has received the transfer of the document of title. At that juncture, delivery cannot be stopped and the seller will have to use an alternate method against the buyer's breach.

Resale of Goods

When goods are still in the possession of the seller and the buyer intends to breach, the seller may resell the goods to recoup as much as possible and minimize its damages. The resale must be in good faith and done in a commercially reasonable manner. Once the resale is completed, the injured seller may sue the nonperforming party for the difference between the contract price and the resale price, adding any expenses and consequential damages that the seller incurred due to the breach.

Code § 2-706(4) specifies what type of sale is acceptable when there has been a breach by the buyer. Section 2-706 distinguishes between a public and a private sale:

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one of more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale, including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.
(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.
(4) Where the resale is at public sale
    (a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and
    (b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily, the seller must give the buyer reasonable notice of the time and place of the resale; and
    (c) if the goods are not to be within the view of those attending the sale, the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and
    (d) the seller may buy.

If the sale is a private one, the seller must comply with certain restrictions to meet its obligations under the Code. The seller must give the buyer reasonable notice of the sale, to give the buyer an opportunity to cure the breach. However, in a public sale, not only must notice be given to the buyer, but the sale must also occur in what is considered the normal, customary procedure for those types of public sales. The method, time, place, and any other conditions must be commercially reasonable. If these conditions are not met, the buyer may question the validity of the sale, and may have rights to invalidate it. Exhibit 15-4 shows sample notice letters for a private and a public sale.

EXHIBIT 15-4 Sample notice-of-sale letters

Mr. Ben Harley
Beds Unlimited
989 Bed Parkway
Detroit, Michigan 01234

Dear Mr. Harley:

I hereby declare that you are in default under our agreement dated August 15, 2011, for the sale to you of 80 twin mattresses. You are in breach of the agreement on November 1, 2011, since you failed to make payment on the goods purchased.

In exercise of my authority under U.C.C. Section 2-706, I shall have a private sale of the goods, which have been identified to our agreement, to James Woods Bedding, 2223 18th Street, Detroit, Michigan, for a purchase price of Ten Thousand Four Hundred Fifty Dollars and No Cents ($10,450.00). I shall hold you liable for the loss sustained by me on the resale to the extent authorized by the Uniform Commercial Code.

Very truly yours,

Dated: December 20, 2011. Abe Stansfield

[OR]

Mr. Ben Harley
Beds Unlimited
989 Bed Parkway
Detroit, Michigan 01234

Dear Mr. Harley:

I hereby notify you that I will hold a public auction sale without reservation at 10:00 o'clock a.m. on November 15, 2011, at my place of business, of those goods identified to our agreement dated August 15, 2011. The goods consist of 80 twin mattresses and may be examined at the location on any weekday between 9:00 o'clock a.m. and 5:00 o'clock p.m.

I shall hold you liable for any loss sustained by me on the public resale to the extent authorized by the Uniform Commercial Code.

Very truly yours,

Dated: November 1, 2011 Abe Standsfield

Persons who buy at such a sale are considered purchasers in good faith. As a result, they take the goods free from any claims of the previous buyer; the previous buyer cannot come back to the good faith purchaser and reclaim the goods. If the seller profits from the public or private sale of the goods (which is unusual), the seller may retain the profit without any benefits to the breaching buyer. If the goods are not identified, § 2-704 governs. Consequently, if the seller identifies the goods after a breach, the seller can proceed under § 2-706 and resell the goods. *Wagal v. SI Diamond Technology, Inc*. 998 S.W. 2d 299 (Tex. App. Houston [1st Dist.] 1999) illustrates the remedy of resale when a buyer has breached.

Line of Reasoning

Suhas Wagal purchased laser equipment from SI Diamond Technology, Inc. ("SIDT") under an installment agreement on June 14, 1996. Under the terms of the agreement, Wagal was to pay SIDT $30,000 in two installments of $15,000: one payment at the time of purchase with the final payment due six months later. The equipment remained on SIDT's property where Wagal used it. When the final payment was due in December, 1996, Wagal notified SIDT that it could not make the payment. SIDT requested Wagal to sign a U.C.C. security agreement and pay rent for the use of its facilities. Wagal refused. Then Wagal took 18 pieces of SIDT equipment from its premises without SIDT's consent. No payment was ever received for the equipment or was it returned. SIDT then sold the remaining equipment for $30,000. SIDT returned to Wagal $15,000 less costs for the sale and rental of its facilities. Wagal accepted the check for $13,340 from SIDT. Wagal sued SIDT for conversion of its equipment for which SIDT countersued for conversion and damages. The case focuses on ownership of the equipment and the remedies that flow from that ownership.

The court found that Wagal repudiated his contract with SIDT by not paying the final payment for the equipment. Once Wagal did this, the seller, SIDT, can resort to any remedy available under the U.C.C. Since SIDT tendered the goods, it was entitled to full payment for those goods. Any right of full ownership is conditioned upon the terms of the contract including payment. When Wagal did not make the final payment, he forfeited any rights to the equipment. The court then analyzed the rights of the seller under U.C.C. section 2-507, which gives the seller the right to reclaim goods regardless whether there is a security interest in the goods. Additionally, when goods are reclaimed, the seller has the right to resell the goods or equipment and recover damages. SIDT did just that under 2-703(4) of the U.C.C. This is a remedy granted by

statute and does not have to be specifically indentified in a contract between the parties. Thus, SIDT exercised a statutory right and did not convert the equipment.

Further, Wagal argues that SIDT cannot reclaim the goods because it did not have title to the equipment. Again, Wagal misreads the U.C.C. Specifically, under section 2-401, the preamble states a seller's remedies under Chapter 2 generally apply "irrespective of title to the goods. . . ." "Title does not affect a seller's remedies. . . ." Thus, by repudiating and subsequently breaching the contract, SIDT had the right to exercise any available remedies under the U.C.C.

Questions for Analysis

Review *Wagal v. SI Diamond Technology*. Would the outcome have changed had Wagal taken delivery of the equipment at his place of business rather than leaving the equipment at SIDT? If SIDT executed a new contract and extended the payments over one year, could SIDT have sold the equipment under those circumstances? Explain your response.

In addition, the following provisions may be useful to include in a contract when resale is a term:

No resale of goods may be made by seller in the event of breach of this agreement by buyer unless seller shall have given buyer not less than ten (10) days' written notice of seller's intention to affect a resale.

In the event of breach of the agreement by buyer, no private sale may be made of any goods intended for or identified in this agreement. Any resale must be made at a public sale.

State Your Case

Using the facts from the introduction, what remedies would Il Italia be entitled to for Designer Outlet's breach of contract? Discuss all possible remedies.

Lawsuit for Damages

When a buyer has breached a sales contract, the seller always has the option to sue the buyer for damages. In this type of lawsuit, the damages will include not only the actual damages, but also any consequential damages, lost profits, expenses, or any other damages that are a direct result of the buyer's breach. The formula used to determine the amount of damages to which a seller is entitled is the difference between the actual contract price and the market price at the time the buyer breached the contract, plus any incidental damages that are a direct or indirect result of the buyer's breach.

Another type of damage suit that a seller can institute against the buyer is a suit for the contract price. A lawsuit on the price occurs when the seller is unable to resell the goods that have been identified to the contract. This is not the best possible route for an injured seller, because there are heavy responsibilities on the seller in this type of action. Section 2-709 suggests:

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price
   (a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and
   (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceding section.

In an action for the price, the seller must hold for the buyer any goods that are under the seller's control. However, if there is any future sale, any proceeds from such a sale must be credited to the buyer, and any goods not sold can be retained by the buyer if a judgment is paid off. The burdens shouldered by the seller that uses this remedy are enormous. Some general provisions to consider including in a sales contract are presented in Exhibit 15-5.

EXHIBIT 15-5 Sample damages provisions

(1) If buyer refuses to accept or repudiates delivery of the goods sold to buyer under this agreement, seller shall be entitled to damages based on the difference between the market price for the goods at the time and place tender of the goods is made under this agreement, and the unpaid sales price, together with any incidental damages authorized by U.C.C. Section 2-710, if applicable, but less expenses saved due to the breach by buyer.

(2) If the measure of damages suffered by seller is inadequate when based on difference in price on the refusal to accept, or repudiation of delivery by buyer, seller shall be entitled to damages based on the profit seller would have received had buyer performed in full, together with any incidental damages authorized by U.C.C. Section 2-710, if applicable, plus due allowances for costs reasonably incurred and due credit for payment of proceeds of resale.

(3) If buyer refuses to accept or repudiates delivery of goods sold to buyer under this agreement, seller's extent of recovery and buyer's extent of liability are limited to the difference between the contract price and the market price at the time and place of tender. In no event shall the seller be entitled to lost profits or incidental or consequential damages as defined in the Uniform Commercial Code.

To have a better understanding of the inner workings of the damage provisions under the U.C.C., examine *Brandeis Machinery and Supply Co., LLC. v. Capitol Crane Rental, Inc*. 765 N.E. 2d 173 (Ind. App. 2002).

Line of Reasoning

Brandeis Machinery and Capitol Crane Rental entered into a lease agreement for the use of a 35 ton Grove Model RT635C Rough Terrain crane for six months on June 16, 1998. In the lease contract, the parties had an option to purchase provision where Capitol could purchase the crane from Brandeis if it so elected. After the lease agreement was over, Capitol continued to lease the crane on a month to month basis. After some discussion with one of Brandeis sales people, Capitol agreed to purchase the crane it had originally leased. The parties executed a sales contract on June 16, 1999 for $291,773.46 "as is." The terms of payment were "net 10 days from invoice date." Otherwise, there would be a 2 percent monthly service charge applied to the purchase price. All parties agreed to the terms and signed the contract on June 22, 1999. Brandeis sent Capitol the invoice for the crane on June 29, 1999. Apparently, between the time Crane agreed to purchase the crane and its return, Capitol had a buyer for its business. In a conversation with Brandeis' manager, Capitol communicated its intent to return the crane and sell its business. According to the facts, this decision was made after it accepted the crane.

Brandeis told its staff to mark the crane "Capitol's" and not resell it to anyone else. Prior to returning the crane, Capitol repaired all damages to the crane, which included any damage to the boom. After its return, Brandeis expended $9,794.86 to inspect the repairs to the crane, in anticipation of a resale. Capitol testified that no money had exchanged hands between the parties for the sale of the crane. Each party submitted their version of how damages should be assessed in this situation. The issues before the Appeals Court are the measure of damages in this case.

In its analysis, one of the first comments the court made was that the U.C.C. did not provide much guidance in determining the appropriate remedy. But the Court did stress that the U.C.C. does not put an injured party in a better position if the other party had fully performed its contractual obligations. Using the Indiana version of the U.C.C., section 2-709(1)(a), it stated that a seller could recover the price and any incidental damages when goods have been accepted. . . . . Once the court set forth the basic parameters, it then went on to discuss what the U.C.C. considers "acceptance," which is a "failure to make an effective rejection." The court then distinguishes between an "ineffective rejection" and a "wrongful rejection." This distinction will determine how the court will determine Brandeis' damages. Damages for

wrongfully rejected goods differ from damages for an ineffective rejection. Thus, the court determined that since this case was a wrongful rejection case, damages based upon the contract price is an incorrect measure. The measure of damages for rejected goods is defined in 2-708. Specifically,

> the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in [2-710] but less expenses saved in consequence of the buyer's breach.

Thus, damages for a wrongful rejection are limited to the difference between the market value of the goods and the unpaid contract price together with any incidental damages.

In this case, Capitol had notified Brandeis in a timely fashion of its rejection of the crane and further did not pay any money toward its purchase. Brandeis had in the past canceled contracts under the same set of circumstances as Capitol. Therefore, the damage award is the difference between the contract price and the market price plus any incidental expenses. In this case, the court followed the trial court's conclusion from the evidence submitted on the market value and contract difference of the crane, which was $19,273.46 and the costs related to the inspection of the repairs, which was $9,794.86. The final issue on damages was the service charges, which had risen to $159,302.38. The trial court did not consider the service charge as an incidental charge and did not award the interest. The Court of Appeals agreed.

Questions for Analysis

Examine the *Brandeis* case, paying close attention to the reasoning of the court in determining the damages. Had Capitol waited two months to return the crane and repudiate the contract, would the court's decision have changed? If Capitol had not repaired the damage to the crane prior to returning it, would that have been considered an incidental damage? Explain your answers.

Cancellation of the Contract

Upon notification of a breach, the seller can cancel the contract and proceed directly to a lawsuit for damages. When a seller cancels a contract due to the buyer's breach, the seller's ability to elect damages is not impeded by the act of cancellation.

Reclamation of Goods

Cybercises

Locate examples of three provisions whose language favors remedies for the seller.

When a buyer has accepted goods and it comes to the seller's attention that the buyer is now insolvent, under § 2-702(2) the seller can reclaim the goods. There are certain restrictions on this remedy, however. To reclaim the goods, the seller must show that: (1) the buyer received the goods on credit while insolvent; and (2) the seller demanded the return of the goods within 10 days of delivery. If misrepresentation of solvency was made to the particular seller in writing within three months before delivery, the ten-day limitation does not apply [§ 2-702(2)]. Exhibit 15-6 is a chart of a Seller's Remedies.

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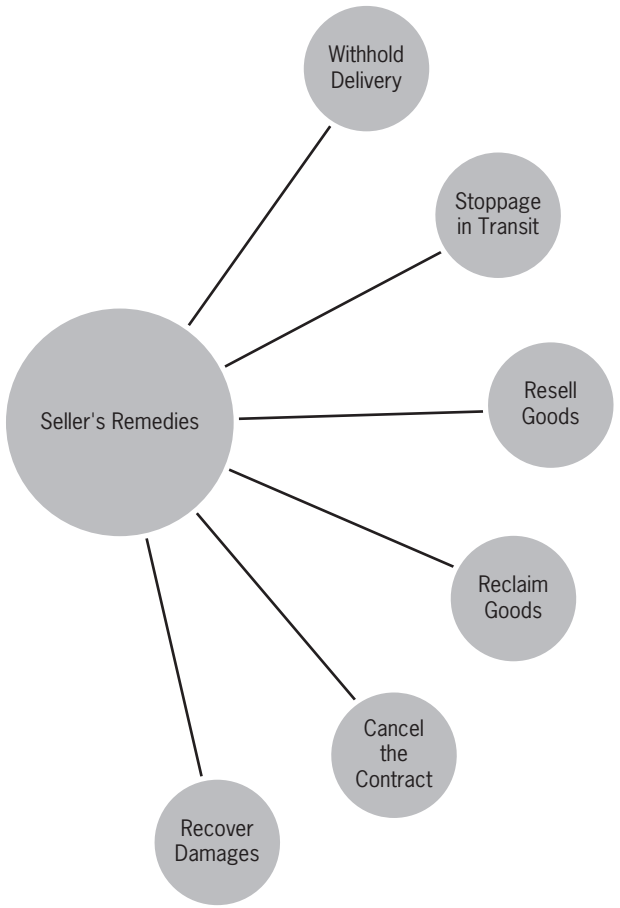
EXHIBIT 15-6 Seller's remedies



TECH CHECK

Downloading information . . . the innocent consumer

Downloading information on the Internet is commonplace. But, consumers and businesses must be aware of the legal implications of their actions. In the early part of 2000, the issue of downloading music for free became big headlines when a company known as Napster became embroiled in lawsuits with the music industry. What started as an online music sharing service, turned into one of the most public copyright and contracts cases involving the Internet. The complaint by many recording artists was that downloading music from Napster without paying for it was a violation of the artists copyright. Purchasing music without paying the royalties violated virtually all of the artists' copyright and contract rights. Napster was sued. Because of the lawsuit, Napster was shut down and was ordered to pay millions in damages. The result was the company's demise. However, the case highlights the importance of understanding what is legal to download on the Internet and the resulting damages that may occur for misuse of information. Parties who violate copyright and contract rights may be held accountable for legal or equitable remedies. As easy as information on the Internet is to access and download, it is just as easy to violate existing laws that protect that information. Granted monitoring the downloading of information is oftentimes difficult, but as paralegals you must be cognizant of the legal implications of the information you acquire through the Internet.

15.3 BUYER'S REMEDIES

When a seller breaches a sales contract, the buyer has a number of remedies to compensate for the loss. The buyer's election of remedy is guided by the circumstances producing the breach.

Lawsuit for Damages

The most common buyer's remedy is a suit for the damages caused by the seller's breach. Section 2-713 of the U.C.C. provides the method of recovery under a suit for damages; the formula used in determining the damages is the excess of the market price over the contract price at the time of the breach and at the place of delivery. Added to this amount are any incidental or consequential damages incurred due to the breach. Each is defined in § 2-715:

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.
(2) Consequential damages resulting from the seller's breach include
   (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
   (b) injury to person or property proximately resulting from any breach of warranty.

This method of recovery is often the best avenue for the buyer. Some contract damage provisions to consider, which benefit the buyer, are shown in Exhibit 15-7.

EXHIBIT 15-7

Sample contract damages clauses

(1) If seller fails to deliver the goods required by this agreement or repudiates the entire agreement, buyer shall be entitled to damages based on the difference between the market price of the goods at the time when buyer learns of the breach and the contract price, together with any incidental or consequential damages authorized by § 2-715 of the U.C.C., if applicable, but less expenses saved in consequence of the breach of seller.

(2) Buyer shall be entitled to all incidental damages resulting from a breach by seller, including, but not limited to, all expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses, or commissions incurred in effecting cover, and any other reasonable expense incident to a delay or breach by seller.

(3) Buyer shall be entitled to consequential damages resulting from a breach by seller for any loss resulting from general or particular requirements and needs of buyer of which seller is aware at the time of executing this agreement, and that reasonably cannot be prevented by cover or otherwise, and damages sustained by buyer from any injury to person or property proximately resulting from any breach of warranty by seller.

cover
A remedy under the U.C.C., which allows a buyer, if the seller has breached a contract of sale, to purchase the goods elsewhere (the "cover") and hold the seller liable for the difference between the cost of the cover and the original contract price

Cybercises

Using examples from the Internet, prepare a letter advising the seller, Chocolate Creations, Inc. that your firm's client, Charlotte's Cards and Things intends to use the remedy of cover because the seller has failed to send the shipment of Belgian chocolates. The shipment was due February 1. It is February 5. Valentine's Day is less than two weeks away. The cost of the shipment would have been $3,500 for various assortments of chocolate.

Cover the Sale

Under § 2-712, an injured buyer may use the remedy known as **cover**. Cover occurs when the buyer has substituted goods from another seller to minimize the loss incurred because of the original seller's breach. If a buyer has to pay more than the original contract price for the substitute goods, the buyer has a right to sue the seller for the difference between the original contract price and the cost of the cover and any incidental expenses related to the cover. Section 2-712 guides the buyer as follows:

(1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.
(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.
(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

For example, assume you are in the market for some video equipment to use in your job as a videographer. You order the equipment over the Internet for $1,500, which is supposed to arrive within 7 days of the purchase. You wait 12 days, but it never arrives. You have a job in two days, so you purchase the equipment from another retailer in the amount of $2,000. Two days is a reasonable amount of time to find and purchase a substitute. You drove to a number of retailers before you purchased the equipment,

which cost you $40.00 in gas and tolls. In such a situation, the buyer would receive the difference between the purchase price and the substitute equipment. Since the gas and tolls were incidental to the purchase, you would be entitled to the $40 as well.

A case dealing with the buyer's remedy of cover is *Mueller v. McGill*, 870 S.W.2d 673 (Tex.Civ.App. Houston [1st Dist.] 1994). After reviewing the case, provisions to consider when drafting a provision on a buyer's right to cover are set out in Exhibit 15-8.

Line of Reasoning

Making a sale on a car seems to bring out an interesting side of sellers. It appears as though some car dealers believe they need a "back-up" buyer to ensure a sale. Unfortunately, as we will see in the *Mueller* case, that may cause problems for both parties. This case involves Rick Muller who wanted to purchase his dream car—a 1985 Porsche 911 Targa. He went to McGill Imports, a specialty car dealership. Rick found his dream car and negotiated a deal with the salesperson for its purchase which included the purchase price and a trade-in allowance for his Mazda. A contract was signed. Although he had financing, McGill suggested he obtain financing through Chase Manhattan because of the low interest rate. Rick did this. Rick was informed that he could pick up the car the next day. But after he went through the loan process, the salesperson then informed Rick that someone else had already begun the process, but was having trouble with the financing. Rick now was made aware that he was a "back-up" contract. As fate would have it, the original buyer was able to acquire financing. When Rick contacted McGill they told him of his fate, but offered to locate another Porsche with the same terms. The dealership looked for a 1985 Porsche, but could not find one. Later in 1986, McGill informed Rick that they could not find a 1985 Porsche, but could sell him a 1986 Porsche at new terms. They would not honor the trade-in allowance from his previous negotiation. In April, 1986, Rick went to one of McGill's competitors, where he purchased a 1986 Porsche 911 at a higher price and a lesser trade-in allowance. Rick sued the dealership for the difference in the prices of the cars. The trial court found that there was a breach of contract but that Rick had not suffered any damage. The Appeals Court disagreed. The issue was the measure of damages and whether a 1986 Porsche was a reasonable replacement.

The court discussed the various damages available to a buyer under the U.C.C. The buyer has remedies for the seller's failure to deliver goods which may include either

(1) "cover" by purchasing goods in substitution of those due from the seller, and recovering damages for the difference in the price of the contract and the "cover," or
(2) recover the difference between the contract price and market price at the time he learned of the breach. If a buyer elects to "cover" he need not show the market price at the time of the breach.

The buyer does not have to show the market price if he can show that he properly "covered under the section 2-712 of the U.C.C. Thus, did Rick properly present the issue at trial and was he entitled to damages under this remedy? As the court observed cover is proper when a buyer makes a "good faith" purchase without unreasonable delay to contract or purchase a substitute. The trial court incorrectly determined that a 1985 Porsche 911 was not a "reasonable substitute" for a 1986 Porsche 911. The Appeals Court disagreed by stating that the U.C.C. provides that the substitute goods need not be identical but must be "commercially usable as reasonable substitutes." The facts in this case supported the conclusion that a jury could decide the

reasonableness issue. The case was sent back to the trial court for further proceedings based upon the appeals court decision. The importance of this case centers on the issues of good faith and reasonableness of the buyer's action in "cover."

Questions for Analysis

Review the *Mueller* case. Compare this case to a Massachusetts case, *Cetkovic v. Boch, Inc.*, 2003 WL 139779 (Mass. App. Div. 2003) where the court cited *Mueller* but had a different result. What facts were distinguishable in the Massachusetts case? What facts in the Mueller case would have changed the Texas Court of Appeals result?

EXHIBIT 15-8

Sample clauses on buyer's right to cover

(1) On any breach of this sales agreement by seller, due to either a failure by seller to deliver the goods specified in this agreement or a repudiation of the entire agreement by seller, buyer shall have the right to effect cover by purchasing or agreeing to purchase substitute goods in the open market. The purchase or agreement to purchase substitute goods must be reasonable and effected without unreasonable delay.

(2) Buyer shall be entitled to recover from seller any damages buyer incurs as a result of being required to effect cover due to either the repudiation of this agreement or the refusal by seller to deliver the goods specified in this agreement.

(3) If seller either fails to deliver the goods required by this agreement or repudiates this agreement entirely, buyer shall not be required to effect cover. The failure of buyer to effect cover will not affect any remedy buyer has for the breach of this agreement by seller, except the remedy granted by the Uniform Commercial Code Section 2-712(2) to claim damages on effecting cover.

Specific Performance

specific performance The equitable remedy of compelling performance of a contract where damages are an inadequate remedy

If the buyer cannot locate suitable substitute goods, the buyer can request a court to order **specific performance** of the contract under U.C.C. § 2-716(1) and (2). Recall that this is an equitable remedy. Normally, a court will not order specific performance unless the buyer has unsuccessfully attempted to cover. In addition, the buyer must show that the goods were unique and that the buyer cannot find the goods at any other place; thus, the buyer can reasonably request the court to order that the seller perform in accordance with the original contract.

State Your Case

Based upon the facts in *Mueller v. McGill* cited above, would Mr. Mueller have been entitled to the remedy of specific performance? Could Mr. Mueller have been entitled to the remedy of cover and specific performance? Why or why not?

Strictly Speaking: Ethics and the Legal Professional

Billing is a natural part of the practice of law. And, a law firm may bill for a paralegal's time. The caveat to this rule is that a paralegal's "substantive work" not clerical work can be billed. Substantive work was generally defined in the U.S. Supreme Court, *Missouri v. Jenkins*, (1989), which consisted of factual investigation; assistance with depositions, interrogatories and document production; legal research and drafting to name a few areas listed. What that means is that when you prepare a document, do research, or interview a client, for example, those activities may be billed. However, when you are making copies, preparing documents for mailing or performing administrative services, those services cannot be billed. There are a number of cases, attorney general opinions and bar associations opinions which further define "clerical work." Thus, be sure your attorney knows your jurisdiction's definition of clerical work when billing your time. A way to ensure that your time will be properly billed for the substantive work you do is to adequately prepare your billing records, which detail and reflect your work accurately. By inputting your time, you will provide both your law firm and the courts, if your time is submitted in a case, with the best evidence of your substantive work. Otherwise, your time may not be billed to the client or may be rejected by a court when attorney's fees are assessed in a case. Now, this is not a good remedy.

Replevin

replevin
An action by which the owner of personal property taken or detained by another may recover possession of it

Replevin is another equitable remedy that is available to the buyer under § 2-716(3) of the U.C.C., when cover is not appropriate. This remedy can be used when a legal one is inappropriate. Replevin occurs when a court orders that the seller turn the goods over to the buyer in accordance with the contract. When the goods have been identified under the contract and reasonable but unsuccessful efforts have been made to find a suitable substitute, replevin is appropriate. Equitable remedy provisions to include in a sales contract are suggested in Exhibit 15-9.

EXHIBIT 15-9

Sample equitable remedy provisions

(1) Buyer shall have the right to bring an action against seller for specific performance of this agreement if the goods covered by this sales agreement are unique.

(2) It is hereby agreed by both buyer and seller that the goods that are the subject matter of this sales agreement are unique. Consequently, if seller breaches this sales agreement, buyer shall have the right to specific performance as an alternative to any other remedy available to buyer at buyer's option. Such option by buyer shall not limit buyer's right to incidental or consequential damages caused by seller's breach of this sales agreement.

(3) Buyer shall have the right to bring a replevin action against seller where the goods required to be sold under this agreement have been identified to the agreement and buyer is unable to effect cover, or the goods have been shipped under a security reservation that has been satisfied or tendered.

Buyer's Resale of the Goods

If the seller ships nonconforming goods *after* notice to the seller of rejection of the nonconforming goods, the buyer may attempt to resell the goods to collect any damages incurred. As in any sale, the sale must be in a reasonable manner and time. Oddly enough, in this type of resale, if any excess results from the sale, the buyer cannot claim the excess, but must return the overage to the seller.

Cancellation

Upon a breach, the buyer has a right to cancel the contract and sue for damages. This is a very common buyer's remedy under the Code.

Revocation of Acceptance

When the buyer has accepted the goods and has determined that there are defects in the goods, the buyer may elect to revoke acceptance if the defect "substantially impairs" the value of the goods to the buyer. A revocation of acceptance is considered a rejection, and thus the buyer can use any remedy that is deemed appropriate under the U.C.C. The section that provides guidance regarding this type of remedy is § 2-608, which states:

(1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it
   (a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured: or
   (b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

Exhibit 15-10 is a letter rejecting a revocation of acceptance.

EXHIBIT 15-10 Sample letter rejecting revocation of acceptance

Dresses Unlimited August 1, 2011
414 State Street
Boston, Massachusetts 12345

Dear Mr. McCoy:

Please take notice that I have received your notice of revocation of acceptance of the dresses shipped to you by me under our agreement dated June 12, 2011.

It was provided in Section 2 of our sales agreement that any notice of revocation must be submitted by you not later than ten (10) days after your receipt and inspection of the goods. In your notice, you stated the goods were received and inspected on July 1, 2011. This notice was given more than twenty (20) days after your receipt and inspection of the goods.

Your notice of revocation of acceptance is untimely and, therefore, unacceptable. I hereby refuse your revocation of acceptance.

Very truly yours,

Thomas McKay

A court decision that analyzed a buyer's right of revocation of acceptance is *Kessner v. Lancaster,* 378 S.E.2d 649 (W. Va. 1989). Pay attention to what the court considers as "substantially impairing the value of goods."

Line of Reasoning

On September 13, 1985, the seller, James Lancaster, advertised a 1974 John Deere tractor-loader for sale in a local newspaper. The buyer, Donald Kessner, responded and arranged to see the machine.

The buyer inspected the freshly painted two-track loader, noting that the undercarriage was in good condition. The seller started the motor, which ran well. The buyer needed the loader to dig a ditch for a septic system. Although the buyer requested to operate the machine, the seller indicated that attachments would need changing, which would take too much time.

On September 16, 1985, the buyer agreed to purchase the loader and the seller continued to assure him of its good condition. Kessner presented Lancaster with a personal check of $9,000 and hauled it away. There was no written contract.

The next day the buyer transported the loader to his job to install the septic system. Kessner began removing the topsoil. Within minutes, the machine stopped and would not move. Kessner believed there was a defective steering clutch.

Kessner decided to fix the steering clutch himself. When he began the repair, he noticed that the transmission had pulled away from its housing. Kessner removed the floorboards to get a closer look, where he saw that the bolts securing the transmission were rusted and stripped. Other parts were rusted with cracked frame rails and other parts welded together shoddily.

Kessner took the loader to a mechanic, who indicated that it would take at least 36 hours to repair at $20.00 per hour for a total of $720. Other inspections would be necessary, which the mechanic could not estimate. Believing the repairs were necessary, Kessner contacted Lancaster to return the loader and get his money back. Lancaster refused.

The appeals court discussed the right of a buyer to rescind a contract if they can establish a "material" breach. When rescission occurs, notice must be provided to the seller within a reasonable period of time after the sale. Thus, a buyer can revoke acceptance when: (1) the nonconformity must have substantially impaired the value of the goods to the buyer; (2) the goods must have been accepted on the reasonable assumption that the nonconformity would be cured, and it was not, or accepted without discovery of the nonconformity, either because of the difficulty of discovery or because of the seller's assurances; (3) the revocation must have occurred within a reasonable time after discovery of the defect and before any substantial change in the condition of the goods; and (4) the revocation is not effective until the buyer has notified the seller. *Id.* at 653. Under this remedy, a "buyer making a revocation after acceptance on these terms has the same rights and duties under the U.C.C. as one who had rejected the goods originally." The question is whether the loader's defects could have been reasonably discovered and whether the loader was substantially impaired as a good. (Note: the court discussed the applicability of the U.C.C. to these parties under the definition of "seller" and found that the U.C.C. applied.)

The focus of this case is "substantial impairment" in that the value of the goods to the buyer has been so diminished to not meet the needs or expectations of that buyer. Both an objective and subjective test are applied; but most importantly whether objectively the value of the goods to the buyer has been substantially impaired is a question a jury can decide.

In this case, a jury could find that the value of the loader had been substantially impaired within the meaning of the U.C.C. The loader was inoperable and needed major repairs. The mechanic's estimate of $720 did not include the cost of disassembling the transmission or the repair of any internal damage. From the time he purchased the loader, the buyer has been unable to use it. From an objective standpoint, the machine's value has been substantially impaired.

The next issue involves the defect and whether Kessner could have discovered the defect from his inspection. In this case the visual inspection did not reveal the defect and could not have been discovered through a visual inspection. Therefore, Kessner has satisfied the "difficulty of discovery" test, making his later rejection of the loader proper. Had the defects been obvious, Kessner would have been foreclosed from revoking his acceptance. This was not the case and Kessner was allowed to revoke his acceptance.

Questions for Analysis

Examine the *Kessner* case. What facts supported the finding of "substantial impairment" to the buyer? If Lancaster had allowed Kessner to operate the loader prior to purchasing it, would the results of the court have changed? Why or why not?

Retain Goods with Adjustment

When a seller has tendered nonconforming goods, the buyer has the option to keep the goods and ask for an adjustment based on the nonconformity. Section 2-714(2) provides guidance in this circumstance. If the seller refuses to make any adjustments on the nonconforming goods, the buyer has the option of suing for the difference between the value of the goods contracted for and the value of the goods received. This is the basis for another form of damages lawsuit. Exhibit 15-11 is a summary of buyer's remedies.

EXHIBIT 15-11 Buyer's remedies when the seller breaches

Buyer's Remedies							
Lawsuit for Damages	Cover the Sale	Specific Performance	Replevin	Resale of the Goods (After Notice to the Seller of Nonconforming Goods)	Cancellation	Revocation of the Acceptance	Retain (Nonconforming) Goods with Adjustment in the Price

15.4 CONTRACTUAL REMEDIES

The Code is not the exclusive guide for remedies when a problem arises between the parties in a sales contract. Contracting parties can agree to additional remedies or remedies other than those found in the U.C.C. Basically the choice rests with the parties involved. Section 2-719(l) (a) and (b) state:

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,
   (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
   (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

One of the remedies that courts closely scrutinize is liquidated damages, discussed in § 2-718(1):

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

Recall from Chapter 10 that the liquidated damages provision must be reasonable in light of the circumstances, or the court will not enforce it. The parties should pay close attention in estimating the damages when a liquidated sum is desired. Some suggested language for liquidated damages provisions is found in Exhibit 15-12.

EXHIBIT 15-12 Sample language for liquidated damages provisions

(1) It is understood that buyer is relying on delivery of the goods on [date], and that delay in delivery will result in serious losses to buyer. It is agreed, therefore, that for any delay in delivery of the goods, regardless of cause and regardless of whether seller had any control over the cause that resulted in delay, seller shall pay to buyer, or buyer may deduct from the price, as the case may be, the sum of Three Hundred Dollars and No Cents ($300.00) per day as liquidated damages to compensate for losses incident to delay. The assessment of such sums shall terminate on delivery of the goods or the effective realization of cover by buyer pursuant to U.C.C. Section 2-712 and, in no event, shall exceed Five Hundred Dollars and No Cents ($500.00). The damages here liquidated are confined to losses resulting from delay in delivery and shall not affect such other rights and remedies as buyer may have under law, including, but not limited to, the Uniform Commercial Code as enacted in [state].

(2) If seller fails to make delivery or repudiates, or buyer rightfully rejects or justifiably revokes acceptance, then, with respect to any goods involved, seller shall pay to buyer the sum of Eight Hundred Dollars and No Cents ($800.00) as liquidated damages, which sum shall include both incidental and consequential damages.

(3) In no event shall seller be liable for consequential damages except where there is injury to the person in a sale of consumer goods.

(4) If, for any reason, buyer fails to accept and settle for the goods, buyer will, if seller so elects and demands, pay to seller, in lieu of the enforcement of this agreement, as liquidated damages, a sum equal to ten percent (10%) of the list price of the goods, and, if shipment has been made, freight from the facility of seller and return, demurrage, cartage, loading and unloading expense, and all other similar expenses actually incurred by reason of the shipment and attempted delivery of the goods. If suit is commenced to enforce performance of any part of this agreement, buyer shall pay to seller reasonable attorney's fees.

Other damage provisions that have come under close court scrutiny are those for consequential damages. Recall from Chapter 10 that consequential damages result from a direct or indirect consequence of the breach. Section 2-719(3) is illustrative:

> Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

But § 2-715(a) and (b) state:

> Consequential damages arising from the seller's breach include:
>
> (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise: and
> (b) injury to person or property proximately resulting from any breach of warranty.

The parties must set a consequential damages provision that is reasonable and not unconscionable similar to the standards for liquidated damage clauses.

State Your Case

Reilly just bought a new gym and is in need of new equipment. She wants to purchase 10 treadmills and 20 state-of-the-art bicycles from Dynamics Ltd. In the sales, contract she notices some peculiar legal sounding provisions, which concerns her. She asks your office to review it and determine whether it is proper under your state's U.C.C.; whether she can modify the provision and how; and whether she should sign the contract and fight it later if problems arise. She really wants the equipment and the price is good. The clause is as follows:

> In no event under this Contract shall Seller be liable for any special, incidental, indirect, or consequential damages, or for any damages of a similar nature arising out of or in connection with this Sales Contract regardless of whether any such liability shall be claimed in contract, equity, tort (including negligence) or otherwise. Seller shall not be liable for all or any part of any of the following, no matter how claimed: loss of profit or revenue, loss or reduction of use or value of any equipment. The limitation of liability contained in this Article shall be effective without regard to Seller's performance or failure or delay of performance under any other term or condition of this Contract.

Explore all issues relating to remedies which could relate to this clause.

15.5 ANTICIPATORY REPUDIATION

Sometimes parties, either directly or indirectly, indicate their intention to repudiate a contract prior to the time performance is required. If repudiation by one party substantially impairs the contract for the other party, § 2-610 guides the injured party:

When either party repudiates the contract with respect to a performance not yet due, the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or
(b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
(c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

The Code goes on to say, in § 2-611, that a party may retract the repudiation under certain conditions. Section 2-611 sets forth those conditions:

(1) Until the repudiating party's next performance is due, he can retract his repudiation unless the aggrieved party has, since the repudiation, canceled or materially changed his position or otherwise indicated that he considers the repudiation final.
(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this Article (Section 2-609).
(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

The Code appears to give each party the opportunity to perform the obligations under the contract unless there is a material change in position by the nonbreaching party. Review *P.D. Upton v. Ginn,* 231 S.W. 3d 788 (Ky. Ct. App. 2007), which dealt with anticipatory repudiation.

Line of Reasoning

P.D. Upton v. Ginn involves the sale of tobacco and whether the seller properly interpreted the buyer's acts as an anticipatory repudiation. In this case, a warehouse collapsed due to the weight of a snowfall. The warehouse contained a tobacco crop. Lloyd's of London insured the warehouse and its contents. In an effort to recoup some of the tobacco, Lloyd's had a sealed bid sale. Ginn was one of the bidders. Ginn was the successful bidder, paying $ 0.71 per pound. Ginn presented a check to Lloyd's in the amount of $177,000 as advance payment for one-half of the estimated value of the tobacco. Ginn's employees began preparing and removing the tobacco during February 23–28, 1998 and on March 3, 1998. Ginn advised Lloyds' that it had a previous commitment and could not continue the removal of the tobacco beginning from March 4–8. Although Ginn's employees left to work on the other project, they did leave 43 pallets of tobacco behind for removal at a later time—some 90,000 pounds. Some of the remaining tobacco was stacked but not palleted. When Ginn's employees returned to continue to prepare and remove the tobacco, the warehouse that contained the tobacco was locked. Apparently, Lloyd's sold the remaining tobacco to a third party for $0.005 per pound because Lloyd's contends that Ginn repudiated the contract. Lloyd's, through a representative, P.D. Upton, sued for the unpaid contract amount and the amount received from the third party.

Lloyd's position was that since Ginn attempted to renegotiate the price due to the disappearance of approximately 12,000 pounds of high-quality tobacco right after the original auction that it could treat that act as one of repudiation; therefore, they were justified in selling the remaining tobacco to a third party. In analyzing the case, the court stated that anticipatory repudiation is a question of fact. Under the U.C.C. anticipatory repudiation

occurs when either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or
(b) resort to any remedy for breach (KRS 355.2-703 or 355.2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
(c) in either case suspend his own performance or proceed in accordance with the provisions of this article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (KRS 355.2-704).

The court stressed that anticipatory repudiation as defined under the U.C.C., Official Comment entails a direct or overt communication of an intention not to perform or an act which renders performance impossible. In reviewing the testimony, the appeals court opined that Ginn's actions of palletting the tobacco and leaving empty pallets at the site were indicators that the intent was not one of repudiation. This is despite the fact that Ginn did attempt to renegotiate the price because of their belief that some of the "good" quality tobacco had been replaced with "junk" tobacco. There was no unequivocal communication of intent to repudiate the contract which is required. Additionally, Lloyd's attempted to argue that because Ginn expressly refused to remove the junk tobacco without an adjustment to the price, this was evidence of an anticipatory repudiation. The court rejected this argument as well. Under Kentucky law, anticipatory repudiation "requires unequivocal words or conduct evidencing an intent to repudiate the contract." No such evidence existed.

One of the important elements in establishing anticipatory repudiation is that the other party's actions must "substantially impair the value of the contract" by the party who is claiming the breach. None of the facts point to any substantial impairment of the value of the contract for Lloyd's. The junk tobacco was less than 2 percent of the contract. Ginn never refused to remove it nor did it refuse to pay the original contract price. Ironically, the third party buyer refused to remove the junk tobacco as well. Thus, under all the facts presented, the court found that there was no anticipatory repudiation of the contract.

Questions for Analysis

Review *P.D. Upton v. Ginn*. What would Lloyd's have had to do for the court to find anticipatory repudiation? Would the result have changed had Ginn not palleted the tobacco and left some of its supplies and packing materials behind? Explain your responses.

State Your Case

Morris and Sons, Inc. manufacture cotton. Organic Products, Inc. wanted to purchase 100 bushels of cotton in installments of 25 bushels monthly for four months to use in the production of some of its clothing. Organic accepted shipment of the first 25 bushels. Through the grapevine, Harvey Morris, President of Morris and Sons, heard that Organic was having some financial problems. He was concerned that Organic would not be able to pay

for the next three shipments of cotton. The next shipment was due on the 1st of the month. In anticipation of Organic's breach of contract, Morris sold Organic's shipment to Cotton Trends, LLC. On the 2nd of the month, Organic's president contacted Harvey inquiring where the shipment was. Harvey stated he sold the shipment because he anticipated Organics' breach. Did Harvey act properly in selling Organic's shipment to Cotton Trends? What damages, if any, can Organic recover from Morris and Sons? Can Organic recover any damages from Cotton trends? Explain your response.

If a party allows retraction of a repudiation, but still remains uncomfortable about a party's performance, the Code, in § 2-609, gives the insecure party the right to *adequate assurances* of performance. Section 2-609 states:

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party, the other may in writing demand adequate assurances of due performance and until he receives such assurance may, if commercially reasonable, suspend any performance for which he has not already received the agreed return.
(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.
(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.
(4) After receipt of a justified demand, failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

If the insecure party makes a written demand for assurance of performance, and the assurance is not given within 30 days, this is treated as repudiation. Exhibit 15-13 is an example of a request for adequate assurances by the buyer. (Note that a seller can also require adequate assurance.)

EXHIBIT 15-13 Sample request for adequate assurances (buyer)

Ms. Marla Coffee October 10, 2011
Dresses, Inc.
2118 Broadway
New York, New York

Dear Marla:

Please be advised that I have not yet received the dresses that, under our agreement dated September 1, 2011, were to be delivered to me at 8212 Main Street, Greenwich, Connecticut on

October 1, 2011. I have not received any reply to the letter dated October 5, 2011, inquiring as to the missing goods.

In accordance with Section 2-609 of the U.C.C., I demand that within ten (10) days from your receipt of this letter you furnish me with adequate assurance that you will make due performance of your obligation to deliver the goods on or before the date to be specified by you.

Very truly yours,

Anthony Finelli

In addition, the parties can contractually agree to the time for adequate assurance. Three sample provisions are found in Exhibit 15-14.

EXHIBIT 15-14 Sample clauses setting time for adequate assurances

(1) Assurance may not be demanded under authority of Section 2-609 of the U.C.C., unless the written demand is sent or dispatched to the other party within ten (10) days after the demanding party learns of the facts giving rise to a right to demand assurance. The expiration of this period of time shall not bar a demand for assurance when additional grounds, considered alone, might not be sufficient to cause insecurity of the demanding party.

(2) Seller shall be deemed insecure when buyer delays making payment for any installment for more than ten (10) days after payment is due, without cause related to performance by seller.

Buyer shall be deemed insecure when there is any strike or threat of a strike at the manufacturing facility or plant of seller.

Grounds for insecurity in this section of the agreement are not exclusive, but are in addition to any other proper grounds for insecurity.

(3) In the event that assurance of performance is rightfully demanded by either party, the party on whom the demand is made shall deliver to the demanding party within ten (10) days thereafter a bond of an indemnity company acceptable to the demanding party in the amount of two (2) times the value of the performance remaining to be performed by that party, conditioned to indemnify the demanding party for any loss the demanding party may sustain by the failure of the other party to perform that party's obligations under this agreement.

15.6 THE DOCTRINE OF IMPRACTICABILITY

The doctrines of impracticability of performance and commercial impracticability (previously discussed in Chapter 9) hold that a party's performance is excused on the occurrence of certain intervening events that were unanticipated in the contract. As in the

common law, the U.C.C. deals with nonperformance due to impracticability. Section 2-615 states that:

> (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not it later proves to be invalid.
> (b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers, but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

However, when a party fails to perform an obligation because of impracticability, the Code sets forth the procedure for notification to the buyer. Section 2-615(c) states:

> (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

Once notification is "seasonably" made, the buyer may terminate or modify the contract. This procedure is described in § 2-616:

> (1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section, he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (Section 2-612), then also as to the whole.
> (a) terminate and thereby discharge any unexecuted portion of the contract: or
> (b) modify the contract by agreeing to take his available quota in substitution.
> (2) If after receipt of such notification from the seller the buyer fails so to modify the contract, within a reasonable time not exceeding thirty days, the contract lapses with respect to any deliveries affected.
> (3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.

Undoubtedly, familiarity with the Code is important in understanding the rights of the parties. Simply follow the general section headings for guidelines as to Article 2's content.

Cybercises

Locating examples on the Internet, prepare a letter requesting "assurances" from the buyer that it intends to perform on the contract. Use the facts from the introduction of the chapter.

15.7 STATUTE OF LIMITATIONS

As with any lawsuit, there is a certain time period within which an injured party must file an action with a court. Section 2-725 provides that a law suit for breach of a sales contract must be filed within four years of the date of the breach. The parties can contractually

agree on a shorter time, but the Code provides that the time period cannot be shorter than one year. Statutes of limitations can always present a problem if a lawsuit is not timely filed, so it is important for both buyer and seller in a sales contract to pay close attention to their rights and responsibilities under the sales contract, and to perform their obligations appropriately to maximize their interests. Language to consider when drafting a statute of limitations provision is illustrated in Exhibit 15-15.

EXHIBIT 15-15 Sample statute of limitations provisions

(1) If either party desires to bring an action against the other party for breach of this agreement, the time within which the action shall be commenced shall be governed by the statute of limitations provided by the Uniform Commercial Code Section 2-725.

(2) If either party desires to bring an action against the other party for breach of this agreement the time with which the action shall be commenced shall be one year after the accrual of the cause of action. This reduced statute of limitations period is established by mutual agreement of the parties.

(3) A cause of action for the breach of this sales agreement shall accrue when the breach occurs, whether or not the parties are aware of the breach at that time.

15.8 PRACTICAL APPLICATION

Giving a seller or buyer proper remedies under a sales contract is crucial. Some examples of general remedy provisions appear in Exhibit 15-16. Be sure not to draft a remedy provision that may be considered offensive, a penalty, or unconscionable. A balance of remedies between the parties will give better assurance of enforceability.

EXHIBIT 15-16 Sample general remedy provisions

(1) On default by buyer, seller shall have the option of refusing to perform further under this and any other existing agreement between the parties that seller may elect, and seller may rescind any agreements between the parties and hold buyer responsible for all damages and losses occasioned thereby; or of reselling, at public or private sale, undelivered goods covered by this and any other existing agreement between the parties that seller may elect. Seller shall not be liable to buyer for any profit on any resale, but buyer shall remain liable to seller for the difference between (1) the agreement price of the goods, plus all expenses and charges for the account of buyer specified in this agreement and all expenses of storage and resale, and (2) the resale price of the goods.

(2) In any action brought in any court by seller, any assignee of seller, or buyer concerning this agreement or the goods, the rights and remedies of seller may be enforced successively or concurrently and the adoption of one or more rights or remedies shall not operate to prevent seller from exercising any other or further remedy given to seller under this agreement.

SUMMARY

15.1 Party 7 of the Code focuses on the remedies available to seller and buyer in the event of a breach or nonperformance. The Code gives guidance for remedies in § 2-703 for the seller and in § 2-711 for the buyer.

15.2 Section 2-703 sets forth the remedies available to a seller: (1) withholding delivery of the goods, (2) stoppage of the goods in transit, (3) resale of the goods, (4) lawsuit for damages, (5) cancellation, and (6) reclamation of the goods. Depending upon the facts, the seller has the right to elect any appropriate and available remedy.

15.3 A buyer has a number of remedies available when the seller breaches. The typical remedy is a lawsuit for damages, in which the buyer can request actual damages as well as consequential and incidental damages. Additional remedies are (1) cover, (2) specific performance, (3) replevin, (4) resale of the goods, (5) cancellation, (6) revocation of acceptance, and (7) retention of the goods with adjustments.

15.4 Parties also can agree to contractual remedies. The most common contractual remedy is a liquidated damages clause, which must be fair and not a penalty. Additionally, the parties can agree to consequential damages.

15.5 Sometimes parties indicate their intent to repudiate a contract. Section 2-610 is the guide. If a retraction of the repudiation occurs, the insecure party has a right to demand adequate assurance of performance of the contract. This demand should occur within 30 days of the retraction.

15.6 As with the common law, the Code excuses nonperformance due to impracticability. Sections 2-615 set forth the procedure for excuse by impracticability. Once notice is seasonably given, the contract may be terminated.

15.7 The Code has a statute of limitations for filing lawsuits. The time period cannot be shorter than one year, but suit must normally be filed within four years of the breach, unless the contract provides otherwise.

KEY TERMS

stoppage in transit specific performance replevin
cover

REVIEW QUESTIONS

1. What two U.C.C. sections give guidance as to the remedies available for seller and buyer?
2. List three remedies available to the seller when a buyer breaches a contract.
3. How does the Code distinguish between a private and a public sale of goods when the buyer has breached?
4. When can a lawsuit for the contract price be instituted against a buyer?

5. Under what circumstances can a seller reclaim goods in the sales contract?
6. What is the most common remedy for a buyer and why?
7. When is the remedy of cover available to a buyer?
8. What equitable remedies are available to a buyer when a seller has breached?
9. What is required by a seller who is anticipating a buyer's repudiation?
10. When circumstances render a contract impracticable, what procedures must a seller follow?

EXERCISES

1. Ocean Supplies Company is in the business of selling scuba diving equipment. Scuba Dive, Inc. ordered 500 tanks to be delivered F.O.B. seller's place of business. The goods were loaded in Miami for shipment to Newport. Rhode Island. During transit of the goods by ship, Ocean Supplies finds that Scuba Dive is unable to pay for all the tanks. What remedies does Ocean Supplies have against Scuba Dive?

2. American Furniture, Inc. has agreed to buy from Chairs and Sofa, Ltd. 50 chairs for $50 apiece and 20 sofas for $300 apiece. The parties determined that in the event either party breaches the contract, the defaulting party shall pay the non-defaulting party $10,000 as liquidated damages. Is the provision enforceable? Discuss all issues.

3. Imports of America, Inc. contracted to purchase from Liquors of the World 900 cases of 2008 Chardonnay at $85 per case. Imports prepaid the shipment of the wine. En route to its final destination in California, the ship carrying the wine sinks due to a storm at sea. What rights and remedies does Imports of America have against Liquors of the World?

4. Jeff and Sondra renovate homes for the rich and famous. Jeff purchases crown molding from Home Repairs, new Pella windows from Design Windows, and custom made doors from Entry-Way Visions. The client that Jeff is working for cannot be found when the vendors who supplied the goods need to be paid. Jeff refuses to pay for the goods. What remedies does each vendor have against Jeff and his client?

5. Richard Clark is the property manager for the Tower Building located in Aspen, Colorado. He receives a telephone call from one of the tenants, Brooks, Dunnston, and Tenison. They need their offices repainted and request Clark to paint their offices. Clark reminds them that if the building paints the offices, there is a set color—egg shell white—which is the standard paint color for the building. One of the partners, Hailey Brooks states that they want to paint their offices different colors. Clark tells Brooks that it is fine, but they will have to pay for the paint. Brooks agrees. The firm hires a decorator to coordinate the renovation of the offices. The designer, Mr. Thomas has chosen silver cloud for Ms. Brooks' office, light sea foam green for Mr. Dunnston's office and taupe illusion for Ms. Tenison's office. All these colors are specially mixed. For the remaining associates' offices, Mr. Thomas chooses pearled beige. Answer the following questions based upon the fact pattern.

a. Mr. Thomas goes to Painter's World to buy the paint. Painter's World mixes all the paint colors, except they do not have the mixture to make the "light sea foam green." The sales person does not tell Mr. Thomas and mixes a color that is similar. When Mr. Thomas sees the color on the wall, he is appalled. What remedies does Mr. Thomas have against Painter's World?
b. All the colors have been properly mixes by Painter's World. To save money, the building offers to paint the offices at no charge since they would have had to paint the offices as part of the lease agreement. Mr. Clark hires Design Paint Company to perform the work. When Mr. Thomas checks the work, he faints. The office colors were mixed up. Ms. Brooks' office is sea foam green, Mr. Dunnston's office is taupe illusion, and Ms. Tenison's office is silver cloud. Does Mr. Thomas have a remedy against Painter's World? The building management company? Does the U.C.C. apply to this transaction? Explain your responses.

6. Toy World is one of the largest toy retailers in the United States. They place an order with Video Adventure Games, Inc. for 6,000 Guitar Hero games for their stores around the country. Video Adventure heard rumors that Toy World was contemplating bankruptcy because of the downturn in the economy. Customers were not spending on expensive video games as they had in the past. Video Adventure sent an e-mail and letter via the U.S. mail requesting assurances that they intend to pay for the games they had ordered. Toy World ignored the letters. What remedies does Video Adventure Games have against Toy World?

7. Using the same facts as in Exercise 6 above, Toy World acknowledges the contract and states that they intend to perform on the contract. Video Adventure responds stating that they will ship half the games C.O.D and the remaining 3,000 games 10 days later. Toy World objects to the terms of the shipment. Video Adventure ships the goods, which arrive on May 2, 2010. Toy World pays for the shipment. Video Adventure ships the remaining games on May 12, 2010. Toy World refuses to pay. What remedies does Video Adventures have against Toy World? Alternatively, Toy World accepts the shipment. It inspects the shipment two weeks later and finds that 400 games are water damaged. What remedies does Toy World have against Video Adventure?

8. Highland Caterers have a big party to cater in the Hamptons. Everyone will be there since it is a fundraiser to support breast cancer research. Highland orders flower arrangements from Hampton Blooms, table cloths and napkins from Party Supplies of New York, and chairs from Rent-a-World. The day before the party, Hampton Blooms contacts Highland and says that they cannot supply the flower arrangements because they never received their shipment from their supplier. They apologized for the inconvenience. What remedies does Highland Caterers have against Hampton Blooms?

9. Angie purchased a designer purse from a home shopping program on November 5, 2009. She wore the purse through the holidays. On January 16, 2010 she contacted the television retailer to tell them that she was rejecting the purse as she did not like it. (Okay, Angie couldn't afford the purse and just wanted it for

the holidays!) The network refused to credit Angie for her purchase. Did Angie timely reject the designer purse from the home shopping program?

10. Sydney needed a new computer for her post-graduate work in economics. She purchased an "IDC" computer. At the time of the purchase, the salesperson told her that this computer had a limited remedy if the computer failed her in any way. The exclusive remedy stated that "This product carries an EXCLUSIVE REMEDY." The seller and manufacturer limit their remedies to the "REPLACEMENT OR REPAIR" of any defective parts in this product." Sydney bought the computer because it was under $500. She brought it home, and when she turned it on, it made a humming noise. She brought back the computer. The seller replaced the computer. Two weeks after she brought home the computer, the computer began freezing up constantly. Sydney brought back the computer for a replacement. The third computer lasted for six weeks when it, too, began freezing up like the second computer. This time, the seller stated that they were out of the IDC computers and that she would have to deal directly with the manufacturer. Sydney just wanted her money back. The seller refused because it stated that the exclusive warranty only provided for replacement or repair. What remedies, if any, does Sydney have against the seller or the manufacturer?

CASE ASSIGNMENTS

1. A new client Linen Lines and Co. supplies restaurant linens to high-end restaurants and hotels. They are a relatively new business but have done quite well during their three years in business. Linen Lines has a contract with Southern Muse Restaurant to supply its napkins and tablecloths on a monthly basis. Last week Southern Muse failed to pay for their monthly shipment and now Linen Lines is concerned that they may be in some financial trouble and may not pay the remaining five months left on the contract. Linen Lines has contacted your office and wants some guidance as to what to do. The monthly charge for the linens is $7,000, which includes weekly pick-up of linens, laundering, and replacing them. Your supervising attorney has asked you to prepare a memorandum on Linen Lines available options under your jurisdiction's applicable U.C.C. provisions and common law.
2. Continuing with the facts from number 1 above, your attorney requests that you prepare and draft a letter to Southern Muse stating your client's position. (Note: You may treat this case as a breach, an anticipatory breach or simply a notice of intent to determine Southern Muse's intentions. However, be sure you letter represents the best interests of your client, Linen Lines.)

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Part III

Drafting and New Developments in the Law

Chapter 16

Contracts and the Internet: Something Borrowed, Something New

Outline

Just Suppose . . .

Your favorite aunt Amelia is just getting started with the Internet. You go online with her and she buys her first computer from a national computer company. When you purchase the computer, the Web site requires you to agree to certain terms and conditions by clicking a box that says "I accept." Of course, you click on the "I accept" box without reading the terms and conditions of the sale. (Who reads the fine print anyway?) Your aunt receives her first laptop by mail from the manufacturer. Attached to the box of the computer is a warranty and what appear to be more terms and conditions to the sale. (No one reads that either.) Hidden in the fine print of the manufacturer's contract is a statement that says, "The buyer accepts all terms and conditions of this product by accepting delivery of the product." It then says that rejection of the product must occur within 30 days of receipt. Excited, your aunt begins using her new laptop every day, becoming more proficient each day. About a month and a half after she received the computer, she goes to turn it on and . . . nothing. The computer does not boot up at all. Your aunt calls the company who informs her that she accepted the computer according to the terms in the agreement accompanying the shipment. Frustrated, your aunt decides that she is going to sue the computer company for not standing by their product—a defective one, no less. She files a suit in your home town, but the computer company sends one of its lawyers to defend the lawsuit who manages to get it dismissed. The only thing your aunt heard at the hearing was something about filing the lawsuit in Ohio. Ohio! She lives in Missouri. This is something

your aunt decides to fight with a vengeance. The question is whether all the terms and conditions can be enforced against Aunt Amelia and whether they are considered unconscionable.

The Internet presents unique legal issues, especially in the area of contracts. Determining whether the common law, sales, or some new law applies to a transaction is just a small part of the challenges facing the courts today. The law is slowly developing as cases make their way through the system. But, the results are mixed and have far-reaching, and often negative, effects for buyers and consumers on the Internet. This chapter will present an overview of the developing law of contracts—cyber-contracts—and the effect of the Internet on e-transactions.

16.1 INTRODUCING CONTRACTS TO THE INTERNET: AN UNEASY ALLIANCE

Over the past thirty years or so, the Internet has exploded from a fledgling idea to a mainstay in everyone's life, home, and office. As common as television, most people have some form of electronic device that can access the Internet, from a computer to a blackberry or an iPhone. It seems as though technology and its application is limitless, creating more and more opportunities for us to stay in-touch and connected. With this connectivity in the modern global world comes the inevitable disputes and problems when parties are injured along with the practical issues of living in a cyber dominated, e-commerce-driven world. How do we enforce a contract between people from different states created in cyberspace? How do we verify a signature in cyberspace and more importantly, what is considered a signature in cyberspace? What if I never see the terms of a contract I am signing? Is the contract enforceable? What terms may be considered unconscionable in the formation of a contract? Is the transaction a sale under the U.C.C., the common law or a new law? These are some of the questions and issues that arise in a cyber world and will be addressed throughout this chapter.

What becomes clear is that the law is developing in our cyber world where court decisions often conflict and new laws have been slow to pass that address the new issues we encounter on the Internet. When there is not existing statutes, the courts apply either the common law of contracts or the Uniform Commercial Code. The irony is that as courts apply these established legal principles, many transactions do not fit into the neat legal categories; thus we often see conflicting results. When analyzing an Internet transaction keep in mind that courts are applying "mixed" principles of common law contracts and the U.C.C. where statutory law is nonexistent. Be aware that many cases are fact driven where courts frequently lean to enforcement of an Internet transaction based upon the time-honored principles of the common law and the U.C.C. The lesson learned is not to forget what you have previously studied as these are the principles that are guiding the establishment of the law of e-contracts and e-commerce.

16.2 THE BASIC PRINCIPLES OF CONTRACT LAW: GROWING PAINS

Throughout this textbook, we have explored formation of a contract—offer, acceptance, consideration, and mutual assent. We also have explored how the common law and U.C.C. differ in the formation as well as other stages of the contracting process. What facts and principles may create a contract under the U.C.C. does not necessarily create one under the common law. Imagine now applying these principles to the Internet. How can an offer and acceptance be determined? The transaction is not only at arm's length but in cyberspace where the offeror and offeree may be unknown to each other. How do you apply the traditional principles of contract law where the parties can be anonymous? The answer to those questions is . . . carefully.

The Offer in Cyberspace: Who are the parties?

Under the common law of contracts the offer and acceptance must mirror each other; otherwise there is no contract. On the other hand, under the U.C.C., an offer and acceptance do not have to mirror each other with contracts being established with varying terms and conditions. But what if one of the parties has never seen the terms of the contract, the contract would be unenforceable, right? Actually, these are some of the basic issues facing everyone who uses the Internet and those who need to enforce them. Knowing these basic principles is a start, but how they apply can be eye-opening. For example, Irina needs to purchase new antivirus software to protect her computer. She visits various Web sites and decides on one. As a condition to purchasing the antivirus software, Irina has to agree to the terms and conditions of usage of the software. A pop-up box appears on the screen that sets forth the terms and conditions of the purchase. Irina must either click "I accept" or "I decline" regarding the terms and conditions. Of course if Irina declines, that is the end of the transaction. She clicks "I accept." The process continues and Irina gets her antivirus software. Does Irina own the software? She purchased it, right?

license
Legal mechanism to use a product without ownership

Under these types of transactions, Irina is not buying the software, only its use through a **license**. A license allows usage of a product without ownership or title. Think of it in these terms, you cannot use the likeness of celebrities, such as the Beatles, Bon Jovi, or Madonna, without permission and payment. This is the same concept when you purchase software on the Internet. You are buying the right to use the product, but not own it.

So how does this fit into our discussion of common law contracts and the U.C.C.? In reality, it may not. The purchase of the software is not a true transaction under the U.C.C. because there is no real sale of goods only the "use" of a good. Yet, the courts have limited laws which apply to Internet transactions. As we will discuss later, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") attempted to create a uniform law applicable to the Internet transactions—UCITA—however it has been met with criticism and resistance from virtually all the states, except two. With that in mind, courts have been relegated to applying established legal principles to transactions

in cyberspace where the established principles may not actually apply. Thus, U.C.C. principles will be applied to our example regarding Irina's purchase of the software, even though it is not really a sales transaction.

The next issue that plagues Internet contracts is establishing the terms and conditions of the online offer—the formation stages. Many Web sites sell merchandise. As part of the transaction, a potential buyer receives the terms of the sale, usually in a preset, predetermined boilerplate form contract. A pop-up box contains the agreement or the Web site has a hyperlink to the contract terms. The buyer clicks "I accept," but does not read the contract or goes to the hyperlink. The question courts are faced with determining is whether the Internet contract—the offer and acceptance—are enforceable between the parties.

A case that did not involve the affirmative act of clicking the "I accept" button is *Trell v. American Association of Advancement of Science*, 2007 WL 1500497 (W.D. N.Y. 2007), but it did discuss the basics of contract formation on the Internet.

Line of Reasoning

In the *Trell* case, the American Association of the Advancement of Science ("AAAS") advertised for scholarly scientific articles. Our plaintiff, Dr. Trell, resided in Sweden. He saw the advertisement on AAAS's Web site, Science Now. Trell claims that the advertisement on the Web site created a unilateral contract, which he responded to by submitting a transcript that *he considered* newsworthy. Trell further claimed that by submitting his manuscript that constituted his acceptance—voila, the formation of a contract. Of course, AAAS rejected Trell's manuscript, and he sued for breach of contract. The court basically stated, "Not so fast, Dr. Trell." Applying traditional principles of common law, the court found that whether an advertisement appears in a paper form or on the Internet, an advertisement is generally not found to be an offer. Therefore, if the advertisement was not an offer, a unilateral contract could not be formed. At best, the AAAS Web site created an "invitation for an offer" but did not extend further. The court's language mirrors the common law principles of offer. It stated:

> Statements that urge members of the general public to take some action in response there to . . . are commonly characterized as advertisements. Advertisements are not offers - they invite offers. Likewise, responses to advertisements are not acceptances—they are offers. (citations omitted) . . . . The Court finds no distinction requiring a different analysis or result merely because the advertisement was soliciting ideas (i.e., "news tips") rather than goods, or because it was communicated over the Internet as opposed to through television, radio or newspaper advertisement.

Therefore, regardless of the form of transmission, the common law of contracts applies.

Questions for Analysis

Review the *Trell* decision. What facts would have constituted an offer on AAAS's part? Are there any circumstances where advertisements on the Internet would have a different result than one in a newspaper?

The Acceptance in Cyberspace: What you should have known

In accepting a contract under the common law or the U.C.C., there are definite rules governing the transactions. So too, there are rules on the Internet, but those rules are borrowed from the common law and U.C.C. As discussed in the *Trell* case, regardless of where the advertisement is made, the law of when and how an acceptance to an advertisement is made did not change. In fact, that case strictly applied established common law principles.

Additionally, when "I accept" is clicked on an Internet contract, regardless whether you read the fine print or the terms of the contract, the presumption is that a contract is consummated. The defense of "I didn't read" or "I didn't know" has not persuaded judges to avoid contractual obligations. By clicking the "I accept" box, the same responsibilities flow as if you were signing a paper contract without reading the terms. Unless other contract defenses can be raised, the courts have enforced the contracts. Therefore, what type of contract would you enter into when you are contracting online? As the next section indicates, Internet or electronic-based contracts are categorized as a *clickwrap agreement*, *shrinkwrap agreement*, or *browsewrap agreement*. Each kind of agreement has different legal obligations which, may or may not, be enforceable.

State Your Case

Joe is in need of a new set of earbuds (earphones) since he wore out his last pair. He first makes a general search on the Internet and finds some Web sites that seem to have competitive prices. He decides to buy the earbuds on electronicoutfitters.com. Before he can click to make his final purchase, a box pops up stating that, in order to continue with his purchase, he must accept or decline the terms and conditions of the purchase. Joe clicks "I accept" and buys the earbuds. Once they arrive, Joe uses them every day. After two months, he tries to listen to some of his music from his iPod, but the right bud is dead—no sound at all. Joe contacts the Web site where he purchased them only to find out that they do not repair or replace defective products. Electronicoutfitters.com refers him to the contract on their Web site that states that any warranty issues must be addressed directly with the manufacturer. Does Joe have a case against Electronic Outfitters for breach of contract?

16.3 INTERNET CONTRACTS: WHAT'S IN A NAME?

There are three basic types of contracts relating to Internet transactions—clickwrap, shrinkwrap, and browsewrap agreements. Each is discussed in this section. See also Exhibit 16-1.

clickwrap agreement Internet contract that requires user to click box indicating assent to terms

Clickwrap Agreements

The most common Internet agreement is a **clickwrap**, click-through, or click-on agreement. A clickwrap agreement involves a consumer or buyer's assent to the terms of an Internet transaction by clicking on the "I accept" or "I agree" box indicated at the end

of a pop-up box, for example, indicating assent to the terms of the contract. Usually the contract terms are displayed in either a pop-up box, a related page or hyperlink. The result is that by clicking, you are agreeing to the terms of that merchant or seller's contract, even though you probably did not read the contract terms; and even though you had not clicked the "I accept" box you would not have been able to complete your transactions. The logic is the same as in the paper world. Parties to a contract are expected to review the terms before signing on the "dotted line." So too are parties held to the same standard in the cyber world. The clear trend of the courts is to enforce clickwrap agreements, applying traditional contract principles to their analysis.

One of the issues that these types of agreements raise is unconscionability. Is the buyer or consumer truly assenting to the terms and conditions of the Internet contract? What bargaining power does the consumer or buyer have when the terms are non-negotiable? Virtually all standardized Internet contracts are "take it" or "leave it" contracts. Should those contracts be enforceable when there is no ability to bargain? The courts have pretty much fallen on the side of enforceability, unless the facts are so egregious to dictate a different result.

A good example of an attempt at modifying a clickwrap agreement is *A.V. v. iParadigms, LLC,* 544 F. Supp. 2d 473 (E.D. Va. 2008) *aff'd in part and reversed in part A.V. ex.rel. Vanderhyne v. iParadigms*, 562 F. 3d 630 (2nd Cir. 2009).

Line of Reasoning

In *A.V. v. iParadigms*, the plaintiffs, a group of four students, were required to file term papers on defendant iParadigms' Web site, which owned a system Turnitin, a software system that detects plagiarism in written works. Apparently, this system is used by many schools, colleges, and universities. As part of the process, iParadigms archives students work mainly to check for future acts of plagiarism. The students' school subscribed to Turnitin requiring the students to file their papers with the Web site. To file a term paper, the student had to agree to the terms and conditions of usage by clicking "I agree." Although the students clicked "I agree" on the face of their submitted works they placed a disclaimer which stated that they did not consent to the archiving of the papers by Turnitin. The students sued because Turnitin continued to archive their work, which they claimed was a copyright infringement. (The court of appeals dealt with the copyright issue finding that Turnitin did not violate the students' copyright rights. What is interesting is the trial court's analysis of the contract formation issue.)

The trial court found that by clicking "I agree" a contract was formed, which entitled Turnitin to archive the term papers. Placing a disclaimer on the document did not constitute a rejection or a modification of the agreement. The terms of the agreement specifically stated "Turnitin and its services are offered to you, the user…, conditioned on your acceptance without modification of the terms conditions and notices contained herein." The basis for the court finding a contract was that the students had a choice either click "Agree" or "Disagree." Because the terms of the agreement were displayed directly above the "Agree" or "Disagree" button, the court found the students had notice of the provisions, thus finding a valid contract.

Questions for Analysis

Review both the lower court and appeals *iParadigms* cases. What alternatives did the students have if their schools required them to file the term papers with Turnitin? Are there ways a party can modify the terms and conditions in an Internet contract? Explain your responses.

Shrinkwrap Agreements

shrinkwrap agreement Legal agreement inserted into product box, such as software, which by opening indicates assent to terms and conditions

Another standard cyber-commerce contract is a **shrinkwrap agreement**, but it has a twist. A shrinkwrap agreement involves the terms of an agreement found within the boxed product itself, such as in the purchase of any electronic equipment or software. Usually the box is wrapped in plastic, thus the term "shrinkwrap agreement." Under a shrinkwrap agreement, the purchaser of the product opens it and subsequently keeps the goods; by opening the product and keeping it, the person assents to the terms of the shrinkwrap agreement. Here, the act of keeping the product constitutes assent. An example of a shrinkwrap agreement, although in the form of a license, is the purchase of a software program, such as antivirus or tax software program. You may not have read the terms of the agreement, but by opening the package, downloading it, and using it, you are accepting the terms of the shrinkwrap agreement.

On the face, clickwrap and shrinkwrap agreements appear to be the same. However, a clickwrap agreement deals mainly with terms between a seller and buyer on the Internet, whereas a shrinkwrap agreement involves the manufacturer and the buyer. The shrinkwrap agreement contains the applicable warranties and recourse each party has in the event of breach or nonperformance. Like the clickwrap agreement, courts have generally favored enforcement of shrinkwrap agreements.

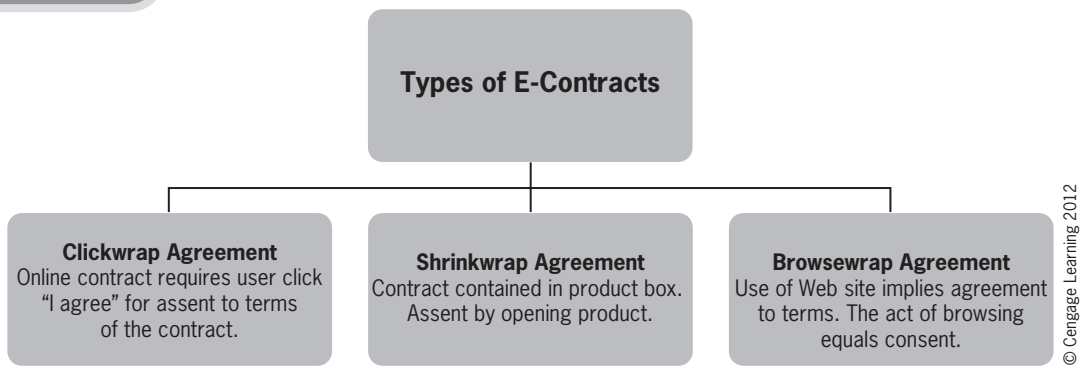
Browsewrap Agreements

browsewrap agreement Internet agreement posted on Web page which binds user by act of browsing

Browsewrap agreements usually are formed through an Internet transaction. Similar to a clickwrap agreement, they are found on the Internet but with a notable exception. Under a browsewrap agreement, the user or purchaser *does not* assent to the terms and conditions of the agreement before gaining access to its product. Consequently, if you are downloading a product without requiring a "click" to show assent, probably a browsewrap agreement is involved. The controversy with browsewrap agreements stems from what appears to be a deviation from principles of contract law—there must be assent to the terms of the contract for formation to be complete. Here, there is no assent to the terms of the contract. The argument of the proponents of browsewrap agreements is that by virtue of either accepting the product or by downloading, you are impliedly accepting the terms of that seller's or merchant's agreement.

There are many critics of the browsewrap agreements with most questioning their enforceability. Perhaps the most widely cited and discussed case involves a browsewrap agreement is *Sprecht v. Netscape*, 306 F. 3d 17 (2nd Cir. 2002). That case essentially held that in order for a party to be held to the terms and conditions of an Internet contract, those terms had to be presented in a conspicuous manner—a manner that gives sufficient notice to a party as to what is being agreed to.

EXHIBIT 16-1 Diagram of Different Types of E-Contracts

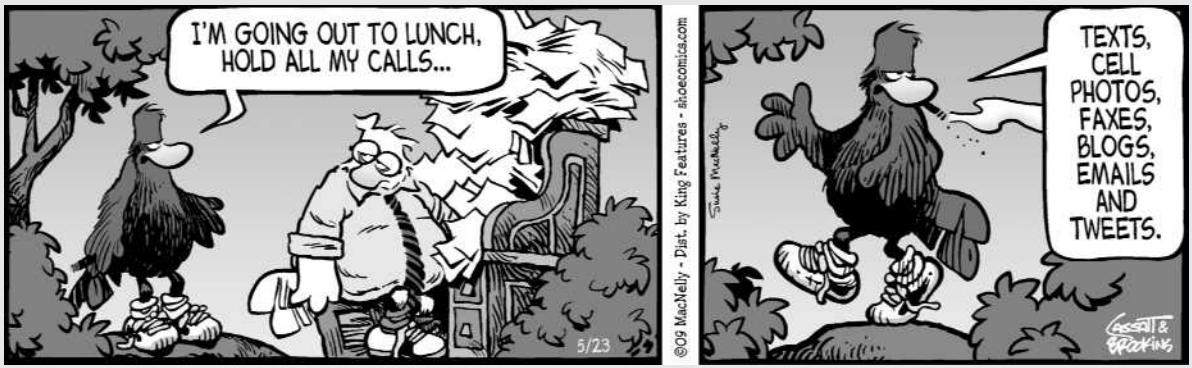


Line of Reasoning

One of the most significant case decisions regarding Internet contracts is *Sprecht v. Netscape*. Decided in 2002, its analysis has laid the foundation for interpreting all types of e-contracts, but specifically browsewrap agreements. In that case, a user of a Web site challenged the terms and conditions in a browsewrap agreement that he did not see while downloading software from the site. Specifically, John Gibson wanted to download a software program, SmartDownload from the Netscape Web site. Use of the software did not first require the user to click "I accept" as with a clickwrap agreement. Gibson downloaded the software. Later, Gibson and others believed that the software transmitted private information about its users. Netscape was sued. Netscape claimed that arbitration clause in the agreement applied to any claims that the plaintiffs had. However, the plaintiffs claim that the conditions of use were located at the bottom of the Web page through a hyperlink, below the download button. The hyperlink was not conspicuous enough so that it was possible to completely miss the link with the terms and conditions, which happened in this case. The term at issue was the enforceability of an arbitration clause. In its reasoning, the court distinguished between the different types of Internet agreements—clickwrap, shrinkwrap, and browsewrap—determining that this case involved a browsewrap agreement. Even though Netscape argued that simply failing to read the contract was not a defense, the court held otherwise. The court focused on meaningful assent and lack of notice of the terms of the contract. It stated that terms must be posted with "clarity and conspicuousness" so that parties to a contract can "fully and clearly comprehend the agreement" that will bind them. Ordinarily ignorance or failure to read a contract is not a defense to its enforceability, but in this case Netscape's displaying of the terms and conditions of the contract was so egregious that the court refused to hold users of the Web site responsible to the terms. The arbitration clause was unenforceable against the plaintiffs.

Questions for Analysis

Review *Sprecht v. Netscape*. Would the result have changed had the hyperlink been posted above the icon to download the software? What facts did the court identify that characterized the contract in this case as a browsewrap rather than a clickwrap agreement?



SHOE © 2009 MACNELLY, KING FEATURES SYNDICATE

State Your Case

Using the facts from the introductory fact pattern, what rights does your Aunt Amelia have against the computer company where she purchased her laptop? What type of agreement did Aunt Amelia enter into with the computer company, if any? Are the terms and conditions enforceable against Aunt Amelia? Discuss all issues.

Cybercises

Using the Internet, find three examples of clickwrap and three examples of browsewrap agreements. Locate an example of a shrink-wrap agreement and compare the type of terms found in it to the terms in a click-wrap agreement

When dealing with Internet or Internet-related contracts, what we believe to be the rules sometimes change. There still is some flux in interpreting and enforcing Internet contracts. One way to standardize enforceability is through legislation. In most instances, Internet-related legislation has developed in response to the growing changes in conducting business both through state and federal actions. With the growth of e-commerce and cyber contracts, legislators have responded and in some instances have done so by enacting legislation regulating records and signatures in e-commerce. But, more legislation is needed to address the issues brought forth in transacting business online and electronically. The section that follows explores some of the legislation, both state and federal, that have been passed.

16.4 WHAT LAW APPLIES: THE OLD VERSUS THE NEW

New laws have been passed to address some of the unique issues presented by Internet contracting. The most ticklish of the issues deals with signatures on contracts or rather signatures on Internet transactions. Both state and federal laws deal with this issue. Otherwise, the body of law dealing with Internet transactions has primarily developed through case law and exiting statutory laws. This is not to say that statutory laws have not been proposed; they simply have not been adopted as expected. Thus, this section will investigate the development of the applicable laws in an e-commerce world.

Assent and the E-signature

One of the basic components of contract formation is assent. Assent can be found through actions, but more often than not, assent is found simply by a person's signature. A problem arises in the cyber world, which is how to transfer and translate a paper signature to the Internet. To address this problem, two laws have developed: **Uniform Electronic Transactions Act (UETA)** and **Electronic Signatures in Global and National Commerce Act (E-SIGN Act)**.

UETA
Uniform statute regarding electronic records and signatures that has been adopted by most states

E-SIGN
Federal statute regulating use of electronic records and signatures in e-commerce

UETA: A State Response

As with the Uniform Commercial Code, the National Conference of Commissioners on Uniform State Laws (NCCUSL) determined that a uniform law was needed to address electronic signatures in contractual transactions. Completed in 1999, the NCCUSL drafted the Uniform Electronic Transactions Act—UETA. The focus of UETA was regulating signatures in a modern e-commerce world. It generally provides that a contract cannot be deemed unenforceable simply because it is in electronic form or has an electronic signature affixed to it. Most states have adopted UETA in some form. But because there are some differences in state UETA laws, outcomes to the same transactions may be different. The main obstacle of UETA is that the parties must agree to have its provisions apply to the transaction. Without agreement, electronic signatures are not accepted.

UETA provides definitions of electronic signature and electronic record. Section 2 of UETA provides definitions that apply to the Act. Under this section, an electronic record is defined as a contract or other type of record created, generated, communicated, received, or stored by electronic means; and, an electronic signature is defined as an electronic sound, symbol, or process attached to or logically associated with [a contract] or record and executed or adopted by a person with the intent to sign the record. Another important definition under this section is the definition of contract, which is the "total" legal obligation resulting from the parties' agreement as affected by [the Act] and other applicable law.

Additionally, certain transactions do not come under UETA's umbrella. The most notable are wills, trusts, codicils to a will, health care powers of attorney, transactions governed by the U.C.C., except for Article 2 and 2A transactions and sections 1-107 (waiver of claim or right under a breach) and 1-206 (Statute of Frauds), the Uniform Computer Information Transactions Act (UCITA) and any state law exempting application. A state may adopt the entire UETA law or part of the provisions that were proposed. What this means for you as a paralegal is that it is important to check your state's version of UETA law to determine its contents.

Cybercises

Locate your state's e-signature law and compare it with the original draft presented by the NCCUSL. Identify the differences and similarities in your state's law with the original version from the NCCUSL.

E-SIGN: The Federal Response

The Electronic Signatures in Global and National Commerce Act, E-SIGN, was enacted by Congress on June 30, 2000. Its purpose is similar to UETA in that E-SIGN recognizes electronic contracts and electronic signatures as a means to transact business between parties. Important to E-SIGN is its broad use of the terms electronic record and

electronic signature allowing for more flexibility in an e-world. One of the critical aspects of E-SIGN is that, like UETA, its applicability is voluntary between the contracting parties. However, E-SIGN has more stringent requirements relating to consumer e-contracts. For consumers' use of E-SIGN, the law requires a detailed consent and acknowledgment process for using electronic documents and signatures. The reason for these heightened protections is so that consumers freely and knowingly enter into transactions without fear of the unscrupulous vendor and to avoid issues of fraud.

However, it is important to note that not all transactions qualify or can be created electronically. E-SIGN has some important exceptions to their application, some of which are:

- Any court documents, orders or notices
- Any notice relating to (1) termination of utility service (2) or shut offs.
- Foreclosure, eviction, repossession or default under a rental agreement or mortgage on a principal residence.
- Termination or cancellation of health care benefits or coverage or life insurance benefits
- Product recall, such as those relating to a products liability case.
- Transactions such as wills, trusts, family law documents and the U.C.C., except for Articles 2 and 2A and 1-107 and 1-206.

Under E-SIGN, other than the consumer requirements, the basis for enforceability will be the touchstone principles of contract law—formation, consideration, mutual assent, and the other remaining principles required in a contract.

Differences between E-SIGN and UETA

There are significant differences between E-SIGN and UETA that should be noted. The following is not an exhaustive list, but highlights the major differences between both statutes:

1. Consumer Consent Requirements: E-SIGN requires the affirmative consent of a consumer to receiving information that would otherwise be available in print form, whereas UETA does not. The consent under E-SIGN is quite involved to ensure that the consumers understand the consequences of their actions.
2. Procedural Requirements: UETA has some procedural requirements that are not found in E-SIGN. These requirements range from mistakes in electronic contracting to the admissibility of electronic records as evidence. Also, UETA has a means to "attributing" a signature in a contract to that specific party.
3. Assent to Use: UETA requires the parties to affirmatively agree to conduct business through electronic means, whereas E-SIGN does not have this requirement.

encryption
A process that converts plaintext or disguises it so it can only be read by the intended user

digital signatures
A signature captured by an electronic fingerprint or coded message that is unique to the signer of the document

But note that use of E-SIGN and UETA is strictly voluntary between the parties; there are no legal requirements to do so. But, E-SIGN appears to more closely follow traditional contractual principles in its application—no agreement to agree to use electronic means as the form of contracting.

TECH CHECK

Preserving the Integrity of Electronic Signatures

Fraud, misrepresentation, forgery, and identity theft are just a few of the words that come to mind when dealing with signatures let alone electronic signatures. The question of the validity of an electronic signature is a persistent one, which, if challenged, could lead to the unenforceability of the transaction. How to protect and verify an electronic signature is an important concept in today's world. Electronic signatures can take a number of forms, such as encrypted, digitized, and biometric. New technologies and software products are used to verify the validity of a signature through specific processes and analysis. **Encryption** converts plaintext or disguises it so it can only be read by the intended user. In order to read encrypted data, a pass code is usually provided to unlock the information. **Digital signatures** are captured by an electronic fingerprint or coded message that is unique to the signer of the document. With special software, a signature is authenticated. With this technology, any attempted change to the signature, such as tampering, invalidates the signature. And finally, **biometrics** is another authentication process that records a person's signature and then through software compares the signature against future signatures. Biometrics captures the unique qualities of how each person signs, such as pressure and duration in the signing process, and uses that information to authenticate a signature, similar to a fingerprint. The development of the technology for authenticating electronic signatures is as vast and limitless as the Internet itself. A method used today will, no doubt, be refined and advanced tomorrow. The point is to ensure that what you receive in electronic form is the "real deal."

biometrics
Records a person's signature and then through software compares the signature against future signatures. It captures the unique qualities of how each person signs, such as pressure and duration in the signing process, and uses that information to authenticate a signature, similar to a fingerprint

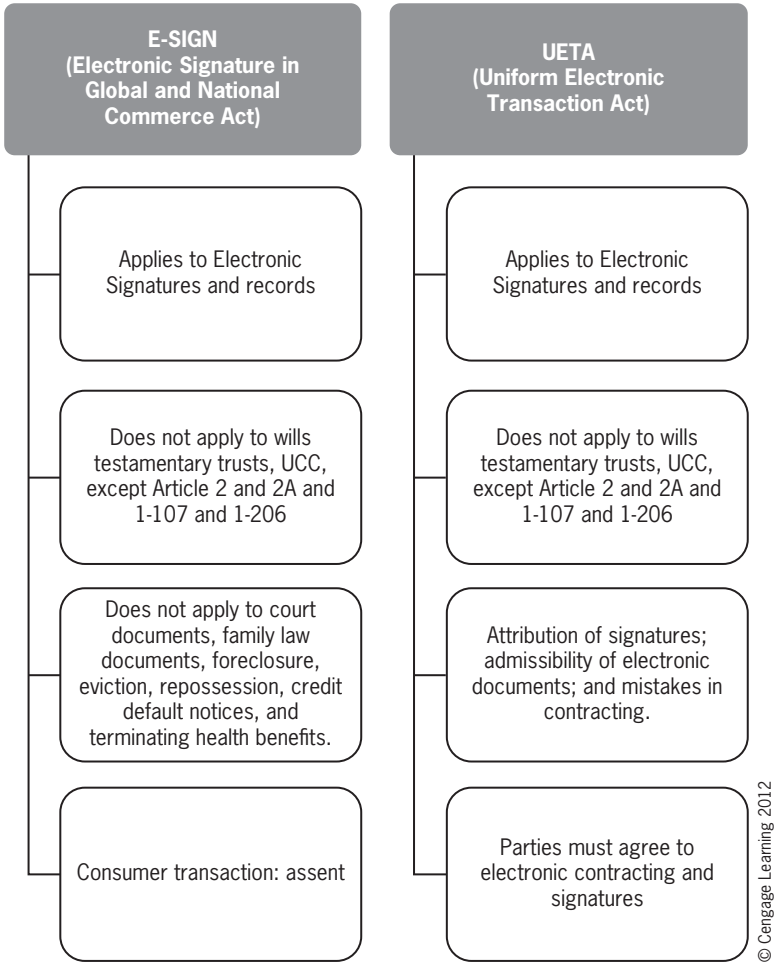
cybercrimes
Crime committed on the Internet, through cyberspace or through any electronic method of communication

Applying E-SIGN and UETA in a Cyber World

The passage of both E-SIGN and UETA is significant to the way parties do business in an emerging e-commerce and e-contract world. Of course, both laws only scratch the surface with many issues left up to the parties through their course of dealings. The issue of determining the authenticity of signatures is developing with software and technology. So too are the security issues that naturally arise when technology is developing to protect the marketplace from the inevitable fraud, misrepresentation, and **cybercrimes** that can permeate electronic transactions and e-commerce.

Often, converting documents to a PDF file using passwords and encryption will restrict tampering with the contents of the document. Moreover, courts are being faced with cases that deal with issues such as whether someone typing their name to an e-mail constitutes assent and a valid signature. In some cases, the courts have found a contract. That can be a simple application of the definition of "electronic signature." There is no doubt that the law and impact of electronic signatures are growing, but there is no doubt that e-signatures and the laws relating to them are here to stay. Exhibit 16-2 is a diagram comparing the provisions of E-SIGN and UETA.

EXHIBIT 16-2 Diagram of comparison of E-SIGN and UETA provisions



A recent case, *Brantley v. Wilson,* 2006 WL 436121 (W.D. Ark. 2006), focused on a UETA problem. The discussion on UETA made it clear that for this statute to be applicable, the parties must agree.

Line of Reasoning

In *Brantley v. Wilson* the issue was whether a succession of e-mails that contained a party's name satisfied the Statute of Frauds creating a contract between the parties. The court determined that it did not. In this case, the sale of a piece of real estate in Arkansas was involved. Here, the sellers and buyers exchanged a number of e-mails where the sellers' signature appeared at the end. The buyers argued that the seller's signature constituted an electronic signature under UETA.

The sellers argued, however, that the series of e-mails was merely a negotiation with a "paper contract" to follow. In reviewing the facts, the court noted that the e-mails *did* contain the price of the property, the financing terms, a discussion of allocation of costs, and a description of the land. It seems that all the required elements to satisfy the Statute of Frauds were present, except for one—agreement by the sellers under UETA. In the e-mails, the sellers clearly referred to "a forthcoming paper contract." Under the Arkansas version of UETA, the parties must agree to conduct their business by electronic means. The e-mails did not support this conclusion and therefore the court did not find an enforceable contract.

Questions for Analysis

Review *Brantley v. Wilson*. What would the parties have had to do to apply UETA? What facts would have changed the court's result? Explain your answers.

State Your Case

Penny is a savvy consumer. She knows how to stretch a dollar. Penny wanted to purchase a sofa set that was being sold by a couple, Benny and Jade Woods, who were relocating to Colorado for their jobs. They were selling everything in their home. Penny went to the Woods's home to look at a sofa set and thought that she could use it in her home. She e-mailed Benny the following: "Like your navy blue and brown striped sofa set. Would you sell it for $200? Signed Penny" Benny wrote back: "We really want $500 for the set as they are brand new. Signed Benny." Penny was not giving up. She then e-mailed Benny again: "Okay, Benny, how about $350." Benny responded: "Penny, you are a hard bargainer, but we will take $350." Benny had not signed the last e-mail. Was a contract created between the parties? Discuss all issues.

UCITA
Uniform law on cyberlaw and technology proposed by NCCUSL

Adoption of UCITA—Not so fast . . .

Similar to the Uniform Commercial Code, the National Conference of Commissioners on Uniform State Laws (NCCUSL) envisioned a uniform law relating to technology and e-transactions. They prepared and drafted what was hoped to be the "new bible" for e-commerce and technology—the **Uniform Computer Information Transactions Act, UCITA**. The law was intended to govern software licensing, online access issues, and general information technology issues. The law also was intended to bring uniform standards to contractual licenses such as clickwrap, shrinkwrap, and browsewrap along with supposed protections for consumers, including warranty issues.

Controversies abound in the legal community because many believe that UCITA is not consumer based enough and favors the producers of technology products, such as software. This slant was probably the death knell of UCITA. There have been attempts to revive it through the creation of a new article to the U.C.C., but with not much fanfare or success. As a result, only two states, Virginia and Maryland, have passed UCITA.

As recently as May, 2009, the American Law Institute attempted a slightly different approach by focusing on software contracting. The new proposed uniform law was called Principles of the Law of Software Contracts. The reception to this new uniform law was lukewarm at best.

Strictly Speaking: Ethics and the Legal Professional

The Internet poses interesting questions regarding the unauthorized practice of law. Attorneys set up Web sites or businesses offering legal advice. Is that the practice of law in a jurisdiction other than the one they are licensed in? What about attorneys who have been disciplined or disbarred? Does cyberspace shield attorneys from the unauthorized practice of law? These are difficult questions because often catching the person can be difficult. Many bar associates have issued advisory opinions or filed lawsuits on the matter focusing on whether "advice" is truly being rendered. These same issues present challenges for paralegals, especially those who offer Internet legal "services." Is providing forms and information on how to prepare a will or a contract constituting legal advice? These are fine lines to be crossed where the law is still developing. Recent cases and controversies in California, Texas, and North Carolina prove how divisive this issue can be. *In re Reynoso,* 477 F. 3d 1117 (9th Cir. 2007) involved the use and preparation of bankruptcy documents and related filings by non-lawyers. The software could be purchased over the Internet where the Web site offered a review service of documents by nonlawyers. The Court of Appeals for the Ninth Circuit found this to be the unauthorized practice of law in California, at least. This appears to be one of many "hot-button" topics as more legal-based Web sites grow. How these challenges will end remains to be seen.

Cybercises

Determine your jurisdictions policy or laws regarding the unauthorized practice of law and web-based legal sites.

16.5 DEVELOPING ISSUES IN CONTRACTING ON THE INTERNET

Recurring themes seem to permeate the area of electronic contracting and e-commerce. Those themes include unconscionability, forum selection (choice of law), arbitration, and capacity. From most of the cases presented to the courts, these issues seem to be the most widespread. A brief discussion of the issues and why they are so prevalent follows.

Unconscionability: Procedural and Substantive

Unconscionability was discussed in detail in Chapter 5 as it relates to defenses to contract formation. Recall that unconscionability deals with the unequal bargaining powers of the parties and has many policy implications. The Internet has opened the flood-gates to new challenges to the formation and enforcement of contracts on the Internet. Here, we examine unconscionability in the context of e-contracts.

Online contracts often focus on the type of unconscionability. Was the unconscionable provision procedural or substantive? Recall from earlier chapters that procedural unconscionability deals with the process where a party has no meaningful choice. Were critical provisions hidden so that the consumer was deprived of real assent and were the parties in unequal bargaining positions? Some courts require procedural unconscionability

to bring a challenge to an online provision. A close cousin to procedural unconsionability is substantive unconscionability. With substantive unconscionability, the terms are of an oppressive nature completely rendering the bargaining power of one party negligible as to unreasonably favor the party with the greater power. Some courts require both types; others just one, to avoid the contract.

It comes as no surprise that many of the challenges to e-contracts come from enforcing clickwrap, shrinkwrap, and browsewrap agreements. Most of the arguments in these challenges center on the lack of bargaining power of the injured party. The argument goes something like this: Buyer purchases a software product. Something goes wrong with the product. The buyer attempts to return the product and either cannot return it, is limited in pursuing damages or warranties, or has to defend a lawsuit in a foreign jurisdiction, or a combination of all three. Many courts have viewed the click of "I accept" as showing assent to the terms and conditions of the Internet contract. Although arguments are made that they did not read the agreement, did not read the offending part of the agreement, or just did not think it applied to them, the results have consistently been for enforcement of the clickwrap agreements.

On the other hand, enforcement of shrinkwrap agreements has been more mixed. Recall that usually the product is forwarded after purchase and has the manufacturer's warranties and exclusions. Courts have viewed shrinkwrap agreements in a number of ways. Some courts state that once accepted and used, the terms of the shrinkwrap agreement apply. Others have found that these are additional terms and unenforceable. It seems as though these cases are fact driven as opposed to clickwrap agreements, which seem to fall under a strict contract analysis.

Browsewrap agreements appear to be another story altogether. With browsewrap agreements the fact that no assent is required for their enforceability is troublesome for many courts. Forcing terms on an unsuspecting buyer or consumer seems to go against most legal precepts in contracts under the defense of against public policy. Therefore, browsewrap agreements have a more spotted history than clickwrap and shrinkwrap agreements.

The importance of understanding the unconscionability issue is that courts do not favor contracts that appear to have unequal bargaining powers. We discussed this in Chapter 5 when dissecting the contractual defenses to enforceability. Now, the issue seems to be front and center in the cyber/electronic/virtual world of contracting. Whether you are tasked with assisting in drafting e-contracts or defending their enforceability, unconscionability is an issue which often surfaces.

forum selection clause
Clause requiring consent to jurisdiction in another place other than one's home state

choice of law clause
Selection of jurisdiction by part(ies) as to place of filing of case where dispute arises

Forum Selection . . . or Where Do I File My Lawsuit?

Determining where to file a lawsuit can be a complicated question. Courses in law school focus entire semesters on the subject. For our purposes the question becomes does the online contract provide for the place to file the lawsuit? This is called a **forum selection** or **choice of law clause**. Under these circumstances, the seller, merchant, or offeror unequivocally states in the online contract where a lawsuit will be filed and what laws will apply to that lawsuit—no questions, no discussions.

personal jurisdiction
Court's power to hear a case over a defendant

general jurisdiction
Power of state court to hear a case, usually granted by statute or state constitution

Ordinarily, a case is filed in the state where the parties reside or the place where business was conducted. This is referred to as **personal jurisdiction**. The law provides for **general jurisdiction**, which is usually statutory in nature. The law also allows for parties to agree—negotiate—the place where a dispute between the parties is filed. Where the issue becomes a "hot button" is when online contracts provide for the place or forum for filing a dispute when the injured party resides far from the stated jurisdiction or worse yet, did not know that by clicking "I accept" to the online contract that the party was agreeing to have all disputes resolved in Florida, for example, when Idaho is the home state. How is that fair to an injured party that did not bargain for that forum?

Challenges to forum selection clauses usually center on the argument of unconscionability, reasonableness, and fairness. Unlike the enforcement of the general terms in a clickwrap agreement, courts have been split as to enforcing forum selection clauses because of the burden it places on the injured party. The analysis often is fact based using such considerations as determining the sophistication of the web users, the frequency of the exchanges between the user and host site, and the reasonable opportunity of the user to learn the terms of the agreement. Forum selection will continue to be a hotly contested topic as the law in this area develops and expands.

Arbitration Clauses

arbitration
Alternative legal proceeding to settle disputes other than a court

arbitrator
Person(s) who hears arbitration case

As you will recall, **arbitration** is a legal means to settle disputes without resorting to a court action. Arbitration clauses have come under fire because of the adhesive nature in the way they are presented and applied in the online setting. Arbitration requires that the parties agree to have their disputes heard before an **arbitrator** rather than a judge or jury. Only under specific circumstances do parties to arbitration have a right to an appeal. Once again, the issue of arbitration clauses center on the unconscionability argument. But, the trend of courts deciding these types of cases revolve around the parties' ability to review and access the terms and conditions of online agreements. Another factor which the courts routinely consider in arbitration clause cases is whether the injured party is a consumer or a business. Courts are more inclined to enforce an arbitration clause against a business or merchant as opposed to a consumer focusing on the level of sophistication of the user. Although the law continues to develop, the courts appear to apply either straight common law or U.C.C. principles in arriving at their decisions in this area.

Capacity

An issue that has not seen much case law, but is an important issue in the development of e-contracting on the Internet, is capacity. The focal point is usually the underage minor contracting for goods or services for which they do not have the legal capacity. Common areas for violations are downloading music by children and teenagers, obligating parents to pay for music they have not been authorized to download; or, purchasing video games on the Internet by a minor who does not have authorization. The Internet presents new issues in the cyber era—issues that were never anticipated. How do you enforce a contract against a teenager who downloads music improperly? Since courts have consistently applied standard contracting principles, it would seem to follow that these contracts would not be enforceable against the minor.

These same common law contract principles as discussed in Chapter 6 apply to any individual who does not have the capacity to contract, such as the mentally challenged or the underaged. An interesting challenge to the capacity argument would be an intoxicated or drugged person. Would their online contracts be enforceable? The answers to these issues remain to be determined. A recent case which presented an interesting twist to the underage minor issue was *Doe v. SexSearch.com*, 502 F. Supp. 2d 719 (N.D. Ohio 2007).

Line of Reasoning

One of the questions in *Doe v. SexSearch.com* centers on the misrepresentation of a minor's age on a Web site and the liability of the Web site. In *SexSearch*, an adult male, the plaintiff, joined a dating service where members posted profiles and photographs. The Web site had represented that all participants on the Web site were of legal age. Plaintiff made contact with one woman online and arranged to meet her. They had sex; she was 14 years old. The plaintiff was charged with various felonies for sexual misconduct. Plaintiff sued SexSearch for breach based on the fact that an underage girl was able to join the Web site. Under the terms and conditions of usage there was a disclaimer that stated that the site did not assume responsibility for the accuracy of the information provided on the Web site by its users. The site further stated that it did not verify participants' ages—a bit of a "buyer beware" philosophy. Applying the Communications Decency Act of 1996 ("CDA"), the court stated that since the Web site only "posted" the information provided, it was not liable under the Act. Additionally, despite the misrepresentations of the minor, there was no breach of contract claim. However, the civil claims were separate and apart from the plaintiff's criminal troubles—sex with a minor.

Questions for Analysis

Review *Doe v. SexSearch*. Was there any way the Plaintiff could have been protected and escaped liability? Would the result have changed if the minor was 17 when the act was committed, but 18 when it was discovered? Was the court correct in not holding the site responsible for the minor's actions? Explain your answers.

The Developing Case: What the future holds

Certain conclusions can be drawn from the development of the case law. It is clear that courts are applying the time honored principles of contract law and the Uniform Commercial Code in deciding cases. Courts have not found that the actions on the Internet preclude the special treatment of the parties or special laws. A common theme in many Internet cases is "reading is fundamental." This means that a party cannot resort to the defense that "I didn't read it" or "The contract was too long to read" or "I had to view too many screens to read the entire contract." What the courts do consider is when the terms were presented, how they were presented and the whether there was an opportunity to review the terms. Based upon this analysis, courts are consistently reaching conclusions based upon long standing legal principles. The form may have changed—to cyberspace—but that is only geography. Whether paper or paperless, parties still have to fulfill the basic legal precepts that have always been required.

Will a uniform statute be passed that regulates Internet conduct like the Uniform Commercial Code? The jury is still out on that question, although the legal scholars continue to draft rules and laws that apply to the Internet and e-commerce. Right now, attorneys and judges use what is already established, which is the voluminous body of common law and U.C.C. principles. Until that changes, it is business as usual even in cyberspace.

16.6 PRACTICAL APPLICATION

Paralegals must be aware of the issues surrounding cyber contracts and e-commerce. When assisting in a drafting assignment, understanding how and where online agreements will be used is important. Terms and conditions must be readily accessible to users and readily available. Be mindful of contract terms that allude to terms not contained in written agreements. For example, the following language may be suspect:

> In consideration of the license fee by Customer *and subject to the terms of this agreement and the Terms of Service posted at* "www.websiteoftheclient.com" or successor Web site, Host grants Customer, its employees, and agents a nonexclusive, nontransferable license to sue the Service for internal business purposes only. This agreement and *incorporated terms* represent the entire agreement of the parties.

The problem with this type of language is that it refers the user to a Web site to view the terms and conditions of the contract. This language poses problems. Thus, be mindful when a written agreement refers to a collateral Web site for further terms of the agreement. There may be enforceability issues.

Additionally, watch for requirements of displaying language in a "conspicuous" manner such as those found in the U.C.C. The more conspicuous and noticeable the language is in an online contract the higher likelihood that it will be enforced. Again, what this means for you is that knowledge of the traditional laws of the "paper world" applies to the paperless one. Do not lose sight of legal principles you have mastered simply because you are viewing them in a cyber world.

SUMMARY

16.1 Contracting on the Internet has presented challenges in a cyber world. The law is slowly developing, especially with the passage of uniform statutes. Courts have applied traditional principles of common law and the Uniform Commercial Code in analyzing disputes involving contracting on the Internet.

16.2 New styles of contracts have been introduced over the Internet and in an e-world. Contracts on the Internet are referred to as clickwrap agreements because the user clicks "I accept" to show assent to the terms. A shrinkwrap agreement is found within a boxed item received by the user. These terms are additional to any contracts previously formed by a user. And, a browsewrap agreement is found on the Internet where the terms are implied by the user visiting a site or downloading software. The case law is developing regarding the interpretation of these types of agreements.

16.3 Some new laws have been passed as e-contracts and e-transactions grow. The two most notable statutory laws are E-SIGN and UETA. Both statutes address electronic records and electronic signatures in e-commerce. Under UETA, the parties must agree to its application. Certain transactions are exempted from UETA and E-SIGN, which include wills, trusts, evictions, and repossessions to name a few. One of the main issues arising under these e-signature statutes is authentication of the signatures. Software and technology are filling that void. One law that was supposed to be the shining star and U.C.C. equivalent was UCITA. However, this statute has met with criticism and has only been passed by two states.

16.4 Many of the issues facing courts in e-contracts focus on unconscionability, forum selection, arbitration, and capacity. Unconscionability is a recurring theme underlying many challenges to e-contracts. Where Internet contract terms appear to be oppressive, courts have not enforced them. However, simply not reading a contract is not a defense to enforcement. Both forum selection and arbitration clauses have been challenged based upon unreasonableness and unconscionability for the injured party. An area that is developing is challenges to capacity. The direction of the law remains uncertain in some areas, but what is clear is unless a uniform statute is passed that is acceptable to the states, the common law of contracts and the U.C.C. will be applied.

KEY TERMS

license
clickwrap agreement
shrinkwrap agreement
browsewrap agreement
UETA
E-SIGN
encryption
digital signature
biometrics
cybercrimes
UCITA
forum selection
choice of law clause
personal jurisdiction
general jurisdiction
arbitration
arbitrator

REVIEW QUESTIONS

1. What are two issues that arise in Internet contracts?
2. What is the difference between a clickwrap and browsewrap agreement?
3. What is a shrinkwrap agreement and how does it differ from a clickwrap agreement?
4. Identify two laws that address electronic signatures and electronic records?
5. List two similarities in the state and federal e-signature laws.
6. What is UCITA and its relevance to e-contracting?
7. Why is unconscionability a problem in Internet contracts?
8. What is a forum selection clause and why is it important to the parties in an e-contract?
9. What are some reasons behind Courts enforcing Internet contracts against an "injured" party?
10. What are some drafting tips that should be applied to e-contracts?

EXERCISES

1. Nahla was a big Rolling Stones fan. She lived in New York City. When Nahla heard the Stones were coming to Atlantic City, New Jersey, she decided to purchase two tickets from an online ticket agency. On the Web site was a "Terms of Use" which stated that by using the Web site you agree to the terms of purchase. The concert was scheduled for November 11, 2010. Nahla received e-mail advertisements promoting the concert. At 5 p.m., just three hours before the concert, there was an announcement on the ticket agency Web site, a mass e-mail and mass-text that stated that the concert had been postponed because Mick Jagger had a sore throat. Nahla had spent a lot of money to get to Atlantic City and simply offering a refund or another concert date was not sufficient. Anyway, she never saw any terms and conditions, which limited her rights to sue and her damages. Nahla sues the Ticket Agency Web site, The Rolling Stones and the venue where the concert was to take place. Would Nahla prevail in a lawsuit? Discuss all issues.

2. Doug was in need of a new pair of jeans. He hated shopping and decided to go online, which was quicker. He went to the Web site www.jeanbonanza.com which advertises that it has the largest selection of jeans in the world. Doug found a pair he liked for $45.99. He began the check out process where a hyperlink appeared to a site for the terms and conditions of purchase. Next to the hyperlink was a box that indicated he must check "I agree" or "I do not agree" before he could proceed to check out. He quickly clicked on "I agree" and completed his purchase. When the jeans arrived they fit perfectly. He wore then a few times and washed them. Taking them out of the dryer he noticed that the "blue" had faded to a light blue—almost white—color. They also had shrunk terribly. Doug had the jeans for over thirty days before he sent them back for a refund. The company refused stating that he failed to give them notice of the problem as required by the terms and conditions cited on their Web site within 30 days of receipt. Should Doug be able to get a refund? Why or why not?

3. It is tax time, and Vince was a firm believer in saving money on accountants. So, he ordered software from www.taxesrourbusiness.com that would help him prepare his taxes. When he received the box with the software in it, he noticed a legal looking pamphlet which was inside the wrapping of the software program. Vince just tossed it aside and began working on his taxes. He filed the taxes with the IRS early. However, upon review of the tax documents, he noticed that there was a big miscalculation. Unbeknownst to Vince, there was a glitch in the program which required a supplemental download from the Web site. Now, Vince was going to owe $500 in taxes with interest and penalties. Can Vince successfully sue TaxesR Our Business? What are the issues each party can raise?

4. Jamal went to download an e-book from www.textbooksforschools.edu. The book was for one of his classes in business law. There were no terms and conditions boxes popping up for him to click. After he downloaded the book, his computer was acting funny and then it died. Turns out that the Web site had

been attacked by a virus, which infected Jamal's computer. Jamal wants to sue the Web site and the school for damages, which includes a new computer.

a. What are Jamal's arguments in favor of the Web site and the school paying him damages?
b. What are the Web site and the school's arguments against paying damages?
c. What arguments can the school advance that the Web site cannot?

5. Elton and Billy had been exchanging e-mails regarding the purchase and sale of Elton's grand piano. Elton wanted $75,000.00 for the piano, whereas Billy was only willing to pay $50,000.00. Each e-mail was signed by Elton simply with the letter "E." Billy on the other hand signed some e-mails "Yours, William" or simply "Billy." In one of the e-mails, Billy asked if he agreed to pay $70,000 how long it would take Elton's lawyers to draft up the contract. Finally, Elton believed they had a deal and presented Billy with a written contract. With record sales down, Billy decided to pass on the purchase of the piano. Can Elton enforce the contract against Billy using UETA?

6. Silvia Gomez was new to buying things from the Internet. She always worried about security issues like someone stealing her credit card information. But, Silvia decided that the deals on the Internet were too good to pass up and joined the millions of Internet purchasers. Silvia went to www.shoesinyoursize.com to purchase a pair of black leather boots and two pairs of casual shoes. During the purchase a box popped up which required her to click "I accept" the terms and conditions of the purchase before she could continue. Hidden in the terms and conditions was a provision that limited Silvia's damages for any claim to the amount of the shoes purchased. She clicked and proceeded to check out. When the shoes arrived, Silvia tried on the shoes. They fit perfectly. The next day, Silvia wore the boots. After about an hour, Silvia's calves started to itch. She had a reaction to some component of the boot leather. Silvia contacted the Web site customer service, but was told all they could do is refund her money after return. Silvia now had medical bills to pay, and she was just working part-time. Silvia sued the Web company. Would the provision in the contract be enforceable? Explain your response.

7. Using the facts from Exercise 6, also within the terms and conditions was a provision that any lawsuits against the Web company must be filed in Pennsylvania. Silvia lived in Wisconsin. Would the forum selection clause be enforceable against Silvia? Why or why not?

8. Plant Doctor and Flower Power had been doing business with each other for nearly 10 years. Plant Doctor would help Flower Power diagnose problems with its plants and flowers and offered advice on how to keep flowers fresh longer. In fact, Plant Doctor had created a special solution that Flower Power used in all its bouquets. Plant Doctor and Flower Power always exchange invoices for each other's services by fax. All the terms and conditions had always been listed on that invoice. Flower Power was having some financial problems and could not pay Plant Doctor in the usual 30 days. Four invoices to Flower Power went unpaid for 3 months. The total of the three invoices was $600. When Flower

Power received the recent past due invoice, they noticed that the bill was now $650.00. Flower Power inquired as to why there was an additional $50 charge. Plant Doctor responded that it had posted on its Web site the terms and conditions for late payments. Flower Power only wants to pay what is owed. Will Flower Power have to pay the $50 additional charge? Explain your answer.

9. Marti loves entertainment news and is always on one of the tabloid Web sites. Marti always sees advertisements for different publications pop-up, but she never was interested. One day, in a moment of weakness, she sees an offer that she cannot resist. The pop-up box offers a one year subscription to *Celebs Magazine* for $25 a year with two months free. That sounds like a deal. Marti clicks on the advertisement and completes the personal information. The next screen requires her to click "I agree" to get the offer. The box looks like a lot of legal stuff and she hates reading long boring information, so she clicks "I agree." (The agreement states that the free months are at the end of the subscription.) After the two months, Marti decides to cancel. Has Marti obligated herself to a year's long subscription to *Celebs*? Discuss all issues.

10. After extensive negotiations, Walters & Chang decided to purchase an accounting program for their business from Accounts Management Consultants. Under the proposal, Walters & Chang was to receive software that included modules and licenses for the program. The software package contained a shrinkwrap agreement stating that all disputes had to be resolved in Oregon. After using the program for a few months, Walters decided that it was not serving their interests, returned the software program and sued Accounts Management for damages. Walters & Chang sued in their home state of Minnesota. One of the allegations in the lawsuit was that the forum selection clause in the shrinkwrap agreement was unenforceable because it modified an existing contract. What are the arguments for each side on the issue?

CASE ASSIGNMENTS

1. International Trucking has been buying parts from Autopoint, LLC for years. The parties had a three-year contract that began on January 1, 2010 and ends on December 31, 2013. Countless invoices have been exchanged by the parties over the years. On the invoice from Autopoint is a reference to its Web site, which contains the terms and conditions of their contractual relationship. The invoice specifically states: By signing this invoice, you are certifying that you have read and agree to the terms and provisions set forth and posted on our Web site at www.autopointllc.net/gentermsconditions. Included in the terms and provisions was an arbitration clause that stated that all disputes between the parties had to be settled by arbitration and that was the parties only and exclusive remedy. This provision also provided that all arbitrations would take place in Autopoint's home state of Mississippi. International was not satisfied with Autopoint's service and decided to sever its relationship in favor of Sam's Auto Supplies, Inc., a competitor. By letter on January 15, 2011, International's President advised Autopoint that they were ceasing all business with them. Autopoint demands

arbitration in Mississippi. International comes to your law firm for advice. They do not want to arbitrate in Mississippi and want to file a counterclaim for breach of contract in their home state of Alabama. What is your law firm's best advice to International? Are the Internet provisions enforceable? Discuss all issues.

2. A group of angry consumers have hired your law firm to file an action against bedsandbreakfastvacations.com. All the potential plaintiffs made their reservations by telephone with bedandbreakfastvacations.com. On the Web site were terms and conditions provisions for booking reservations. The company referred them to their Web site for the terms of their travel contract. One of the consumers, Dorothy Dale, stated she did not own a computer and did not intend to buy one. According to the group, they were charged service fees and "additional fees" including an energy fee of $10.00 per day. The group wants to sue the company and wants reimbursement for all the excess fees, including their attorney's fees. When you check the Web site, it states that any disputes must be filed in Virginia and any damages are limited to $500 per person. The group of consumers lives in Arizona. Prepare a memorandum to your attorney regarding the likelihood of enforcement of the terms and conditions provision on bedandbreakfastvacations.com Web site.

Chapter 17

Drafting a Contract: The Essentials

Just Suppose . . .

Rushing to complete an assignment, your supervising attorney has prepared a draft professional services agreement between Nature Takes, a company that photographs animals with their owners, and Serena Parklin. Serena and her dog, Onyx, a teacup poodle, are inseparable. Serena takes her everywhere, so it is no surprise that Serena wants to have a formal picture taken of her and Onyx. The contract contains all the standard language, except that Serena wants a specific photographer from Nature Takes, Raine Atherholt, to shoot the pictures. Serena just loves her work. Of course in the contract, there is a clause addressing assignability. Normally, contracts can be assigned with a party's approval, but in this case, Serena wants only Raine to shoot the pictures. Both you and your attorney review the contract and have all parties sign it. When Serena arrives at the shoot, Matteo Cervesa is there. Serena asks where Raine is and Matteo tells her that she was called out of town. He is here to do the shoot. Serena quickly pulls out the contract and points to the assignability clause. It states that: "This duties and obligations under this contract may be assigned. An OMG moment! It appears that the word "Not" was omitted. That was not Serena's intent, but what can she do. Matteo assures her that the pictures will be great, but Serena is not convinced.

Outline

The point of the fact pattern above is to bring attention to the need to carefully proofread the document you are preparing. One omitted word can affect the intentions of the parties and the performance of the contract—and it has happened to all of us at one time or another. Proofreading is one of the many tasks you need to perform when drafting a contract. Missed words or mistyped words are often not caught with spell check or even the human eye. Care should be taken when reviewing any document that is being sent out to a client. This chapter addresses the importance of the drafting process which ranges from word choice to editing. Every stage of the process is not only dependent upon the other but is also integral to the outcome. Therefore, attention to detail is essential to properly completing assigned tasks.

17.1 PREDRAFTING CONSIDERATIONS

Learning how to draft a contract, or any legal document, is essential to the effectiveness of any paralegal. Drafting may seem tedious, but it will be more satisfying if you understand what needs to be accomplished and appreciate the value of good word craft. What does the client require? Are all the facts known? Are multiple parties involved? Have the parties agreed to the final contract terms? Before the drafting process can begin, the paralegal must know what the client wants and must develop a plan of organization.

Knowing What the Client Wants

In the normal course of business, clients come to an attorney's office and discuss their legal problems with the attorney and the paralegal. During the initial conference, the attorney and paralegal ask questions about the clients' needs and what the clients hope to accomplish by retaining the attorney. When a contract is involved, it is imperative that the attorney and paralegal ferret out as much information as possible regarding its terms and conditions. It is always important to determine who the parties to the contract are, how long the contract is to last, the subject matter, the general terms and conditions, any warranties of the parties, termination provisions, and any other provisions that might be important to the clients' objectives.

During the initial conference, the paralegal should take copious notes—and not rely upon memory—while determining what the client's objectives are and recording what was communicated. Memories fade and details blur as days pass, so take comprehensive and accurate notes.

If the paralegal has some idea in advance as to the clients' needs and the purpose of the meeting, it may be prudent to do some preliminary research, such as finding a checklist of questions to be addressed or doing some background legal reading on the topic. For example, assume that you know a client is coming in to discuss setting up a new business, and one area of concern is the preparation of a confidentiality and nondisclosure agreement. Your preliminary checklist could include the following:

1. Names of parties
2. Objectives of client
3. Purpose of agreement
4. State of employment
5. Geographical restrictions

6. Period of nondisclosure
7. Information not to be disclosed

Many reference materials contain legal checklists, some of which are state specific. Transactional guides such as *American Jurisprudence Forms, West Legal Forms,* or Rabkin and Johnson's *Corporate Forms* assist attorneys in ensuring that all the significant points that should be in the contract are covered. Most reference materials that were only in traditional book form can be found in electronic form and on many legal Web sites, especially Westlaw and LexisNexis. Be aware that many forms are not state specific on the Internet. Therefore, when using forms from the Internet, be sure to adapt them not only to the client's needs but also to the law of the applicable jurisdiction.

It is also important for the attorney to discuss any legal ramifications that might arise from the contract provisions and to assist the client in understanding the scope of the contract. When these legal consequences are not discussed with the client and problems later arise, the attorney may inadvertently end up in a compromising situation. It is important that both attorney and paralegal be as honest as possible with respect to the legal effect of the contract by explaining the client's various options for the contract.

Knowing what the client wants and expects can minimize contract drafting problems. The initial step for effective drafting is communication and openness with the client. But a word of caution, remember that you are the paralegal and not the attorney. There are limitations as to what you can and cannot do on behalf of the client.

Strictly Speaking: Ethics and the Legal Professional

Attorneys can render legal advice and paralegals cannot. It is as simple as that. The laws of professional responsibility prohibit "nonlawyers" from rendering legal advice, and either the attorney or nonlawyer or both could run the risk of sanctions from a court or bar association by violating this rule. Sometimes rendering legal advice and simply providing information is a delicate balance where you may be navigating a fine line. The more experienced you become, the more you sound like a lawyer and run the risk of providing legal advice. The best approach to not violating this rule is to suggest to the client that "you will have your supervising attorney contact them with the responses to their questions" if they involve legal advice. You may know the answer, but you never want to be placed in the position where a client acts on "your advice" in a business or contractual transaction. Frustrating as this may seem, it is better to be safe than sorry. Or, it is better to not risk ethical violations and tactfully and professionally decline to provide the legal advice. Clients no doubt want responses to their questions "now" and may attempt to push you into areas outside of your comfort zone or worse yet push you into violating codes of ethics. Do not let it happen. Be firm, but professional in your response and dealings with clients. Know the ethical limits as well as your own.

17.2 DEVELOP A PLAN OF ORGANIZATION

Once both attorney and paralegal understand the client's needs, the paralegal may assist in outlining the general terms to be included in the contract. This does not necessarily mean preparing a formal outline; often the task is simply to gather general notes of guidance

to ensure that all the client's needs are covered. However, it is probably a good idea, for a more complicated project, to prepare a formal outline to use as a guide in drafting. By outlining, the paralegal can set out the basic components of the contract and minimize unintentional omissions and errors. A well-structured outline can be invaluable when the contract is complex. Your outline should focus on the following points:

1. The purpose
2. The parties
3. The subject matter of the agreement
4. The terms of the agreement
5. The statutory or legal requirements
6. The legal ramifications of the agreement
7. The effective date

After these general points have been set forth and applied to the client's particular needs, some general structural considerations of the instrument must be dealt with. You will normally have general provisions at the beginning of your document, followed by any special provisions between the parties. Here is a good list to follow for contract organization:

1. Title, if any
2. Statement of purpose or policy, if any
3. Definitions
4. Statement as to whom or to what the instrument applies
5. Most significant general provisions and special provisions
6. Subordinate provisions and exceptions (usually these are important enough to be stated in a separate section)
7. Default provisions, if any
8. Specific provisions relating to amendments
9. Severability clauses, if any
10. Expiration date, if any
11. Effective date, if different from the date of execution

This checklist for organization will help you avoid missing any important sections.

Once you have made your checklist, the next step is to organize the provisions in a logical sequence. For example, you would not want a definitions section in the middle of the document and termination provisions at the beginning. Logical development and presentation of the contract are important. Consequently, think about the importance and use of each section and where it should logically be placed in the contract.

form
A printed instrument with blank spaces for the insertion of such details as may be required to make it a complete document

17.3 CHOOSE A MODEL OR FORM

As much as attorneys would like to take credit for all the elegant and seemingly perfect language in a contract, it is well known that most attorneys and paralegals use *models* or **forms** to assist them in drafting. Many of us, without a model or form, would be lost in even beginning the task of drafting. Consequently, the first thing a paralegal should do in

preparing to draft a contract is locate any models or samples that the attorney may have drafted dealing with a situation similar to the present assignment. Models and samples may be drawn from old client files, and many offices also compile generic form banks, in both electronic and hard copy form, containing examples of the different documents a law firm has drafted. Using models and samples will prevent the waste of valuable time.

template
Generic form of a document

Most law firms have **templates** of standard documents. A template is a generic form of document. The document is then drafted with the specific needs of the client's transaction. Usually the template contains blanks where required information is inserted into the document. For example, if you are preparing a simple purchase and sale agreement of a car, the template would include blanks for the name of the seller and buyer, the model of the car, vehicle identification number, year of the car, price and maybe the mileage. The template may even provide for terms of payment. These sections would be completed based upon the client's terms, creating a specific document for the client. Remember that a template does not necessarily mean that all the blanks must be filled in, as each transaction is different. Here, you must be flexible and knowing the terms of the client's transaction is critical to the preparation of the document.

The paralegal may also want to find some examples that are found either in hardbound volumes or as electronic versions, also known as *forms* or *form books.* Forms or form book have many samples of documents containing what are considered standard provisions, together with general structural guidance for arranging such documents. Often these forms have blanks to be filled in, but form contracts should always be modified to meet the specific needs of the client, just like a template. Remember that these form books are only a guide; they are not carved in stone, but rather are designed to be flexible, so that they can be modified and adapted to any particular client's needs. Form books do, however, give the paralegal a good starting point and a good basis for assisting the attorney in drafting the contract to suit a specific client's objectives and needs.

Virtually all states have their own form books that reflect state law requirements. First examine your state-specific form books before venturing into general form books, which may not comply with your state's regulations for the particular transaction that you are to reduce to writing. Form books, whether general or state specific, can be found in hard copy and electronic form. Do not think that referring to a form is "cheating" or an underhanded, dishonest method of drafting a contract. All attorneys use forms to draft contracts and most other legal documents. Do not, however, get caught in the trap of using wording from form books or models that do not pertain to your client's needs. Your attorney and the form book authors intended that the model forms would be tailored to specific needs. Such samples were never meant to be used solely in their present forms. In fact, courts have admonished attorneys for relying too heavily on forms and form books in drafting document.

The case of *Clement v. Public Service Electric and Gas Co.,* 198 F.R.D. 634 (D.N.J. 2001) should be called "don't blame it on the form book." Even thought this case deals with the professional and ethical obligations of an attorney who files a pleading, one of the universal lessons of this case is forms should not be copied—they should be adapted to the facts and circumstances relating to the client's issues.

Cybercises

Using www.google docs.com find a template of a simple sales transaction and adapt it to the following transaction: Rudy Gomez wants to sell his bicycle. He's an avid biker and wants to buy a more advanced bike. His present bike is a Greg LeMans Croix de Fer. His friend, Mac Elliott is looking to begin biking and Rudy's bike is perfect. They agree on the price of $1,000. The bike is "as is" with no warranties—it's used. Prepare the sales document between Rudy and Mac.

Line of Reasoning

In *Clement*, the attorney simply filled in the blanks in the "form" without regard to the applicability to the client's particular set of facts. In a five page opinion, the court publicly reprimanded the attorney, sanctioned her, but also forced her to attend continuing education classes on federal practice.

The facts that led to the court's admonishment were poor drafting and the failure to properly investigate the law and facts before filing a complaint in federal court. The case was a discrimination case based on retaliation. The attorney pled a portion of Title VII dealing with an "Opposition Clause." [Opposition clause prohibits an employer from retaliating against an employee who has 'opposed' any practice by the employer made unlawful under Title VII; and prohibits an employer from retaliating against an employee who has 'participated' in any manner in an investigation under Title VII. *Clement v. Public Service Electric and Gas Co.*, 122 F.Supp. 551,553 (D.N.J. 2000.)] The problem is that her client, the employee, was not employed with the Public Service Electric and Gas Co., the defendant—a key prerequisite to filing a complaint. The attorney claimed to have used form books in developing her complaint. But, what irked the court was that certain provisions in the form did not apply to the facts of the case, even though the attorney pled them. The reason behind her failure was that the statute and annotations were too long to read! The court found this explanation "mind-boggling." Here, the court was outraged with the attorney's conduct because she had not read the law nor adequately reviewed the facts of her case. Had she adequately performed her due diligence as required, she would have not only realized that certain cited provisions did not apply, but that she may not have had a case at all. As the court explained in a stinging comment:

> [The attorney] copied a form complaint out of a practice manual without regard to the facts and law applicable to this case. Attorneys who merely copy form complaints and file them in this Court without conducting independent legal research and examining the facts giving rise to a potential claim do so at their peril. Lawyers are not automatons. They are trained professionals who are expected to exercise independent judgment.

This case is an excellent example of what not to do when practicing law and is a good lesson for us all. Form books and models are guides and should be modified according to the client's facts and circumstances.

Questions for Analysis

Review the *Clement* case. Was the judge fair in his analysis of the attorney's conduct? What could the attorney have done to change her fate? What rules of professional responsibility and ethics are cited in the case?

17.4 LANGUAGE IN THE CONTRACT

legalese
Legal or archaic language

Lawyers are notorious for using complicated, confusing, and unintelligible language in drafting documents. This **legalese** is unnecessarily complex and sometimes uses archaic language, such as "henceforth," "herewith," and "hereinabove." Legalese also refers to the stilted or overly formal construction of sentences, such as:

> The said party is intending to purchase the said property hereforth.

Cybercises

Determine whether your state has adopted a "Plain English" law. If it has, compare the requirements in your state to other jurisdictions that have passed a similar law. If your state has not passed a "Plain English" law, compare two states that have and identify some of the differences in the statutes. Find examples of "Plain English" consumer contracts.

This sentence is awful! It says almost nothing and does so in a needlessly complex, obscure way.

Some legal professionals nevertheless persist in using such language and construction. This habit is based partly on tradition; in very old English law, certain specific wording had to appear in a document for it to have legal effect. Those who did not use the proper "magic" phrases often lost, regardless of intent or equity.

Fortunately, such formalistic law has evolved to reflect modern attitudes and needs, and today a new method of contract drafting, known as the "plain English" movement, is gaining momentum and attention. Writing in plain English requires contract drafters to replace complex, incomprehensible legalese with simple, straightforward, understandable language.

In keeping with this trend, a number of states require that consumer contracts be written in plain English. Many states, New York, Connecticut, New Jersey, and Massachusetts among them, have passed legislation requiring that legal documents be simplified to eliminate consumer confusion as to meaning. Whether or not the states have accomplished their goals, they are at least proceeding in the right direction. Requiring that contracts be readable and understandable is important to eliminating some types of unconscionability.

Unfortunately, many lawyers do not use the plain English approach and still write with technical language, convoluted sentence structure, and formal tone. When drafting, try to keep in mind that the persons who will read the contract may not be schooled in law, and may not understand the terms of the agreement if the contract is poorly drafted. Therefore, it is good practice to write in language that is understandable and straightforward. It may prevent later legal disputes.

17.5 WORD CHOICE: LESS IS MORE

Words are an important component of any contract and should be chosen with care. Many people still believe that the more complicated the word, the more legal-sounding it becomes. This is clearly wrong. Legal terms often cannot be avoided; however, they can be used so that they can be understood within the context of the sentence in which they appear. It is not necessary to use a formal legal term when a simple word will suffice. Exhibit 17-1 contains examples of straightforward terms to substitute for traditional legalese.

EXHIBIT 17-1

Substitute terms for legalese

Term	Substitute Term
Assist or assistance	Help
Endeavor	Try
Forthwith	Immediately
Institute	Begin or Start
Subsequent or subsequently	Later
Utilize	Use

These are just a few examples of how a simple word can be substituted for a technical term.

Remember, though, legal words sometimes have specific and necessary meanings and that any substitute may change the meaning of the sentence or document. Such words are known as **terms of art**. When a word is used as a term of art, it should not be changed, but perhaps it should be explained in the context in which it is used or a definitions section. The following are some frequently used terms of art:

term of art
Technical words are words or expressions that have a particular meaning in a particular science or profession

life estate	laches	duces tecum
quiet title	sua sponte	habeas corpus
domicile		

Other words that should be avoided as "legal gobbledygook" are very formal words that have little or no legal significance or are really only an affectation. The following words can almost always be avoided without consequence:

abovementioned	aforementioned	aforesaid	henceforth
hereinafter	hereunto	said	thereunto
wheresoever	whosoever	within-named	

Another bad habit legal professionals have is using two words when one is sufficient. The use of such words is redundant and can be avoided without changing the meaning of the document. Common redundancies in legal drafting include:

assumes and agrees	bind and obligate
for and in behalf of	each and every
kind and character	due and owing

Again, these word combinations are commonly seen in legal documents, but they really should be replaced by single words when drafting. By paying attention to these combinations, redundancy can be eliminated and the contract made easier to understand. A word of caution, however, when words appear to be redundant in a document, be sure the terms you are eliminating or changing are not considered "terms of art" in the contract or document you are preparing.

Ambiguity

When writing, be sure your intent is being conveyed clearly. *Say what you mean.* Vague or unclear phrases and words create *ambiguity*, which means that a reader can interpret the sentence or word in more than one way. Ambiguous writing lacks clarity and precision and results in confusion. Precise writing is important, especially when drafting contracts. If a person is to assume an obligation, say so. Do not dance around the subject with words that create uncertainty. Ambiguous drafting may even result in a lawsuit, which would have been unnecessary had the contract been more carefully drafted.

Payroll Advance, Inc. v. Yates, 270 S.W. 3d 428 (Mo. Ct. App. 2008). This case involves the application of a noncompetition clause. The central question was how the words in the noncompete were to be interpreted. Essentially, the case hinged on the drafting issues.

Line of Reasoning

The facts in *Payroll Advance* are straight forward. Barbara Yates was hired in June, 1998 as a manager for one of Payroll's offices. [It appears that Yates worked at the Kennett, Missouri branch. Payroll Advance loans money to customers on a short-term basis at a higher interest rate than a bank.] In November, 1999, Yates signed an employment agreement that contained a noncompete clause. The clause stated:

> Employee [Yates] agrees not to compete with Employer [Payroll Advance] as owner, manager, partner, stockholder, or employee *in any business that is in competition* with Employer and within a 50 mile radius of Employer's business for a period of two (2) years after termination of employment or Employee quits or Employee leaves employment of Employer.

Yates ceased working for Payroll Advance on November 8, 2007. [She was fired for cause.] Around 32 days later, Yates was hired by Check Please, a competitor of Payroll Advance. Yates performed the same basic responsibilities as she had at Payroll, which included managing the office and customer care.

Less than three months later, Payroll Advanced filed a lawsuit for injunctive relief requesting that Yates be prevented from soliciting former clients and using its client information to assist her new employer. The lawsuit also included a breach of contract claim for damages. At trial, the testimony established that Yates did not take any client information with her. But, more importantly, the trial testimony established that because of the language in the noncompete, which forbid Yates from seeking employment within a 50 mile radius from any business that is in competition with Payroll, the provision effectively prohibited Yates from seeking employment within three states—Missouri, Arkansas, and Tennessee. And, the language of the noncompete "arguably" prohibited Yates from working at a "bank, saving and loan company, credit union, pawn shop, or title-loan company" within a 50-mile radius of any Payroll Advance location. Thus, the trial court found the noncompete to be unenforceable as unreasonable.

The Appeals Court focused on the enforceability of the noncompete clause and whether it was "reasonable as to time and space [scope]" under Missouri law. The court cited the general legal stance accepted by most courts that noncompete agreements cannot be "more restrictive than is necessary to protect the legitimate interests of the employer." A noncompete must be "narrowly tailored geographically and temporally" for the restriction to be enforced. In its analysis, the court examined another case that had a "50-mile" restriction, but pointed out that each case must be evaluated individually, examining the language of the clause in question for compliance with the "reasonable" standards. The court also added that the noncompete clause cannot be "greater than fairly required for protection" of its business. Protection of a business interest weighed against punishing an employee is the essence of the law. As the court aptly stressed:

> Here, the covenant not to compete grandly declares that Respondent cannot "compete with [Appellant] as owner, manager, partner, stockholder, or employee *in any business* that is in competition with [Appellant] and within a 50 mile radius of [Appellant's] business. . . ." (Emphasis added.) There was evidence from Appellant's representative at trial that Appellant has seventeen branch offices in Missouri and still other locations in Arkansas. If this Court interprets the plain meaning of the covenant not compete as written, the covenant not to compete would prevent

> Respondent not only from working at a competing business within 50 miles of the branch office in Kennett, Missouri, but Respondent would also be barred from working in a competing business within 50 miles of *any* of Appellant's branch offices. Under this interpretation, Respondent would be greatly limited in the geographic area she could work.

Continuing with its analysis, the Court criticized the drafting of the noncompete because "it fails to set out with precision what is to be considered a competing business and certainly does not specify that it only applies to other payday loan businesses." Effectively, the noncompete barred Yates from working at "any business that is in competition with" [Payroll Advance.] Thus, because of the language of the noncompete and how it was drafted, the provision was deemed "unduly burdensome and unreasonable." The court struck down the provision and found for Yates.

Questions for Analysis

Review *Payroll Advance v. Yates*. How could the noncompete clause be redrafted so that it is enforceable? Was the language in the noncompete ambiguous? Why or why not?

Clearly, *Payroll Advance v. Yates* is an example of the importance of precision in drafting language. Each word counts and, as Payroll Advance learned, has legal effect that may not have favorable results.

State Your Case

Karl Solis works for a company that manufactures the barrels used in the wine fermenting process. After working for International Vintners for 8 years, he decides to start his own company. At the time of his original hire with International, Karl signed an employment contract that included a noncompetition agreement. The clause stated that:

> Employee cannot seek employment in the wine industry for one year after ceasing employment with Employer in the states of California and Washington.

Karl's new company advises winemakers on the best fermenting processes to use based upon the type of wine they are creating. Karl believes that Organic Products of California, a competitor of International, makes a better product than his former employer. He contacts Berlinger and Gallion wineries to encourage them to switch their production from wood barrels to the more organic products. Before the meeting takes place, Karl is sued by International Vintners. Is the language in the contract ambiguous? Is the contract enforceable? If not, redraft the provision so that its enforceability in California is less likely to be challenged? As drafted, is the noncompetition enforceable against Karl, who resides in the state of California? Why or why not?

Contractions

In formal writing, contractions are inappropriate. Although use of a contraction may seem more familiar, legal drafting has not reached the point where the informality of contractions is acceptable. Stay away from them.

Neutralizing Terminology: Bias-Free Writing

The use of the word *he,* although traditionally neutral, is now considered sexist. Using *he* to refer generally to a person such as a lawyer, judge, or doctor is seen as reinforcing gender-specific stereotypes. Therefore, to avoid inappropriate or offensive pronouns, try one of these methods: (1) pluralize; (2) use "he or she"; (3) specify.

Using the plural form avoids any gender-specific references. For example:

Biased: Before a judge signs an order, he reviews it.

Neutral: Before judges sign orders, they review them.

An alternative to pluralizing is using the construction "he or she." Some object to the awkwardness of this phrasing, but it is currently widely accepted and used.

A better option, particularly when drafting a contract, is to specify. If a party to the contract is a male, *he* is perfectly acceptable. A group or corporation has no gender, so use short references such as "the Company," "ABC Co.," or simply "it." Such specificity often avoids not only biased writing but also ambiguity.

17.6 GRAMMATICAL STRUCTURE IN THE CONTRACT

When the word *grammar* is mentioned, we tend to think of the grade-school horrors we suffered when the subject was introduced. But proper grammar is a necessary component of drafting any documents, including contracts. Proper sentence structure, verb tense, and punctuation are critical, so a brief review of some general grammar points is necessary.

Sentence Structure

The nucleus of any legal document is the sentences created by the writer. Sentences are the lifeline of communication. They are built from the basic subject, verb, and object format. Recall that the subject is the actor, the verb is the action, and the object is the recipient or focus of the action. Keep subject and verb close together for clarity. Too many words confuse the reader and cause ambiguity problems. However, when writing, do not use only the subject/verb/object construction. Words can also modify or explain. Such words are *adjectives* and *adverbs.* More complex sentence construction employs clauses to describe the subject of the sentence or create compound sentences. The choice is yours as long as your communication is clear.

Voice and Tense

Related to sentence structure is the verb tense or *voice.* The general rule is to write in the active voice rather than the passive voice. To maintain the active voice, have

the subject of the sentence do the action, rather than receive the action. Ask who did what, rather than what was done by whom. Attorneys have a tendency to write in the passive voice—a difficult habit to break. Determine what type of document you are drafting and often times that will dictate the voice or tense you use or will be using! Exhibit 17-2 provides illustrations.

EXHIBIT 17-2 Active versus passive voice

Active Voice	Passive Voice
The court decided to rule.	The decision to rule was made by the court.
The defendant presented the evidence	The evidence was presented by the defendant
The jury deliberated the fate of the defendant.	The fate of the defendant was deliberated by the jury.

Parallel Construction

Another grammatical rule that we all have violated at one time or another is the requirement of parallel construction. When making a list of items, the following occurs:

> Today I ran to the court, started finishing final drafts, and began to draft a new lawsuit.

This example lacks parallelism because the verbs are all in different tenses. To have parallel structure, the sentence should read:

> Today I ran to the court, finished final drafts, and drafted a new lawsuit.

All the verbs are in the same tense—they are parallel. Adhere to parallel structures in your drafting, especially when creating lists.

Run-On Sentences and Sentence Fragments

Run-on sentences have too many components, whereas a sentence fragment has too few. Although long sentences can be grammatically correct, they tend to be difficult to follow. If a sentence goes on for four or five lines, break it into two. It will be clearer and less likely to contain grammatical errors. A fragment, in contrast, does not complete a thought. The omission and imprecision usually result in an ambiguity.

Punctuation

Knowing how to use and where to place commas, semicolons, and other punctuation marks is critical to drafting any contract or other legal document.

Commas. A comma is one of the most important tools of punctuation. Commas are used to separate thoughts, create pauses, and set off a series or transitional phrase. Some basic rules for the use of commas are:

1. In a series of three or more terms, use a comma after each term except the last.
2. Use a comma before a conjunction such as *because, while,* or *since.*
3. Use a comma to set off a transitional word or phrase, such as *therefore, however, consequently,* or *furthermore.*
4. Commas should precede and follow abbreviations such as *Esq., Jr.,* and the like.
5. A comma should precede abbreviations such as *Ltd., Co.,* and *Inc.*

Apostrophes. The apostrophe is used to show possessives and contractions. When showing a possessive for a singular noun, add an apostrophe followed by an *s.* Although there are some exceptions with plural names (see the following examples), the general rule is simply to add an apostrophe.

EXAMPLE: Mr. Browns attitude has changed toward me. (incorrect)
Mr. Brown's attitude has changed toward me. (correct)

EXAMPLE: The Harris's are moving to Arizona in two week's. (incorrect)
The Harrises are moving to Arizona in two weeks. (correct)

The apostrophe is also used in contractions, to take the place of omitted letters. In formal legal writing, contractions should not be used. However, the most notable error is committed with the contraction *it's.* Too many students confuse the possessive pronoun *its* with the contraction *it's* (it is). The best way to avoid this embarrassing error is to try substituting "it is" in the sentence where *its* or *it's* is used. If the sentence makes no sense when you substitute "it is," then you use the possessive pronoun—omit the apostrophe. For example, look at the sentence: "The court abused its discretion." If the contraction *it's* were used, the sentence would read, "The court abused it is [it's] discretion," Now that sentence makes no sense. Therefore, no apostrophe should be used.

Semicolons. Semicolons are often used to join the clauses of a *compound sentence.* If two sentences could stand alone but are related, a semicolon can be used.

Colons. Colons are used to introduce information, such as an explanation, list, or quotation. Words like "the following" or "as follows" usually take a colon preceding the next text item.

Parentheses. Parentheses are used to set off an explanation or comment that refers to but is not part of the preceding sentence. Parentheses are also used to introduce acronyms or shortened references for a name or position.

Hyphens. Hyphens are used to connect two words to form a single word. In some terms which once were hyphenated, the hyphen is now eliminated. Check a dictionary to determine appropriate modern practice.

Big Nate: © Newspaper Enterprise Association, Inc.

Stay away from using hyphens with the prefixes *anti, co, inter, multi, non, para, post, pre*, *re, semi,* and *super.* If the second word is capitalized, then a hyphen can be used.

Incorrect	Correct
Para-legal	Paralegal
Post-mortem	Postmortem
Semi-annual	Semiannual
Multi-purpose	Multipurpose

Capitalization. Another common problem in writing is when to capitalize a word. The obvious ones we all know, such as proper names, street addresses, cities, and the days of the week. But there are times when we are not sure whether to capitalize a name or word. You should:

1. Capitalize names of governmental bodies when referring to a specific unit by its full name.
2. Capitalize counties and administrative divisions.
3. Capitalize words used in association with a governmental act.

Brady Bill	Senate Resolution 4321
the Freedom of Information Act	the Warren Commission Report

Although *U.S. v. Snider,* 976 F.2d 1249 (9th Cir. 1992) was a criminal appeal, a footnote in the case illustrates why proper drafting is not only important but also reflective of your professionalism.

Line of Reasoning

Apparently, both the appellant and appellee used novel ways of highlighting what they considered important points in their briefs to the court in *U.S. v. Snider*. Perhaps the court interpreted the presentation as demeaning to the court because in a very stinging footnote, the Court stated:

> We do not (except in the caption) follow the appellant's counsel's interesting practice of writing the names of the people involved in CAPITAL LETTERS. Neither do we follow the appellee's counsel's practice of writing appellant's name in **BOLD-FACED CAPITAL LETTERS.** Nor do we intend to write all numbers both as text and numerals, as in "eleven (11) loose teeth, two (2) of which were shattered[;] [m]oreover, her jaw was broken in three (3) places." Appellee's Brief at 7. Finally, we will also not
>
> "set off important text"
>
> by putting it on
>
> "separate lines"
>
> and enclosing it in
>
> "quotation marks."
>
> *See, Id.* at 10. While we realize counsel had only our welfare in mind in engaging in these creative practices, we assure them that we would have paid no less attention to their briefs had they been more conventionally written.

The court's quote is an important lesson in drafting and the repercussions deviating from the accepted rules of the court and proper grammar rules have. Important to the court's message is that presentation counts; tone counts; and proper rules of writing style count. The court's words should be heeded in drafting a contract.

Questions for Analysis

Review U.S. v. Snider. Did the court's annoyance with the parties affect the court's result? Why or why not? From the court's quote, on what rules of legal writing was the court admonishing the parties? What are the correct rules for citing quotations, referring to numbers and identifying parties in a document?

TECH CHECK

Computer Assisted Grammar Checks

Most of us use computers when writing. We all know that as we tap those keys on the keyboard those inevitable "squiggly green and red lines" appear under a word or group of words. Usually it is telling us something is wrong with a word, a phrase or a sentence. Here is the deal. The green and red squiggly lines are NOT always right. Yes, sometimes the suggested correction is wrong. That is not to say that a spell or grammar check is not essential in your routine in preparing any document,

because you should perform a check. What is important is that the check does not pick up everything, especially if a word is accidentally omitted or a word is typed correctly but is not what you had intended to type. For example, an attorney typed the following in his brief to the court: Exercise of the courts pendent jurisdiction is with the descration of the court." What the attorney (hopefully) meant to say was: "Exercise of the *court's* pendant jurisdiction is *within* the *discretion* of the court." Pay close attention to the suggested changes in a spelling or grammar check and make sure it is what you want. Sometimes errors are difficult to catch and that is why is important not to rely solely on a computer generated spelling and grammar check when reviewing your work. Spelling deviations, especially in the legal professional, are not in a computer's dictionary, so be mindful that even when a word is underlined as incorrect—according to the computer program—it may in fact be correctly used. The word "unconscionability" is constantly underlined as incorrect, but it is correctly spelled. Additionally, some of the suggested changes are also not correct. For example, in this chapter, the term "nonlawyer" was used and [again] the red squiggly line appeared. The computer wants to hyphenate the word non-lawyer [and yes, the red line disappeared] but that is not correct. When in doubt about a word or phrase change that the computer is giving you, check with a supervisor or colleague to determine the correct usage of the word or spelling when it becomes a concern or check a legal dictionary for guidance. Having said all this, a spelling and grammar check is absolutely necessary when placing the final touches on a document. For the times when the computer is incorrect, it captures many basic errors in grammar and sentence construction that are easily revised and are too often subtle "misses" that in all of our haste we simply overlook.

Cybercises

Locate three legal documents on the Internet that can be drafted and edited to convey more precisely and more clearly the legal concepts contained within the documents. Sites such as www.findlaw.com have an abundance of documents to assist in this task.

17.7 EDITING AND REWRITING

Editing is an element of drafting any document. It is important to critically evaluate your work to make it better. Editing often requires rewriting. Sections of the contract may have to be reworked, rewritten, and changed before the draft can be finalized. Many of us, in high school or college, typed papers, and it never entered our minds to change a word or modify any part of a first draft [and oftentimes final draft]. Your thinking needs to change. Editing and revising are crucial parts of the drafting process. It is virtually impossible for any legal document to be prepared in one draft, and may require three, four, or more drafts. Ask any paralegal currently in the profession how many times they or their attorney drafts a document. The responses may surprise you!

When editing, look for substantive accuracy and errors in grammar, punctuation, spelling, and sentence structure. Also be sure that your language is clear, precise, and, most importantly, understandable. Ensure that all the headings and subheadings flow logically and that each numbered section is in sequential order. When appropriate, use plain English; unless you are using terms of art that cannot be changed, stay away from

legalese. Use the active voice whenever possible, and be consistent with verb tenses. Most importantly, when you are editing, *edit!* Cut out language that is unnecessary; be as precise and concise in your presentation as possible. Editing and rewriting must be taken seriously and accounted for in the time allotted to a project. Unlike high school or college, you will prepare more than one draft of a document. Editing and rewriting simply make the document better and this is what you are striving for.

17.8 PRACTICAL APPLICATION

There are no hard and fast rules to follow when drafting a contract, but following certain steps helps. Here is a checklist:

1. Write down the client's goals and objectives
2. Prepare a detailed outline
3. Find a template, form, or model to follow
4. Review the template, form, or model and modify it to satisfy the client's needs
5. Review the template, form, or model for legalese; eliminate it if possible
6. Explain or define terms of art and legal terms
7. Avoid awkward construction
8. Check for proper grammar
9. Check for punctuation
10. Edit
11. Review
12. Re-edit
13. Submit final product for review by attorney.

If these steps are followed, the paralegal's task will be accomplished with more ease and precision.

SUMMARY

17.1 In drafting a contract, it is important to determine the client's needs. Seek out all the pertinent information to complete the contract. This may include doing some research. Creating a checklist is helpful to be sure all necessary points are covered in the contract.

17.2 Proper organization is critical to any contract. In more complicated transactions, a detailed outline may be appropriate, with specific provisions set forth. After you have created the outline, organize the provisions in a logical order.

17.3 Often a paralegal will use a guide to draft a contract. The best legal guides are form books or models. Both models and forms should be adapted to the needs of the current client. Be flexible in using forms or models.

17.4 Legal jargon is known as legalese. Avoid legalese if plain English can be used. Plain English is more understandable and is mandated in some states for consumer contracts.

17.5 Choose words carefully when drafting a contract. Stay away from formal legal words when simple ones will suffice. When a legal word has to be used, such as a term of art, try to explain its meaning in the context in which it is used. Also, avoid using redundant word combinations when one word will communicate your intention. Watch for ambiguity and sexist or biased writing, and avoid the use of contractions in contract drafting.

17.6 Sentences should be created so that they are understandable. Most sentences are built from the subject/verb/object format. Watch for nonparallel construction and run-on or fragmented sentences. In addition, pay close attention to punctuation and capitalization.

17.7 Editing is part of writing. It is a necessary prerequisite in preparing any contract. When editing, look for substantive accuracy, and errors in grammar, punctuation, spelling, and sentence structure. Use plain English when possible, and write in the active voice.

KEY TERMS

forms legalese terms of art
template

REVIEW QUESTIONS

1. What information should a legal professional obtain from the client before drafting a contract?
2. Identify what should be included in a preliminary checklist for an employment contract.
3. List some of the points that should be considered when drafting a contract.
4. When drafting a contract, what sources can you use to assist in completing your task?
5. Define the term *legalese.*
6. What is a term of art?
7. Identify some writing traps to avoid.
8. Which tense should a paralegal write in and why?
9. Distinguish between a run-on sentence and a sentence fragment.
10. What is the most commonly misused contraction and why?

EXERCISES

1. Find a sample contract (you can use one from the Internet, a form book, a model from a lawyer's office, or even one previously used in a legal transaction). Identify all the legalese and then rewrite those provisions in plain English. Identify the "terms of art" in the document and determine whether the terms can be changed or must remain in the document. Justify your decision.

2. Determine the errors and correct the following:

   a. The court will announce it's findings in due time.
   b. Prior to the attorney presenting his argument, he began to review his notes, doing some legal research, preparing his presentation and practiced his argument.
   c. One of the tasks of a paralegal is to take proficient copius notes while in a conference and reviewing the notes with the attorney and then to assist the attorney in drafting the final product for the client's review.
   d. Finding many of the objectives impossible to achieve because of the complexity of the project.
   e. Considering the courts jurisdictional issues with the party's, the result wasn't to appaelling.
   f. With the court's desission in the matter, the party's decided to entertain mediation and Arbitration as a means of resolving and settling the case at hand before the court had another opporutnity to render and hold another disasterously bad ruling.

3. Edit the following paragraph:

   The buyer agrees purchased that certain parcel of land herein located on the northwest corner of Sycamore Street with said parcel of land being located therein the within City of Manchester, state of New Hampshire. The said stated purchase price between the specified parties having agreed at $450,000 to be paid under the following terms and conditions which is hereby acknowledged.

4. Redraft the following sentences to eliminate any grammatical errors:

   a. The attorney's are finding the President's speech informative but agree with only the parts relating to corporate accountibility.
   b. Given our short timeframe, we've indicated to the clients that proper identification of the property and performing the inspection, examination of the title is critical to meeting the time and deadlines or we won't be able to close in a timely and punctual manner as required.
   c. Whether we can make the meeting or not keeps me wondering whether our practice has grown to quickly and if we can keep up with the demands of our clients certainly is a concern.
   d. Whoever is the most important player on the world scene today regarding environmental and climate issues appears to be finding it increasingly more difficult to encourage the use of gasoline to run cars, but the hybrid is clearly the way of the future.

5. Your attorney is rushing off to a meeting and has to have an "Option to Purchase Land" prepared to present to a client first thing in the morning. She asks you to review the document and edit it, if necessary. You notice that all she gave you was a template. In the file is a description of the land which states: that certain parcel of land located at 835 S. Bridle Road, Jackson, Wyoming consisting of 15.34 acres of undeveloped land. The file also contains the terms which is a down payment of $24,000 upon signing

the Option and $275,000 at closing. The client's name on the file is WHM Developers. They are the purchasers. The seller's are Mary and William Johnson. Find examples of an Option to Purchase Land and draft the document based upon the facts presented.

6. Your state has just adopted legislation that requires that all contracts be in plain English.

   Redraft the following contractual provisions so that they are in plain English.

   a. Each party hereby and forever grants, bargains, sells and conveys all of its right, title and interest in that certain property, real property, and personal property, which each presently owns with the clear and present intent to convey and vest in the other upon the surviving party's death.
   b. This contract constitutes the entire agreement between the parties concerned relating to the subject matter contained herein and supersedes all prior and contemporaneous representations, agreements, communications, or understandings between the parties to this contract.
   c. The parties hereto hereby forever release and discharge each other from any cause of action, known or unknown herein, arising from or related to that certain agreement between the parties.
   d. This contract and agreement shall be binding upon and inure to the benefit of each of the parties thereto, their heirs, executors, administrators, or assigns.

7. As a paralegal, you decide that you want to draft your prenuptial agreement. You believe that you do not need an attorney. Locate examples, from any source, of a prenuptial agreement and prepare an agreement based upon your jurisdiction requirements. Be as creative as you like.

8. Your best friend is getting married and knows that you are going to become a paralegal. You told her you were drafting yourself a prenuptial agreement. She thinks that's a great idea and asks if you could draft hers, too. Based upon your jurisdiction's professional responsibility requirements, can you draft an agreement for your friend? Would your response change if you agreed not to charge your friend a fee for the agreement? Explain your response.

9. Christine and Darcy are best friends. Christine has three laptop computers and offers to lease one of them to Darcy. The computer is a Dell Inspiron Computer 1502. Christine wants Darcy to pay $50.00 a month for one year. At the end of the term, Darcy can buy the computer for $200.00, if she wants. Prepare a simple lease installment contract between Christine and Darcy.

10. Hank Benson is an avid seller on sites like eBay. He needs a simple sales contract for the goods he sells on the sites. He is concerned about getting sued and wants to sell all products as they are with no warranties. Hank has hired your firm to draft the sales agreement and your supervising attorney wants you to prepare two drafts of contracts for her review. Prepare the sales contracts. Are there any facts that you need to know to adequately prepare the draft documents? If so, prepare a list of questions you would need answers to in preparing the documents.

CASE ASSIGNMENTS

1. A meeting has just ended where your supervising attorney asked you take notes. You prepared a summation with the following information:

   a. Client: Mitchell Marks Construction: Owner and contact Mitchell Marks.
   b. Won bid for construction of new amphitheater.
   c. Location: 87400 East Stadium Blvd., Philadelphia, Pennsylvania.
   d. Terms of contract: total price $750,000; one year; start date: May 15, 2010; completion date: May 14, 2011; liquidated damages in the amount of $500 a day.
   e. Special terms: Specs in accordance with architects design; solar panels; use green products where possible.
   f. Needs draft contract.
   g. Prepare letter confirming the representation and draft firm retainer agreement.
   h. Retainer agreement: Hourly: attorney $350; Associates: $200; paralegal $90.
   i. Retainer: $25,000.

   Your attorney's executive assistant prepares the following draft letter based upon the attorney's notes:

Dear Mr. Mitchell:

Congratulations on winning the bid for our city's need convention center. We know that it will be a great addition to the area. We also welcome representing you in this matter. You have requested that we prepare a construction contract of the center for submission to the city. The site is located at 8740 W. Stadium Blvd. in Philadelphia. I am concerned about the liquidating damages clause, but no that you have already agreed to this term with the city.

Before we can begin assisting you, we require that you sign the Retainer Agreement setting forth our representation of your firm. Please review the document carefully and if you have any questions, please do not hesitate to contact me or my paralegal Ken Barton.

Sincerely,

D. Leslie Greenley

Leslie signed the document without reading it, but you decided to review it one more time before sending it out. When you review the letter you believe that there are some substantive mistakes. You immediately contact Leslie who tells you to redraft the letter and prepare a draft of a retainer agreement to enclose with the letter. Prepare the new letter and retainer agreement for your attorney's review.

2. After Mr. Marks receives the letter and retainer, he contacts you about the status of the construction contract draft. (He still has not signed the retainer agreement.) He really needs it today. Mitch was asking a lot of questions about the liquidated damages clause and was wondering whether he should renegotiate that term. He also wanted you to draft a quick sales agreement for the sale of his 2007 Honda Civic. He found a college student, Elisabeth Downing who goes to Penn, who wants to buy it. You tell Mitch that you will have to discuss it with Leslie first. He insists you draft the document or he will reconsider have Leslie represent him. How should you best handle the situation and what course of action should you take? Discuss all issues.

Chapter 18

Drafting a Contract: Specific Provisions

Just Suppose . . .

A new client, Rick Santos, has just arrived for the initial meeting with your law firm. Apparently, the client owns a DVD rental business that has been up for sale for about 8 months. Finally, Rick received an offer he can live with. But, he needs to get a contract prepared ASAP because the new buyer wants to close in two weeks. Your attorney is heading to a professional development conference in Las Vegas tomorrow. He does not have the time to prepare a draft and asks you to help out. He has supplied you with some examples and suggested that you look at your state's form books. After reviewing some of the forms, you develop a draft that includes a noncompetition clause which prohibits your client from setting up a competing DVD store within 50 miles of the existing store—that is what the form suggested. You e-mail the draft to your supervising attorney who does a cursory review and sends it by e-mail to the client. Rick reviews the contract and sees the noncompetition clause and becomes furious. He wants to know who you are representing—the buyer or him! He stated that he did not want a noncompete clause in the contract, but you were only following the form.

Outline

Crafting documents that reflect the needs of a client is important. Form examples are excellent guides, but contracts must be drafted to conform to a client's needs and not the wholesale recommendations of a form. This chapter will examine the importance of drafting specific types of contracts and some of the language associated with them in preparing a contract. Always be mindful that each client's needs are different, which means that each contract document will be a reflection of a client's specific requirements.

The previous chapter focused on drafting considerations, such as language, grammar, and editing. This chapter will take those considerations and set them into action by identifying what basic provisions should be contained in a contract. The suggested provisions in this chapter are not exhaustive, but do provide a solid foundation for understanding what provisions to include or look for when preparing, reviewing, or analyzing a contract.

18.1 THE GENERAL CONTRACTUAL AGREEMENT

Certain provisions are commonly included in a final contract. These provisions include identification of the parties, definition of terms, representations, conditions, duration, termination, payment, guarantees and indemnities, limitations of liability, time of the essence, liquidated damages, restrictive covenants, arbitration, release of liability, merger or integration, choice of governing law, choice of forum, assignability, and notice. Not all these provisions are included in all contracts. However, you will see many of these provisions in more complex contracts and thus, it is important to, at least, have a basic familiarity with some of the standard provisions found in many contracts. The provisions discussed in this chapter are intended to give the paralegal guidance as to some of the basic provisions to consider when drafting a contract.

Introductory Paragraph and Identity of the Parties

The introductory paragraph identifies the correct names and capacities of the persons or entities that are parties to the contract. This section is important for a number of reasons. First, the obvious reason is that you want to identify the parties involved in the contract. Second, an individual party in a contract has different liability than, for example, a corporation, and a corporate officer acting as an agent of the corporation has different liability than that same person acting as an individual. And finally, identifying the parties may affect how parties are legally identified if a dispute arises. For example, if a corporation does not indicate that it actually is a corporation in the identity section, that corporate protection may lapse or be challenged. Therefore, it is incumbent upon the paralegal to clearly identify the parties in their proper legal capacities.

After the parties are formally identified, it is often appropriate to use shorthand references for them. This is usually done in a parenthetical that identifies the parties as "seller" or "buyer," or by their last names only. An acronym is often used to shorten a long name. It is important to clearly state any shorthand name used for easy identification throughout the contract. Exhibit 18-1 gives examples of a typical introductory paragraph and party identification as used in contracts.

EXHIBIT 18-1 Sample party identifications

INTRODUCTORY PARAGRAPH

AGREEMENT made this 12th day of December, 2011, between ABC Corporation, a Delaware corporation qualified to transact business in Texas, having its principal place of business at 5560 Main Street, Harris County, Texas (hereinafter referred to as the "Company") and John Smith, residing at 4739 West Seventh Street, Fort Worth, Tarrant County, Texas (hereinafter called "Smith").

METHODS OF DESCRIBING PARTIES

Individual: Richard Rye, residing at 2200 Harrison Street, Wichita Falls, Wichita County, Texas

Sole Proprietor: Richard Rye, doing business under the assumed name of Pets Galore or as Richard Rye's Pets Galore

General or Limited Partnership: Pets Galore, Ltd., a Texas limited partnership doing business under the firm name and style of _____ or composed of _____ and _____

Corporation: Pets Galore Corp., a Texas corporation [if foreign, add: qualified to transact business in Texas]

Definitions Section

Defining terms in the contract can be important for clarity. If terms are defined, little is left open to question by the parties. Most definition sections are tailored to the specific contract, but some general words that often are defined are given in Exhibit 18-2.

EXHIBIT 18-2 Common general definitions

1. Where _____ the [word or term or phrase] _____ appears in this contract it shall be construed to mean _____.
2. Unless otherwise provided in this agreement, the word "year" shall be construed to mean a calendar year of 365 days, the word "month" shall be construed to mean a calendar month, the word "week" shall be construed to mean a calendar week of 7 days, and the word "day" shall be construed to mean a period of 24 hours running from midnight to midnight.
3. The use of the singular form of expression shall be construed to include the plural when the meaning so requires.
4. Feminine or neuter pronouns shall be substituted for those of masculine form or vice versa, and the plural shall be substituted for the single number or vice versa in any place or places in which the context may require such substitution.
5. The use of the masculine gender shall be construed to include the feminine gender.
6. The clause headings appearing in this agreement have been inserted for the purpose of convenience and ready reference. They do not purport to and shall not be deemed to define, limit, or extend the scope or intent of the clauses to which they pertain.

Representations and Conditions

Any material facts or representations that the client is relying upon to enter into the contract should be set forth in a section entitled "Representations and Conditions." This provides a basis for the parties' understanding of the contract and shows what facts they are relying upon in entering the contract. This section has important legal ramifications. For example, if issues such as fraud or misrepresentation arise, it may provide a basis for substantiating or negating those allegations.

Representations are often conditioned upon a certain event happening before final execution of the contract. If this is the case, it is important to use language to create conditions, such as those discussed in Chapter 9. Remember that terms such as *if, when, after, on condition that, provided that, subject to, unless,* and *until* suggest that an event must happen before the contract comes into effect. The language chosen for a condition can greatly affect the extent of a party's liability, whether in the past, present, or future.

Duration

The time period for which the contract will last—its *duration*—should be specifically stated so that the parties know and understand the term of the contract. Omission can pose serious problems. For example, if the contract is intended to last for only one year, then that term should be clearly stated in the contract. If this provision is left out, the length of the contract might be determined by what is "reasonable," or it could be considered terminable at the will of either party. Similarly, any provisions whereby the parties agree to extend the time of the contract should be expressly noted in the contract as well. This often occurs in lease agreements. For instance, a contract for a lease is for five years and the parties are given an option to renew or extend the lease for another period of five years.

When automatic renewals are included in a contract, it is important to determine the length of the term and how the option or automatic renewal is to be implemented. Often this can be done by one party giving notice of the decision to exercise the renewal or to not exercise the option within a certain period of time prior to the original contract's expiration. Exhibit 18-3 provides illustrations.

EXHIBIT 18-3 Sample renewal and expiration clauses

(1) Unless either party notifies the other by registered mail, at least 60 days before the expiration of this agreement, of its intention not to renew and continue the agreement, such term shall be automatically extended for a period of one year. In such event, all the terms and provisions of the agreement shall remain in full force and effect during the extension period, except that there shall be no automatic renewal after the expiration of the extension period.

(2) Unless terminated on notice, the rights and privileges granted, together with all other provisions of this contract, shall continue in full force and effect for an additional term of one year from the date of expiration, unless either party, at least 60 days prior to the date of expiration, shall notify the other party in writing that it does not desire the contract to be extended for such additional period.

Payment or Consideration

In Chapter 4, we discussed the need for consideration in all contracts. In most instances, consideration is money, but as you now know can also be an exchange of services. All contracts must have a provision for consideration or payment otherwise the contract could be unenforceable. Therefore, identifying the payment or consideration for the contract is a critical term in the drafting process. When drafting a payment or consideration provision consider the person to whom payment is due, the time due, the amount, and any conditions for payment for which the parties agreed. The terms must be clear and precise.

installment
A payment of money due, the balance of which is to be paid at other agreed-upon times

acceleration clause
A clause in a note, mortgage, or other contract that provides that the entire debt will become due if payment is not made on time or if other conditions of the agreement are not met

One typical payment method is through an **installment** contract, under which payments are made incrementally until the agreed balance is paid. If payments are missed, it is appropriate to provide an **acceleration clause** requiring immediate payment of the remaining balance together with any interest or charges due. It is also common to include a provision for opportunity to cure the default after notice, typically 10 to 45 days after notice has been sent to the person in default. Depending on how the provision is drafted, the notice period can begin either upon receipt or as of the date of the notice. This is negotiable: determine what is best for your client. When drafting installment provisions, be sure that any penalty provisions for nonpayment comply with your jurisdictions statutory requirements. Most jurisdictions have a limitation as to how much interest can be charged for a late payment. Knowing the legal standards may be the difference between an enforceable and an unenforceable provision.

Another payment consideration, which favors the debtor, is a provision that does not penalize the debtor for early payment of the amount due or prepayment of interest. Again knowing what your jurisdiction requires is important. Illustrations of payment provisions are shown in Exhibit 18-4.

EXHIBIT 18-4

Sample payment provisions

Payment Due. Contractor will pay subcontractor, on or before [date], the sum of [amount] which, at the option of subcontractor, shall be a condition precedent to the performance of the contract.

Time for Payment. Payment of [amount] under this contract shall be made at subcontractor's place of business on or before [date].

Time for Payment—Installment Payments. Contractor agrees to pay to subcontractor the sum of [amount], on or before [date], and the sum of [amount] thereafter as follows: monthly at [amount] per month until paid.

It is further agreed that in case of failure of contractor to make any of the mentioned payments, or to perform any of the mentioned covenants on such party's part to be made and performed, then subcontractor may declare this contract null and void, and all payments already made by contractor shall be retained by subcontractor; or subcontractor, on performing the covenants and agreements on such party's part to be performed, shall be entitled to recover the sums as above set forth from contractor, and all costs and expenses, as well as interest from the time the above payments shall have become due and payable.

Cybercises

Determine your jurisdiction's statutory law on interest provisions in contracts or usury laws. Are there limits to the level of interest that can be charged in a default situation? If so, what are those limits?

Performance

Closely related to payment is performance under a contract. A contract must set forth the rights and obligations of the parties with respect to the performance that is required of each of them under the contract. Specifically enumerating these obligations, not leaving anything to chance, is important to the parties' participation in the contract.

Time for Performance

In many instances, the contract will require a specific time for performance. This may be critical, as a delay in performance could be damaging to one of the parties. The best approach when the time of performance is critical is to set out any contingencies related to the performance itself. It is important to distinguish such things as strikes, earthquakes, flood, fire, and governmental regulation, which are unavoidable but may negatively affect performance, without creating liability for default. This type of provision is known as a **force majeure** clause. A force majeure excuses either performance or the time of performance due to an event which is out of control of one of the parties. When a hurricane hits a region, then it could become impossible for a party to perform because, for example, citrus crops were either flooded or destroyed. If a force majeure clause is in the contract, the affected party's liability may be relieved or excused altogether depending on the terms of the contract and the event. Standard provisions are given in Exhibit 18-5, including an example of a force majeure clause.

force majeure
A provision in a contract that excuses nonperformance because of the occurrence of an unforeseeable event, such as an act of God

EXHIBIT 18-5

Sample time of performance and force majeure clauses

Force Majeure. In the event that [party] shall be prevented from completing performance of its obligations by an act of God or any other occurrence whatsoever which is beyond the control of the parties hereto, then [party] shall be excused from any further performance of its obligations and undertakings hereunder.

OR

In the event that performance by [party] of any of its obligations or undertakings hereunder shall be interrupted or delayed by any occurrence not occasioned by the conduct of either party hereto, whether such occurrence be an act of God or the common enemy or the result of war, riot, civil commotion, sovereign conduct, or the act or conduct of any person or persons not party or privy hereto, then [party] shall be excused from such performance for such period of time as is reasonably necessary after such occurrence to remedy the effects thereof.

Termination Provisions

Certain contingencies that arise during the term of a contract often afford a party the right to end the contract. Sometimes situations simply do not work out and, therefore, the parties desire to terminate the contract. This would be a termination for convenience,

which is often contained in government contracts. This right should be stated in the contract. Typically there will be a provision allowing either party to terminate the contract upon 30 days' notice to the other party (or some other time period).

Similarly and more importantly, there are a number of events that might give rise to the right to terminate. The obvious is a breach of performance or nonperformance of one of the parties that gives rise to terminating a party's performance and the contract. Other events that can terminate performance under a contract are insolvency, bankruptcy, or death of one of the parties. There are a myriad of different provisions that set out the various contingencies for termination. These should be examined closely, as this could be one of the most important provisions of a contract. Having a clear understanding of the facts behind the contract or transaction could give rise to unique termination provisions that are specific to that contract. Here is when strictly following a model or form is not necessarily helpful. Always remember that a contract can and should be tailored to the parties' needs and facts. Do not become wedded to a form. Your attorney will guide you when deviation and specialized drafting is required. Exhibit 18-6 sets forth some drafting alternatives for standard termination provisions.

EXHIBIT 18-6 Sample termination clauses

Termination upon Notice. This agreement may be terminated by either party by giving [specify time requirement, if any, e.g., thirty (30) days] written notice thereof to the other party.

Termination for Unsatisfactory Performance. If [party to whom performance is due] at any time shall become dissatisfied with the performance of [party rendering performance] under this agreement, he or she shall have the right to terminate this agreement by giving written notice thereof to [party rendering performance].

Termination upon Happening of Event. In the event that [specify event, e.g., renewal financing is not obtained], [party] may terminate this agreement by giving notification thereof by registered or certified mail to [other party].

Termination upon Payment of Stipulated Sum. This agreement may be terminated [specify time period, e.g., at any time during the first year] by either of the parties hereto by the payment of [amount] to the other party as compensation for relinquishing its rights hereunder.

Automatic Termination. This agreement shall remain in full force and effect for a period of [time period, e.g., five (5) years], and shall terminate automatically at the end of such period unless [specify condition of renewal, e.g., (party) shall give written notice of its intention to renew the agreement for a like period to (other party), such notice to be given at least ninety (90) days prior to the expiration of such initial term].

Termination upon Failure to Cure Default. If [obligor] shall default in the performance of any of the terms or conditions of this agreement, he or she shall have [specify time period, e.g., ten (10) days] after delivery of written notice of such default within which to cure such

default. If he or she fails to cure the default within such period of time, then [obligee] shall have the right without further notice to terminate this agreement.

Termination for Default. If [obligor] defaults in the performance of this agreement or materially breaches any of its provisions, [obligee] shall have the option to terminate this agreement by giving written notification thereof by registered or certified mail to [obligor]. For the purposes hereof, the following actions shall constitute material breaches of this agreement: [specify].

Indemnification

indemnification
The act of or agreeing to pay or compensate someone for their loss

An **indemnification** clause, or "hold harmless" clause, is an essential provision that can benefit both parties. Indemnification provisions allow for reimbursement of funds, expenses, and attorney fees when there is a loss or the potential for loss. When drafting an indemnification provision, consider your objective. As a general rule, draft the clause as broadly as possible to cover any possible contingency.

indemnitor
A person who indemnifies another

If the indemnification is triggered, a party may have to expend monies in defending a lawsuit. It is prudent to include a notice provision telling the **indemnitor** that if a third party raises a claim, the indemnitor will have the opportunity to defend or participate in the defense as deemed appropriate. Some indemnity provisions are given in Exhibit 18-7.

EXHIBIT 18-7 Sample indemnity clauses

Indemnity. Indemnitor shall indemnify and save harmless indemnitee and its agents and employees from all suits, actions, or claims of any character, type, or description brought or made for or on account of any injuries or damages received or sustained by any person, persons, or property, arising out of or occasioned by the negligent acts of indemnitor or its agents or employees, in the execution or performance of this contract.

OR

[When the parties intend that the indemnification shall be unlimited]

[Indemnitee] shall not be liable or responsible for and shall be saved and held harmless by indemnitor from and against any and all claims and damages of every kind, for injury to or death of any person or persons and for damage to or loss of property, arising out of or attributed, directly or indirectly, to the operations or performance of indemnitor under this agreement.

Limitation of Liability

exculpatory clause
A clause in a contract or other legal document excusing a party from liability for his or her wrongful act

The occurrence of certain events may limit the performance of the parties to a contract. As with termination, limitations of liability are often found in force majeure clauses.

To provide complete limitation and exoneration from unforeseen events, an **exculpatory clause** is advisable. Here, parties are relieved from liability for events out of

Cybercises

Find examples of exculpatory clauses from your everyday life, such as theater tickets, ski lift tickets, or parking garage tickets.

their control, including fires, mechanical breakdowns, lockouts, riots, and other unpredictable events.

Liability limitations can also be drafted for damages, such as consequential damages or negligence. If a limitation is appropriate, it should be drafted into the contract.

Exculpatory clauses usually are heavily scrutinized by courts with an eye toward the public policy implications. Such was the case in *Stelluti v. Casapenn Enterprises,* 308 N.J. Super. 435, 975 A. 2d 494 (N.J. Super. A.D. 2007).

Line of Reasoning

In *Stelluti v. Casapenn Enterprises,* the plaintiff, Ms. Stelluti was taking a bike spinning class and fell off the bike, injuring herself. She sued the fitness club, Powerhouse Fitness, where she was a member, for negligence, breach of implied warranty of fitness, and a litany of other related claims. (Powerhouse Fitness was the trade name of Casapenn Enterprises.) The focus of the case, however, was the language in the membership contract she signed not an hour before she joined the club. The contract provided as follows:

> **POWERHOUSE FITNESS (The Club) WAIVER & RELEASE FORM**
>
> Because physical exercise can be strenuous and subject to risk of serious injury, the club urges you to obtain a physical examination from a doctor before using any exercise equipment or participating in any exercise activity. You (each member, guest, and all participating family members) agree that if you engage in any physical exercise or activity, or use any club amenity on the premises or off premises including any sponsored club event, you do so **entirely at your own risk**. Any recommendation for changes in diet including the use of food supplements, weight reduction and/or body building enhancement products is entirely your responsibility and you should consult a physician prior to undergoing any dietary or food supplement changes. You agree that you are voluntarily participating in these activities and use of these facilities and premises and **assume all risks** of injury, illness, or death. We are also not responsible for any loss of your personal property.
>
> This waiver and release of liability includes, without limitation, all injuries which may occur as a result of, (a) your use of all amenities and equipment in the facility and your participation in any activity, class, program, personal training or instruction, (b) the sudden and unforeseen malfunctioning of any equipment, (c) our instruction, training, supervision, or dietary recommendations, and (d) your slipping and/or falling while in the club, or on the club premises, including adjacent sidewalks and parking areas.
>
> You acknowledge that you have carefully read this "waiver and release" and fully understand that it is a **release of liability.** You expressly agree to release and discharge the health club, and all affiliates, employees, agents, representatives, successors, or assigns, from any and all claims or causes of action and you agree to voluntarily give up or waive any right that you may otherwise have to bring a legal action against the club for personal injury or property damage.

To the extent that statute or case law does not prohibit releases for negligence, this release is also for negligence on the part of the Club, its agent, and employees.

If any portion of this release from liability shall be deemed by a Court of competent jurisdiction to be invalid, then the remainder of this release from liability shall remain in full force and effect and the offending provision or provisions severed here from.

By signing this release, I acknowledge that I understand its content and that this release cannot be modified orally.

Signed: */s/ Gina Stelluti* Names of family members (if applicable):

Printed

Name: _____ _____

Dated: *1/13/04*

[Boldface in original.]

Within 15 minutes of signing her contract, the plaintiff began her spinning class. She told the instructor that she was a novice. He helped her get positioned. When the instructor told the class to stand on the bike's pedals, the plaintiff's handle bars dislodged and she fell off, injuring herself. She suffered back and neck injuries as a result of the fall, including a loose tooth. Aside from the negligence issues that were raised, one of the issues before the court was the enforceability of the exculpatory clause. Ordinarily courts look with disfavor on exculpatory clauses because they are considered contracts of adhesion. They are a "take it or leave it" provision in a contract. Had the plaintiff not signed the exculpatory clause, she would not have been able to join the gym. However, the court in reaching its conclusion considered four factors. They include:

> [1] the subject matter of the contract[;] (2) the parties' relative bargaining positions[;] (3) the degree of economic compulsion motivating the 'adhering' party[;] and (4) the public interests affected by the contract. (Citations omitted) As part of that assessment, a court considers not only the "substantive" contents of the agreement, but also the "procedural" context that led to its execution.

In applying the four factors, the court determined that, although the language in the exculpatory was very onerous, the plaintiff could have walked away and joined another gym. She had choices and therefore, the court found that the clause was enforceable. The court also believed, after an exhaustive analysis, that the case did not violate public policy and that the plaintiff had alternative choices. However, and this is big, the court did state that this case was restricted to the facts of the case. Thus, the exculpatory clause, although not favored under the law, was acceptable under these set of facts.

Questions for Analysis

Review *Stelluti v. Casapenn Enterprises*. What facts would have changed the conclusion of the court? What weight did the court place on the fact that the plaintiff had just signed the contract? Did the court properly interpret previous case precedent in reaching its conclusion? Explain your response.

State Your Case

Robert and Jenny Carlucci love the ski season. They usually ski in Vail, but this year decided to try Sunny Valley, Utah instead. When they purchased their lift tickets, there was fine print on the back of the ticket that stated "Use of the ski facilities is at the skier's own risk. The facility is not responsible for or liable to the skier for any injuries incurred through the use of any equipment located on the premises, including the lift. Damages are limited to the cost of entry to the facility." Robert and Jenny made a number of runs on the most difficult courses. As it was getting to be dusk, Robert convinced Jenny to make one last run. The ski area was not well lit. As they were getting off the lift, Jenny's ski caught some ice where she fell and injured her leg and sprained her back. She could not work for months. Robert and Jenny sued the ski resort. The attorney for the ski resort filed a motion to dismiss their law suit because of the language on the back of the ski ticket. Would a court in Utah find the exculpatory clause enforceable? Explain your answer.

Time of the Essence

Time of the essence provisions have not been strictly enforced by courts. Although such a provision may be clear in the contract, the tendency of courts is to forgo enforcement of these provisions, especially if the delay in performance was not essential to the purposes of the contract. Therefore, determine whether time is of the essence for your client; if it is, be sure to include such a specific provision. If this condition is essential to performance of the contract, it is important to include that as well. That way, if performance is not accomplished by the time specified in the contract, the injured party will have the right to cancel and/or pursue its rights in a court of law. See Exhibit 18-8 for an example.

EXHIBIT 18-8 Sample time of essence provisions

(1) **Time is of Essence—Option.** It is understood and agreed that time is of the essence in this option agreement, and that the option set out must be exercised on or before [date]. If the option is not exercised before the expiration of such time, all rights to exercise it shall cease.

(2) Time is of the essence in this contract; and in case either party shall fail to perform the agreements on such party's part to be performed at the time fixed for performance by the terms of this contract, the other party may elect to terminate the contract.

Liquidated Damages

Recall in Chapter 10, we discussed remedies and their enforceability. One of the types of damages discussed was liquidated damages. When the parties to a contract are uncertain about the amount of possible damages, or when damage amounts are difficult to ascertain,

it is not unusual for the parties to agree in advance to a specific damage amount in the hope of avoiding a lawsuit. What is important in determining whether a liquidated damages clause is valid is the reasonableness of the estimate of the liquidated damages. If the liquidated damages clause is grossly disproportionate to the possible damage that could occur between the parties, it is highly unlikely that a court will enforce it. Courts will not enforce a liquidated damage clause that is really a punishment or penalty. Careful drafting of liquidated damages clauses is thus very important. Some illustrations are provided in Exhibit 18-9 (see also Chapter 10).

EXHIBIT 18-9 Sample liquidated damages clauses

(1) **Liquidated Damages Provision** [General Liquidated Damages Clause]. It is agreed by the parties that the actual damages which might be sustained by [obligee] by reason of the breach by [obligor] of its promise to [specify performance, e.g., make delivery within ninety (90) days] are uncertain and would be difficult to ascertain. It is further agreed that the sum of [specify amount, e.g., $1,000 or $10 for each day that delivery is overdue] would be reasonable and just compensation for such breach. Therefore, [obligor] hereby promises to pay and [obligee] hereby agrees to accept such sum as liquidated damages, and not as a penalty, in the event of such breach.

(2) [Liquidated Damages Provision for Delay in Performance of Construction Contract]. It is understood and agreed that, if said project is not completed within the time specified in the Contract plus any extensions of time allowed pursuant thereto, the actual damages sustained by the Owner because of any such delay will be uncertain and difficult to ascertain. It is agreed that the reasonable foreseeable value of the use of said project by the Owner would be the sum of [amount] per day; and therefore the Contractor shall pay as liquidated damages to the Owner the sum of [amount] per day for each day's delay in fully completing said project beyond the time specified in the Contract and any extensions of such time allowed thereunder.

Restrictive Covenants

The buyer of a business often wants to restrict the seller's right to carry on or participate in the same business for a certain period of time and in a specific geographic area. The paralegal must determine what the state laws are regarding restrictive covenants. Many states have set out guidelines regarding what length of time and what areas will be considered reasonable. Case law is very specific, and if a covenant is drafted too broadly, it is very possible that it could be declared void.

It is also possible that a restrictive covenant would be needed in an employment contract. Normally the same standards apply with regard to employment covenants: they must be reasonable with respect to time and geographic limitation. Again, it is important for the paralegal to check state law with respect to the extent of any restrictive covenant.

Closely tied to the restrictive covenant is the applicable law provision. If your employment is located in California, but the applicable law to the employment contract is Pennsylvania, the results of the enforceability of the provision may depend upon which law applies. Here, knowing the application of the law in the jurisdiction is critical. Would application of Pennsylvania law be binding to a party in California if the choice of law in the contract is Pennsylvania? The answer to that question has many variables and thus if your attorney is in control of the drafting of the contract how one provision affects another is vital to the entire contractual process.

State Your Case

Jasminder Palevy is being considered for a job with Remco Corporation located in North Carolina. Jasminder lives in Virginia and will be working in the Virginia area office. The company specializes in manufacturing laser equipment for eye surgery. The employment contract has some troubling clauses that Jasminder has asked your law firm to review before she signs the contract. The contract contains a restrictive covenant, which states that "Employee *cannot* work in the sale of eye laser equipment in the state of Virginia and North Carolina for two years after ceasing to be employed with Employer." The other clause that concerns her is that "The laws of the State of North Carolina shall apply to this contract." Are these provisions enforceable? Explain your response.

Arbitration

arbitration
A method of settling disputes by submitting a disagreement to a person (an arbitrator) or a group of individuals (an arbitration panel) for decision instead of going to court

Arbitration has become a common means of settling disputes, as parties attempt to resolve their differences without resorting to the courtroom. Arbitration is an informal court-like proceeding where arbitrators, not judges, decide the outcome of the case before it. Arbitrations can be before a single arbitrator or a panel depending on the terms of the provision or the complexity of the case. Arbitration is common in the labor area, for example, and are usually the exclusive remedy for the parties. Arbitration is usually final and binding on the parties which mean that, unless there are extraordinary circumstances, the decision of the arbitrator is final. Arbitration is sanctioned under the Federal Arbitration Act. If arbitration is desired, determine whether your state recognizes arbitration by statute or case law, and whether it is an enforceable method of dispute resolution for your fact situation.

In certain contracts, arbitration is agreed to be the exclusive remedy. If this is the case, the American Arbitration Association suggests the following language:

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

This provision can be modified according to the needs of the parties and the requirements of a particular industry. Additional examples are in Exhibit 18-10.

EXHIBIT 18-10 Sample arbitration provisions

(1) Any controversy or claim arising out of or relating to this contract, or the breach thereof, except [specify exceptions, e.g., controversies involving less than $1,000] shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

(2) **Short Form—Texas General Arbitration Act.** As concluded by the parties hereto upon the advice of counsel, and as evidenced by the signatures of the parties hereto and the signatures of their respective attorneys, any controversy between the parties hereto involving the construction or application of any of the terms, covenants, or conditions of this agreement, shall be submitted to arbitration on the written request of one party served upon the other, and such arbitration shall comply with and be governed by the provisions of the Texas General Arbitration Act.

With arbitration clauses, the issue is usually not the drafting *per se*, but rather the notice of its provision. If the client requires an arbitration clause in a contract, whether a paper or electronic contract, be sure the parties know that they are contracting for such a clause. One place where this has become a *hot* issue is on the Internet as discussed in Chapter 16. Many cases involving clickwrap and shrinkwrap agreements deal with the enforceability of the arbitration provision. Thus, as many of the cases illustrate, it is not a drafting issue, but rather a reasonable notice and unconscionability issue.

Merger Clauses

merger clause (integration clause) A clause in a contract that integrates all prior agreements into the contract with any prior contradictory terms or conditions excluded from the final contract of the parties

A provision that appears in virtually all contracts is a **merger** or **integration clause**. A merger clause states that everything in the agreement is what the parties finally agreed to and anything that contradicts the agreement was not a part of the agreement and therefore is not part of the contract. Sound familiar? This is the indirect reference to the parol evidence rule that was discussed in Chapters 8 and 12.

Usually, as part of the merger provisions, there is a provision regarding modification. It is best to require that any modification of a contract be written rather than oral. Oral modification is likely to pose enforceability problems, especially if one party challenges whether the modification actually took place. You never want to have a "he said, she said" situation. Exhibit 18-11 exhibits some merger clauses.

EXHIBIT 18-11 Sample modification and integration clauses

Disavowal of intent to modify earlier contract. It is understood that this agreement shall in no way act as a waiver of any of the conditions and obligations imposed on the parties by the earlier contract executed between them, and any rights that either of the parties may have by virtue of such earlier contract are to be considered as in full force and effect.

Changes in printed portion of contract. No change, addition, or erasure of any printed portion of this agreement shall be valid or binding on either party.

Integration

(1) The documents that constitute the agreement between the parties are attached hereto and made a part of this agreement and consist of the following:
(a) This document, numbering _____ pages
(b) Exhibits to this agreement, numbering _____ through _____.
(c) Other _____.

(2) This instrument embodies the whole agreement of the parties. There are no promises, terms, conditions, or obligations other than those contained herein; and this contract shall supersede all previous communications, representations, or agreements, either verbal or written, between the parties.

Choice of Governing Law and Choice of Forum

A standard contract provision is the one determining which state's law will govern if any disputes arise between the parties. As part of the contract, the parties name the jurisdiction in which a lawsuit or dispute is to be filed, unless some case law otherwise governs. Such provisions are usually enforced.

venue
The county or judicial district in which a case is to be tried

The parties can determine not only what laws will apply, but also where suit may be filed (known as **venue**). Ordinarily, such a clause states where a lawsuit is to be filed and which laws will govern. As innocuous as a choice of law provision may sound, it can be critical. As mentioned above, when a restrictive covenant is at issue, the applicable law may be the difference to its enforceability or unenforceability. Similarly, if one party is in New York and the other party to the contract is in Ohio, which laws would you want to apply? You would want the laws of your jurisdiction to apply, of course. Where choice of law provisions become a real headache is in standard form contracts or when dealing with big companies where a client's bargaining power may not be as strong. These are provisions to expect and should be discussed with the client when entering into a contract. Exhibit 18-12 sets forth some choice-of-law provisions.

EXHIBIT 18-12 Sample choice-of-law provisions

Venue. The obligations and undertakings of each of the parties to this agreement shall be performable at [specify place such as state or county].

Choice of Law. This agreement shall be governed and construed in accordance with the laws of [state].

OR

The validity of this agreement, and of any of its terms or provisions, as well as the rights and duties of the parties hereunder, shall be interpreted and construed pursuant to, and in accordance with, the laws of [state].

OR

It is expressly agreed and stipulated that this contract shall be deemed to have been made and to be performable in [specify jurisdiction, e.g., the state of Texas], and all questions concerning the validity, interpretation, or performance of any of its terms or provisions, or of any rights or obligations of the parties hereto, shall be governed by and resolved in accordance with the laws of [state or country].

Cybercises

Find five examples of choice of law provisions in contracts. Compare the provisions and identity the differences in the provisions.

Where these types of clauses become an issue usually involves e-contracts. Similar to the issues arising from challenges to arbitration clauses, the forum selection or choice of law provisions can be held unconscionable and therefore unenforceable. This is not a drafting issue, but a notice and enforceability issue. These issues were discussed in Chapter 16 when dealing with Internet and e-commerce related transactions.

Assignability

It is normally important for the parties to determine whether the type of contract they are making can be assigned to another party. Ordinarily, contracts involving personal services are not assignable. If the parties determine that notice and opportunity to approve of the **assignee** are necessary, then that should be designated in the assignment clause. Typical assignment provisions are found in Chapter 11.

assignee
A person to whom a right is assigned

Notice

Contracts frequently require that the parties give notice to each other upon the happening of certain events. These provisions are very important because they dictate when a default has occurred and may trigger the right to an opportunity to cure. The notice must be specific as to when it is effective, such as on the date of mailing or upon the date of receipt. It is also important to set forth the manner or method of giving notice—for example, delivery by registered or certified mail or, if appropriate, by hand. Often, notice is also sent to the attorneys of record or any other persons who may have an interest in the contract. Be complete and accurate with your designations. Exhibit 18-13 gives some examples.

EXHIBIT 18-13 Sample notice provisions

(1) Any notice to be given hereunder by either party to the other shall be in writing and may be affected by [personal delivery in writing or registered or certified mail, return receipt requested]. Notice to [name of party] shall be sufficient if made or addressed to [specify

address], and to [other party] at [address]. Each party may change the address for notice by giving notice of such change in accordance with the provisions of this paragraph.

(2) Whenever in this agreement it shall be required or permitted that notice be given by either party to the other, such notice must be in writing and must be given personally or by certified mail addressed as follows: [specify].

Time of Notice. Every notice under this agreement shall be deemed to have been given at the time it is deposited in the United States mail, as determined by the postmark.

notary public
A public officer whose function is to attest to the genuineness of documents and to administer oaths

Signatures of Parties and Date

One of the most important parts of the contract is the signature section showing the parties' assent to the contract. Be sure that the signature block for the parties is appropriate to their capacities. If they are signing as individuals, the contract should so state. If a party is signing in a corporate capacity, that should also be noted. In addition, often it is required that the document be signed before a **notary public**, an official who attests to the genuineness of documents. The need for notarization is normally determined by the parties to the contract. In some cases, notarized is required by statute, such as in many real estate transactions. In this instance, determine the law in your jurisdiction to ascertain whether notarization of signatures is required.

Cybercises

In your jurisdiction, determine five types of transactions that require a notary public. What information must appear and in what form must be contained in a notary acknowledgement?

The contract must be dated. This date normally determines the effective date of the contract, so any legal ramifications flow from the date of signing. Be sure that there is no question as to the date.

Sometimes contracts require that they be witnessed. It is important that these sections be specifically designated and entitled "Witness." Witnesses usually have to be disinterested parties, that is, persons who have no interest in the contract. Exhibit 18-14 provides some illustrations of signature blocks.

EXHIBIT 18-14 Sample signature blocks

Execution

[General format where all parties sign at the same time and place]

Executed in [specify the number of executed copies, e.g., triplicate] on December 24, 2010, at Dallas, Texas.

_____
Robert P. Jones

_____
Glen W. Smith

OR

Executed by the parties hereto on the day and year first above written.

_____
Robert P. Jones

_____
Glen W. Smith

OR

Witness our hands at Arlington, Texas, on this 24th day of December, 2010.

_____
Robert P. Jones

_____
Glen W. Smith

[General format where parties are signing at different times]

Executed on December 14, 2010, at Arlington, Texas.

_____
Robert P. Jones

A new issue discussed in Chapter 16 was electronic signatures and their enforceability. Recall that electronic contracts and transactions are becoming more and more prevalent in the business world. Statutes such as UETA and E-SIGN dictate the applicability and enforceability of an electronic signature in a transaction. Be mindful of the changing business climate and the need to adapt your drafting to the e-world, if necessary.

Sample Contract

The final product should reflect the needs, objectives, and intentions of the parties to the contract, tailored to the client's situation. Exhibit 18-15 provides a typical sample contract for an independent contractor.

EXHIBIT 18-15 Sample contract (independent contractor)

AGREEMENT made between Homes of Florida (the "Company"), 1234 Ninth Street, West Palm Beach, Florida, and ABC Concrete Company, (the "Contractor"), 5678 West Fruit Street, Tampa, Florida.

IN CONSIDERATION of the mutual promises made herein, and for other good and valuable consideration, the parties hereby agree as follows:

1. **Scope of Work.** The Company engages the Contractor to furnish the work described in the Schedule attached to this Agreement at the times specified in that Schedule, and the Contractor agrees to furnish the work at the times specified in the Schedule.

2. **Price and Payment.** The Company agrees to pay the Contractor in accordance with the price and payment terms set forth in the Schedule attached to this Agreement, and the Contractor agrees to accept such amounts as full payment for its work and to sign such waivers of lien, affidavits, and receipts as the Company shall request in order to acknowledge payment.

3. **Independent Contractor Relationship.** The Contractor is an independent contractor and is not an employee, servant, agent, partner, or joint venturer of the Company. The Company shall determine the work to be done by the Contractor, but the Contractor shall determine the means by which it accomplishes the work specified by the Company. The Company is not responsible for withholding, and shall not withhold, FICA or taxes of any kind from any payments which it owes the Contractor. Neither the Contractor nor its employees shall be entitled to receive any benefits which employees of the Company are entitled to receive and shall not be entitled to workers' compensation, unemployment compensation, medical insurance, life insurance, paid vacations, paid holidays, pension, profit sharing, or Social Security on account of their work for the Company.

4. **Business of Contractor.** The Contractor is engaged in the business of doing the work specified in the attached Schedule. Copies of the following documents verifying the Contractor's established business shall be attached to this Agreement:

(a) Current occupational licenses issued by the counties and municipalities in which the work is to be performed.

(b) Articles of incorporation, if the Contractor is a corporation.

(c) Partnership or joint venture agreement, if the Contractor is a partnership or joint venture.

(d) Acknowledgment of sole proprietorship, if the Contractor is a sole proprietor.

(e) Federal Employer Tax Identification Number.

5. **Employees of Contractor.** The Contractor shall be solely responsible for paying its employees. The Contractor shall be solely responsible for paying any and all taxes, FICA, workers' compensation, unemployment compensation, medical insurance, life insurance, paid vacations, paid holidays, pension, profit sharing, and other benefits for the Contractor and its employees, servants, and agents.

6. **Insurance.** The Contractor shall furnish the Company with current certificates of coverage of the Contractor, and proof of payment by the Contractor, for workers' compensation insurance, general liability insurance, motor vehicle insurance, and such other insurance as the Company may require from time to time. If the Contractor is not required by the [state] Workers' Compensation Law to provide workers' compensation to its employees, the Contractor shall waive its exemption or exclusion from that law and shall purchase workers' compensation insurance and furnish the Company with a current certificate of coverage and proof of payment. The Contractor shall maintain all such insurance coverage in full force during the term of this contract and shall furnish the Company with certificates of renewal coverage and proofs of premium payments. If the Contractor fails to pay a premium for insurance required by this paragraph before it becomes due, the Company may pay the

premium and deduct the amount paid from any payments due the Contractor and recover the balance from the Contractor directly.

7. **Risk.** The Contractor shall perform the work at its own risk. The Contractor assumes all responsibility for the condition of tools, equipment, material, and job site. The Contractor shall indemnify and hold harmless the Company from any claim, demand, loss, liability, damage, or expense arising in any way from the Contractor's work.

8. **Assignment.** The Company may assign any or all of its rights and duties under this Agreement at any time and from time to time without the consent of the Contractor. The Contractor may not assign any of its rights or duties under this Agreement without the prior written consent of the Company.

9. **Termination.** This agreement may be terminated for any reason by either party by giving thirty (30) days notice, and may be terminated for cause at any time upon notice.

10. **Term.** This Agreement is effective as of [date] and shall continue for one year.

11. **Law.** This Agreement shall be governed and construed in accordance with [state] law.

IN WITNESS WHEREOF, the parties have executed this Agreement on the dates shown below.

_____ _____

(Date) Homes of Florida

_____ _____

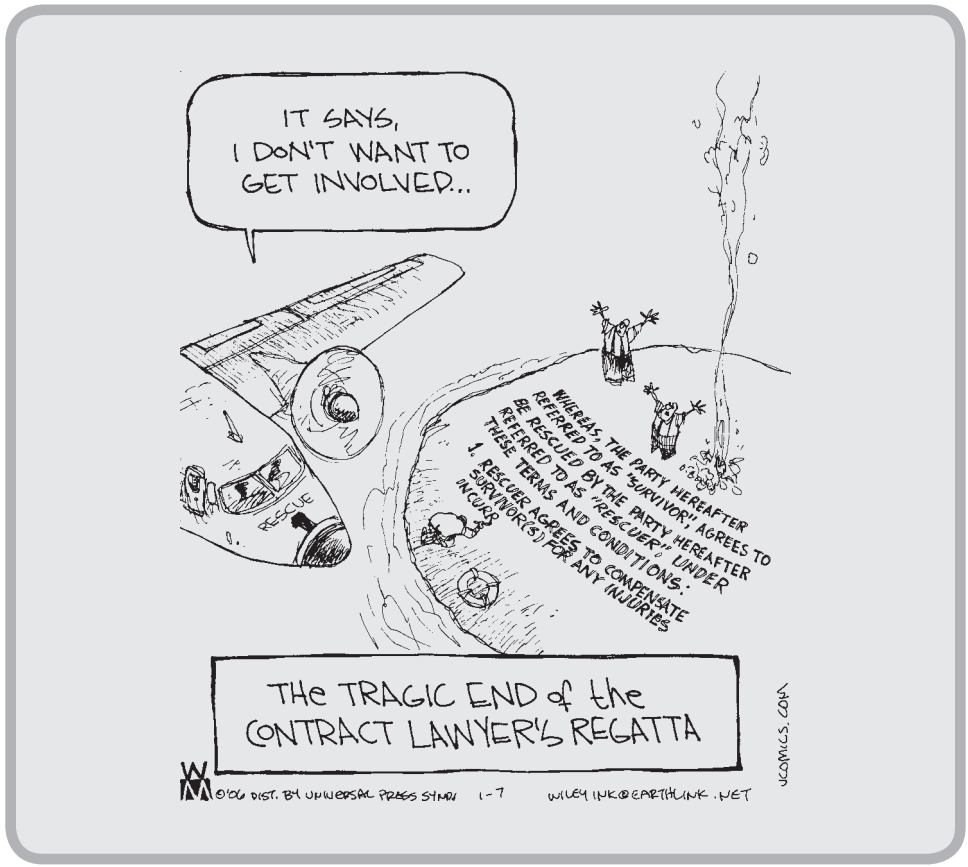
(Date) ABC Concrete Company

18.2 THE SALES CONTRACT

As we know, the Uniform Commercial Code (U.C.C. or the Code) has different requirements of the parties than in the common law of contracts. There are different provisions and considerations that apply in a sales contract. Of course, a sales contract has many of the same requirements as a common law contract, but some special provisions should be included as standard in drafting a sales contract.

Under the U.C.C., a contract can be formed even though certain key terms are missing. Certainty and definiteness are the cornerstone of common law contracts, but are relaxed substantially under the Code. These are principles we discussed in previous chapters. Thus, the U.C.C.'s relaxation of many of the traditional rules of contract formation and writing requirements makes it easier to create a contract between parties. As a result, when drafting a sales contract, it is important to set out all the particulars that the parties desire, so as to avoid clients becoming bound by terms to which they did not agree.

In preparing any sales agreement, be sure the terms are set forth in an understandable manner, and be sure that they are conspicuous, so that there can be no claims that parties did not know that certain terms were present or that they did not understand a particular provision. If terms are to be set forth on the back side of a printed form, specific and conspicuous reference should be made to the reverse side of the form, so that the parties to the contract will know that those terms are present.



In addition, pay close attention to the federal and state administrative regulations that may govern sales transactions. In many instances restrictions are placed on contract terms concerning pricing, advertising, labeling, and other such areas. Many states also require parties to obtain permits or licenses before they transact business. It is imperative that, as part of the sales contract, the requisite licenses be made a condition of the transaction. Clearly state the conditions that are necessary to meet the contractual obligation, so that neither party inadvertently violates state or federal law.

The rest of this section contains suggestions as to general provisions that may or should be included in a sales contract. Although some of the restrictions have been relaxed under the U.C.C., specificity can avoid problems in sales transactions.

The Parties

As with a general contract, the parties always need to be identified. The same principles mentioned in the previous discussion of the parties apply. When dealing with a business, be sure you correctly identify the party with their proper designations. For example, many businesses incorporate under one name and do business under another name.

You may see the advertised business as "Just Desserts," but the corporation's proper name is ChocCo, Inc. The name Just Desserts is called a "dba—doing business as" and is the not the legal name of the company. Knowing the correct and legal name of a business may have important legal ramifications down the road, especially if there is litigation. Of course this issue is not limited to sales contracts. Therefore, always ask or check the proper name of any business your firm may be representing.

Strictly Speaking: Ethics and the Legal Professional

In the practice of law, attorneys must avoid a conflict of interest between them and a client. This also includes conflicts with other members of a law firm. A conflict of interest occurs when an attorney and a client's interest are adverse to each such as an attorney previously representing a third party whose interest was adverse to the client's interest. From an ethical standpoint, a conflict can create the impression, rightly or wrongly, of impropriety or improper relationships whether personal or business, for example. From a lawyer's perspective, a conflict of interest could disqualify the attorney from representing the client or taking the case from the inception. With regard to a paralegal, conflicts of interest arise from different sets of circumstances with usually different results. A conflict of interest may arise when a paralegal is related to a client or has a close personal relationship; or a conflict may arise when a paralegal changes jobs and may have been involved in cases relating to the new firm's clients in an adverse way. Whatever the reason, if a potential conflict or actual conflict exists, the firm may create an "ethical wall" or what is commonly known as a "Chinese wall," which is really an "imaginary wall" shielding you from any interaction with the case including review of documents, interviews, and direct contact. Consequently, if you believe that you may have a conflict of interest in a case you should immediately report it to your supervising attorney who will determine the appropriate course of action. Do not take it upon yourself to determine how you believe the conflict or potential conflict should be handled. This is a serious ethical matter and must be addressed by your supervising attorney. Of course if you are not certain whether a conflict of interest exists, communicate with your attorney who will decide. This is not a matter that should be handled by you on your own.

Description of Goods

The goods that are the subject of the sales agreement should be adequately described. Different grades, sizes, styles, or any other particulars should be specifically stated in the contract so that there is no dispute or question as to what is the subject of the contract. Properly identifying the goods to the contract will avoid future problems.

Often the parties to the sales contract are ordering different sizes and styles. If you are representing the seller, draft provisions for normal deviations in style, size, color, weight, texture, and pattern, so there will not be an undue burden on the seller in filling the order.

What's in a word? As we will observe in *Frigaliment Importing Co.v. B.N.S International Sales Corp*, 190 F. Supp. 116 (S.D. N.Y. 1960), it is everything. This is an older case,

but illustrates the importance of precision in drafting and why not defining your terms could be fatal.

Line of Reasoning

The *Frigaliment* case deals with the sale of chickens and for what kind of chickens the parties contracted. The buyer contracted for fresh frozen chickens. What the buyer received were chickens that were apparently of a quality that were only good for stewing, whereas the buyer wanted chickens suitable for broiling and frying. (It appears that different types of chicken grades are used for different things!) The contract only referred to the purchase of a generic "chicken" and thus the court was tasked with determining the meaning of the word "chicken." The defendant, a New York corporation sold chickens to a Swiss corporation, the plaintiff. The parties contracted for "'US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2½-3 lbs. and 1½-2 lbs. each all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export." This contract was followed by a second contract except that it called for the heavier chickens. When the chickens arrived the plaintiff found that that "the 2½-3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or 'fowl'; indeed, many of the cartons and bags plainly so indicated." The plaintiff protested the quality and stopped the second shipment in transit. In analyzing the situation, the court found the word "chicken" ambiguous—chickens come in different sizes, weight and ages. To further complicate the situation all the negotiations and transmittals between the parties were in German, except for the word "chicken." The reasoning for this is because it was "understood 'chicken' meant young chicken, whereas the German word, 'Huhn,' included both 'Brathuhn' (broilers) and 'Suppenhuhn' (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this" so says the plaintiff. Resorting to trade usage, the plaintiff claimed that "chicken" meant "young chicken." Unfortunately, the plaintiff was not able to establish the trade usage since this was the first business transaction with the defendant. The court then proceeded to gather different definitions of the word "chicken" and witness interpretation. The end result is that the plaintiff could not establish what he interpreted as a "chicken" and the case was dismissed. The moral of the story is define your terms and always be aware that a chicken is not always just a chicken!

Questions for Analysis

Review *Fraligment Importing Co. v. B.N.S. International Sales Corp*. How could the parties have avoided the issues in this case? What types of provisions should the parties have included in the contract? What lessons can be learned from this case?

Quantity

Quantity is an important term in the contract and should be stated with as much specificity as possible. Although the Code does relax some of the requirements for definiteness, be as specific as possible in delineating the minimum and maximum

quantities which are the subject of the contract. If the contract requires a specific quantity, different sizes, styles, colors, or patterns, state those requirements in clear and specific language. If you represent a buyer that will need additional quantities of the same goods in the future, it is especially important to include such conditions in the purchase contract.

When dealing with output and requirements contracts, it is incumbent upon the parties to be flexible as to price. Because output and requirements contracts are indefinite by nature, try to set fixed minimum and maximum quantity standards or a formula that sets a standard. In this section, it may be appropriate to set out the conditions of notice to the seller of the buyer's requirements and the subsequent delivery schedule by the seller when the goods are ordered. Careful drafting is critical. This becomes even more critical when under the Code lack of specificity may create an enforceable contract.

Price

Although the U.C.C. does not require that a specific price be set forth in the contract, it is probably a better practice, if at all possible, to do so. When the price is not stated in the contract, a contract could still exist under the Code; under § 2-305, price is the reasonable value at the time of delivery. If nothing specific is stated as to price, it is left to be agreed by the parties. There is much flexibility in the price term standards in sales contracts and this should be recognized by the person doing the drafting.

Once the parties set the price, payment is normally required. If the parties agree to a certain method of payment, that should be clearly stated in the contract so there is no question as to what is required. For example, if the parties require a cashier's check or C.O.D., that should be specified as a condition of payment and ultimate delivery.

In addition, certain sales include excise, sales or other required taxes. If a tax is included in the price, specify it. If the price does not include the taxes, say so. If any other items (such as packing and labeling) are included in a price, state them as well in the contract.

When payment must be tendered is an important component of a sales contract. Unless this is specifically stated in the contract, the U.C.C. provides that the price is normally payable either upon delivery of the goods or according to custom and usage and prior dealings between the parties. Consequently, if the intent is to have different payment terms, it is incumbent upon the drafter to clearly set forth those payment requirements. This means that questions need to be asked of the client. Do not guess what the terms and conditions of payment should be. Ask the client. If deviation from prior practices is expected then you would know that if the client was questioned.

If the payment is due in installments, this should be specifically stated, and any conditions to payment should be stated as well. How a default is to be remedied also should be a part of the price terms or included in a separate section entitled "Default." When installment payments are agreed to, a grace period is often granted, and written notice of any default is required, before it becomes effective.

Payment can also be conditioned upon an inspection. This is the buyer's right under the Code, but if possible, it should be specifically stated so that there is no confusion as to when payment is due and the conditions of such payment.

Title

The U.C.C. specifies the manner in which title passes to the parties in a sales contract. If the parties desire any variations with respect to transfer of title, they should be so stated in a title provision.

In addition to the specifics of passing title under the Code, documents of title may also be required in a sales contract. Governed by Article 7 of the Code, such documents may include warehouse receipts, bills of lading, or delivery orders. If title documents were part of the transaction, the terms and conditions with respect to the passage of title should be stated in the sales contract. This section should also set forth whether the documents of title are **negotiable** or **nonnegotiable**, so there is no question as to the manner in which the documents must be transferred. Being specific as to such requirements is important when documents of title are involved.

negotiable
Transferable by indorsement or delivery

nonnegotiable
A document or instrument not transferable by indorsement or delivery

Delivery

Specifying the time, place, and manner of delivery are essential elements in any sales contract. Failure to state these terms may make the contract unenforceable, as certain rights and obligations flow from the delivery terms. Unless specifically stated in the contract, the presumption under the law is that the party will pay for the goods upon delivery. If this is not the intention of the parties, it should be stated in a delivery provision.

Setting forth a specific place of delivery is critical, where goods are delivered has a direct bearing on when title is transferred and who bears the risk of loss. As stated earlier, such terms as F.O.B., F.A.S., and C.I.F. have specific legal ramifications. It is important to specify the legal responsibilities of the parties in this regard—otherwise, the U.C.C. will control this aspect.

Furthermore, the general rule is that if there is a slight delay or deviation in the terms of delivery, performance could be excused under the contract. Remember the Code provides some leniency in performance. Consequently, if time is of the essence and critical to the parties, that should be specifically stated. Otherwise, the Code will not treat minor deviations as a breach or a waiver of the buyer's claims based on delivery delays.

Another consideration when drafting a delivery provision is the occurrence of events which are out of the control of the parties. Exculpatory clauses will excuse performance without legal ramifications if properly drafted. Such provisions can be important and should be drafted according to the needs of the contracting parties.

Warranties

The Code allows for a variety of provisions regarding express and implied warranties. If the parties intend to exclude certain warranties in the sales contract, the exclusions must be specifically identified in the sales contract. If the warranty of merchantability is to be excluded, it must be stated in conspicuous language with the word *merchantability*

specifically used in the exclusion. This exclusion must be in writing and must be conspicuously set with boldface print, underlining, or some other method that sets it apart from the rest of the language of the contract.

If the parties want to exclude implied warranties of fitness, it is sufficient to state that "there are no warranties which extend beyond the description on the face hereof." In addition, if the buyer is purchasing the goods as presented, language such as "as is" and "with all faults" or other commonly used phrases is sufficient to draw the buyer's attention to the fact that all warranties are being excluded from the sales agreement. The more specific the disclaimers, the more likely that the party attempting to exclude the warranty will succeed in having the exclusions enforced.

If the seller is not warranting title, and is therefore attempting to exclude or modify that which it is transferring to the buyer, such exclusion or modification of the warranty of title must be specifically stated. Also, include additional language indicating that the buyer knows the seller is not warranting the title. Transfer of title is important and provisions affecting it should be clearly drafted.

If you are representing the buyer, you should ensure that certain express warranties are included as the basis of the bargain. It is incumbent upon the buyer to include language that states that the seller is warranting the product for the particular purpose for which it was intended. This will place the burden upon the seller to be sure that the goods are warranted for the purposes for which they are being purchased.

A seller may want to limit the time period in which a buyer can return defective goods. Or, the seller may want to include provisions stating that, in the event that the goods are defective, the seller can repair or make substitutions within a specified period of time without any recourse by the buyer. Think about your client's needs and include them in your contract.

On a different front, it may be appropriate for the person who is drafting on behalf of the seller to attempt to limit the amount or types of damages that the other party can recover for breach of warranty. In this section, the seller may want to exclude any special, incidental or consequential damages, or add any other limitations it deems appropriate. Where exclusions are at issue, be sure you examine the law in the jurisdiction where the exclusion is to be applied.

Posting Warranties Conspicuously on the Internet

In Chapter 14, we discussed that warranty exclusions have to be conspicuous, that is in language that is sufficiently noticeable to place a party on notice of its contents. The Internet presents some interesting warranty exclusion issues. In a recent case against McDonald's, *In re McDonald's French Fries Litigation*, 503 F. Supp. 2d 953 (N.D. Ill. 2007), a group of consumers sued the fast food giant for breach of an express warranty because it made claims that its french fries contained no allergens and were gluten-free. This express warranty was on McDonald's corporate Web site

(McD's has many individual owners called franchisees). Posting the information was not sufficient enough for the federal district court in the northern district of Illinois, however. Even though the consumers were not in privity of contract as the U.C.C. would ordinarily require, another federal law, the Magnuson-Moss Warranty Act (the Act) allowed an injured consumer to file against a warrantor even though privity did not exist. Under the Act, the definition of written warranty is silent as to electronic transactions. This gave the consumers a cause of action against McDonald's. The point for you to understand is that the Internet presents new twists to existing laws, especially when involving consumers. What may be adequate on paper may not be sufficient on the Internet. When working with clients that have Web sites or electronic transactions, be sure all applicable laws are reviewed and analyzed to determine their application to your client's transaction in the electronic world.

Credit

Many sales transactions are made on credit. Consider including a credit clause stating that no credit will be extended until approved in writing by the appropriate party and then communicated back to the seller.

One of the problems that arise with credit is that circumstances may change and the buyer may become insolvent. The U.C.C. leaves little remedy for the seller, but a seller can contractually protect itself by reserving the right to revoke credit, and insisting upon cash payment prior to actual shipment of the goods, if it determines that the buyer's financial situation has materially changed. This provision should leave no question as to the seller's rights and obligations against the buyer in the event that credit terms are no longer desirable.

Remedies Provided to the Parties

The U.C.C. presents a number of options for buyer and seller in the event of a breach by either party. Nevertheless, a contract should specifically set out the parties' rights and obligations after a breach, even though these rights are specified in the Code. It is always a good idea to set forth in writing the remedies for breach, so that there is no question as to what is available to the parties. However, if you are representing the buyer, it may be appropriate to include not only the damages granted under the Code, but also any special or consequential damages incurred because of the breach. If you are working with the seller, a provision regarding limitation of liability may be appropriate, including limiting all incidental, special, and consequential damages as a result of the breach.

Miscellaneous Standard Provisions

As with other standard contracts, sales contracts usually include miscellaneous standard provisions, such as those on governing law, merger, assignability, notice, and signature. Follow the basic guidelines set forth earlier in this chapter to draft these provisions.

With the advent of e-business and e-commerce, adding provisions such as whether electronic records and electronic signatures are applicable may be a new and added provision to consider. Recall that UETA requires a party's consent to use an electronic contract and signatures in their business dealings. If this is the case for a client, be sure a provision is included in the contract if necessary.

Sales contracts usually differ from each other, but an example of a typical sales contract is given in Exhibit 18-16.

EXHIBIT 18-16 Sample sales contract

Agreement made April 20, 2011, between Imports, Inc. of Atlanta, Georgia, in this agreement referred to as "seller," and Wines, Inc. of Des Moines, Iowa, in this agreement referred to as "buyer."

1. SALE OF GOODS. Seller shall sell, transfer, and deliver to buyer on or before May 20, 2011, 900 cases of Australian Shiraz.

2. CONSIDERATION. Buyer shall accept the goods and pay Fifty Four Thousand Dollars ($54,000.00) for the goods.

3. IDENTIFICATION OF GOODS. Identification of the goods to this agreement shall not be deemed to have been made until buyer and seller have specified that the goods are appropriate to the performance of this agreement.

4. PAYMENT ON RECEIPT. Buyer shall make payment for the goods at the time when, and at the place where, the goods are received by buyer.

5. RECEIPT CONSTRUED AS DELIVERY. Goods shall be deemed received by buyer when delivered to buyer at 187 Main Street, Des Moines, Iowa.

6. RISK OF LOSS. The risk of loss from any casualty to the goods, regardless of the cause, shall be on seller until the goods have been accepted by buyer.

7. WARRANTY OF NO ENCUMBRANCES. Seller warrants that the goods are now free, and that at the time of delivery shall be free, from any security interest or other lien or encumbrance.

8. WARRANTY OF TITLE. Furthermore, seller warrants that at the time of signing this agreement, seller neither knows nor has reason to know of the existence of any outstanding title or claim of title hostile to the rights of seller in the goods.

9. RIGHT OF INSPECTION. Buyer shall have the right to inspect the goods on arrival. Within ten (10) business days after delivery, buyer must give notice to seller of any claim for damages on account of condition, quality, or grade of the goods, and buyer must specify in detail the basis of its claim. The failure of buyer to comply with these conditions shall constitute irrevocable acceptance of the goods by buyer.

IN WITNESS WHEREOF, the parties have executed this agreement at [designate place of execution] the day and year first above written.

_____

Imports, Inc.

_____

Wines, Inc.

18.3 PRACTICAL APPLICATION

Drafting a contract can be an involved process. As a result, this chapter can only act as a guide, but does not and cannot include every possible contract provision or every type of contract. Two types of contracts that paralegals often encounter, which include many of the provisions previously discussed, are employment agreements and contracts for the sale of a business. Specific provisions should be included in each.

Employment Agreement

When drafting an employment agreement, consider the following:

1. *Terms of Employment*. Set forth the contractual term between the employer and the employee. Within this paragraph, it is appropriate to include any automatic renewals and the conditions for renewal.
2. *Compensation*. Clearly state the compensation to be paid to the employee and how it will be paid (e.g., monthly, bimonthly, or weekly).
3. *Duties and Responsibilities.* An employee should know what is required for satisfactory performance. If there are any special duties or responsibilities, describe them in the contract.
4. *Vacation and Sick Leave.* It is customary for employers to provide vacation and sick days. Specifically set forth the conditions of vacation and sick leave. Must the employee work a certain period of time before receiving paid vacation? Is sick leave paid or not? These provisions can be a source of controversy and consternation; therefore, be specific.
5. *Termination of Employment.* In this section, make the distinction between termination with cause and without cause. If notice is desired by either party for termination with cause, identify the time period required for each party to notify the other of the termination. If termination with cause provisions are needed, be as detailed as possible.
6. *Modification.* Most contracts require modifications to be in writing and approved by all parties. This requirement is standard
7. *Covenants against Competition*. Covenants not to compete have come under close scrutiny by the courts. Most states have either statutes or case law which identifies the necessary elements for a legally effective noncompetition provision. Check your state laws and draft accordingly. Usually the law requires that the covenant be reasonable in time, place, and manner.
8. *Nondisclosure of Trade Secrets.* Coupled with the noncompetition clause is usually a nondisclosure agreement by which the employee agrees not to disclose the confidential, proprietary information and trade secrets of its employer. This provision is important because the employer does not want employees misappropriating information that the employer deems valuable.
9. *Miscellaneous Provisions.* Include the miscellaneous provisions, such as governing law, assignability, merger, and notice, at the end of the contract.
10. *Signatures.* End your document with the appropriate signatures and dates to make the agreement effective.

Exhibit 18-17 is a sample employment agreement.

EXHIBIT 18-17 Sample employment agreement (with modification)

Sample Employment Agreement

This contract, dated November 1, 2011, is made between Benjamin Wright, referred to as the "Associate," and XYZ Law Firm, P.C., referred to as the "Law Firm."

1. **Parties.** The Associate is duly admitted to the practice of law in [state]. The Law Firm is engaged in the practice of law in [state].

2. **Term of Employment.** The Law Firm shall employ the Associate for a period of one (1) year for the purpose of providing legal services on behalf of the Law Firm to such members of the general public as are and as become accepted as clients by the Law Firm. The initial term may be extended from year to year.

3. **Compensation.** The Law Firm agrees to pay the Associate the salary of $60,000.00 per year, payable monthly at the rate of $5,000.00 on the first of each month (for the prior month). Salary increases may be made from time to time at the discretion of the Law Firm.

4. **Bonus.** The Law Firm may at its sole discretion pay to the Associate a year-end bonus. The Law Firm shall determine the amount, if any, of such bonus considering in part the services rendered to the Law Firm by the Associate.

5. **Clients.** All clients are to be considered clients of the Law Firm and not the clients of any particular member of the firm.

6. **Vacation.** The Associate shall be entitled each year to a paid vacation of three (3) weeks, which must be approved by the Law Firm not less than two (2) months prior to the vacation leave.

7. **Medical Insurance.** The Law Firm maintains policies of insurance covering certain hospital and medical expenses incurred by its employees and their families. The Associate shall become eligible to participate in these insurance plans upon the completion of ninety (90) days of employment. The cost of such insurance for the Associate alone shall be paid by the Law Firm, with the Associate paying for all of the additional cost required to provide family coverage. The Law Firm reserves the right to change carriers or plans.

8. **Disability.** If the Associate shall become unable to perform his duties fully by reason of illness or incapacity of any kind, the Law Firm may, in its sole discretion, reduce or terminate all salary payments. Full salary shall be reinstated upon the return of the Associate to full-time employment and full discharge of the duties of employment.

9. **Life Insurance.** The Law Firm provides group life insurance for its employees. The general purpose of this plan is to provide to the beneficiaries the equivalent of twice the employee's annual salary as a death benefit. The Law Firm pays the cost of this insurance. Upon completion of ninety (90) days satisfactory employment, the Associate will be furnished a policy contract indicating the coverage under the plan. The Law Firm reserves the right to change plans and carriers in its sole discretion.

10. **Nonliability of the Law Firm.** All matters of eligibility for coverage or benefits under any insurance provided by the Law Firm shall be determined in accordance with the provisions of the insurance policies. The Law Firm shall not be liable to the Associate, or his heirs, family, executors, or beneficiaries, for any payment payable or claimed to be payable under any plan of insurance.

11. **Duties of Employment.** The Associate shall devote his full business time and attention to the practice of law on behalf of the Law Firm and to the furtherance of the best interest of the Law Firm. The Associate shall not engage in the practice of law except as an employee of the Law Firm. The Law Firm shall have exclusive authority and power to determine the matters to be assigned to the Associate, including the specific duties and standards of performance.

The Law Firm shall have the following powers:

(a) To assign clients and cases to the Associate:
(b) To review all work performed by the Associate and to modify, cancel, or require the Associate to revise the work or work product:
(c) To determine the time and manner of performance of all work; and
(d) To determine standards of performance and, within reason, necessary hours of work.

12. **Authority to Bind the Law Firm.** The Associate is not authorized to enter into any contracts which would bind the Law Firm, or to create any obligations on the part of the Law Firm, except as shall be specifically authorized by the Law Firm.

13. **Professional Standards.** The Associate agrees to abide by and perform his duties in accordance with the ethics of the legal profession and all federal, state, and local laws, regulations, and ordinances regulating the practice of law.

14. **Assistance.** The Law Firm shall make available to the Associate a private office, secretarial assistance, paralegal research aides, and such other facilities and services as are customary, consistent with the position and adequate for the proper performance of the duties of the Associate.

15. **Expense Reimbursement.** The Law Firm shall reimburse the Associate for all expenses reasonably and necessarily incurred in the performance of his duties. Such reimbursable expense shall include but not be limited to the following: (a) travel expenses; (b) automobile expenses; (c) expenses for entertainment for the promotion of the Law Firm; (d) professional and other dues; (e) attendance at lectures, forums, and other meetings conducted for the continuing education of members of the profession.

16. **Accounting for Services.** The Associate shall keep an accurate record, as required by the Law Firm, of all billable time spent on clients' matters and affairs. Such records shall be submitted to the Law Firm as the law requires, together with any special billing instructions that apply to the matter. All client billings shall be made by the Law Firm and the Law Firm shall have the exclusive authority to fix the fees to be charged to all clients. All fees, compensation, and other monies or things of value received or realized as a result of services provided by the Law Firm shall be strictly accounted for upon demand and turned over to the Law Firm upon receipt thereof. This includes all income generated by the Associate, including but not limited to fees and compensation received for services rendered as executor, administrator, trustee, guardian, and the like, and all income generated by the Associate.

17. **Termination of Employment.** Either party may give written notice to the other, at least sixty (60) days prior to the end of any such term of employment, that the employment is to terminate. No cause is required for termination.

The Associate will also be automatically and immediately terminated if for any reason the Associate becomes disqualified to practice law in this state or otherwise violates the terms of this agreement to provide services to this Law Firm without a conflict of interest with other employment.

The Law Firm may also immediately terminate the Associate upon the occurrence of any of the following events:

(a) the Associate fails or refuses to comply with the policies, standards, and regulations of the Law Firm reasonably established from time to time; or
(b) the Associate's fraud, dishonesty, or other misconduct in the performance of legal services on behalf of the Law Firm; or
(c) the Associate's failure to faithfully or diligently perform the provisions of this agreement or the usual and customary duties of his employment; or
(d) if the Law Firm discontinues the practice of law.

18. **Waiver of Breach.** The waiver by either party to this agreement of a breach of any of its provisions shall not operate or be construed to be a waiver of any subsequent breach of the same or any other provision of this agreement.

19. **Notices.** Any notice to be given under this agreement may be deemed sufficient if made in writing to the party and sent by mail to the address provided in the beginning of this agreement or to such other address provided by the Associate as his new address.

20. **Governing Law.** This agreement shall be governed by the laws of [state].

21. **Binding Effect.** This agreement shall be binding upon the parties hereto and shall inure to the benefit of their respective successors and assigns and to the estate, beneficiaries, and heirs of the Associate.

22. **Signatures.** Both the Law Firm and Associate agree to the above.

LAW FIRM:

By:_____ _____

Name of Associate

Modification of Employment Agreement

AGREEMENT made this 30th day of November, 2011, between the Law Firm, a Maine corporation, hereinafter called "Employer," and Benjamin Wright, hereinafter called "Employee."

The parties hereby agree that the Employment Agreement dated November 1, 2011, between the Law Firm and Benjamin Wright is hereby modified and amended by changing § 3 to read as follows:

3. **COMPENSATION.**

a. **Base Salary.** In consideration of services rendered under this agreement from and after the date hereof. Employee shall receive a base salary per annum of Sixty Thousand Dollars ($70,000.00), payable at Five Thousand Dollars ($6,000.00) a month. The base salary may be changed by mutual agreement of the parties at any time.

In all other respects, the Employment Agreement shall remain as it existed prior to this Modification.

IN WITNESS WHEREOF, the parties or their authorized representatives have signed this Modification as of the day and year first above written.

EMPLOYER: _____

By: _____
President

EMPLOYEE:

_____

Sale of Business Contract

When drafting a contract for the sale of a business, consider:

1. *General Introduction.* This section introduces the parties and the places where the parties reside or have their principal places of business.
2. *Sale and Purchase Provision.* In this section, specify the business purchased and what the sale includes, such as inventory, fixtures, and goodwill of the business.
3. *Purchase Price.* Set forth the purchase price and how it will be allocated. (This usually has tax implications.)
4. *Inspection of Inventory.* The purchaser usually has the right to inspect the inventory prior to any purchase. The inventory verifies what the purchaser is buying.
5. *Accounts Receivable.* The seller of a business often has continuing accounts payable to the business. The issue arises as to who is entitled to this money. A specific date should be identified so that there is no question as to which party is entitled to money received thereafter. The sale need not include the accounts receivable, though: this provision must be negotiated by the parties.
6. *Payment of the Purchase Price.* In this provision, specify how the purchase price is to be tendered to the seller. If the payment is in installments, say so. If the seller is going to lend the purchaser the money and a promissory note is needed, this should also be stated in the contract.
7. *Documents at Closing.* Any documents to transfer title must be identified. Any other corresponding documents also should be noted in this section.
8. *Seller and Buyer Representations.* As part of the sale, seller, and buyer make certain representations to each other. The seller represents that there is good title, taxes are paid, no judgments or liens exist, and no contracts have been entered into that affect the business. The buyer represents that an inventory has been taken, books and records have been inspected, and the buyer is satisfied that everything properly reflects the status of the business. This is standard and a very important provision in such a contract.

9. *Compliance with Bulk Sales Law.* Under Article 7 of the U.C.C., when all or substantially all of the assets of a business are sold, notice shall be given to creditors. If notice is not sent, both seller and buyer will be responsible for the debts. Sometimes the parties agree to waive compliance with the bulk sales law, but if that occurs, the seller will be legally responsible for any consequences.
10. *Restrictive Covenant.* It is customary for the buyer to insist that the seller not compete with the buyer for a period of time within a specific geographic area. If the buyer does not include this provision, the seller could set up a similar business next door. Undoubtedly, the buyer does not want this to occur. Therefore, a restrictive covenant should be in the contract.
11. *Time and Place of Closing.* Specify where and when the closing is to take place.
12. *Notices.* Because letters may have to be sent to the parties because of a problem with the contract, each party's mailing address should be stated.
13. *Miscellaneous Provisions.* Include the general miscellaneous provisions, such as choice-of-law, assignability, and merger clauses.
14. *Signature of Parties and Date.* Set forth a signature block for all parties who intend to sign the contract. Be sure to date the contract. Exhibit 18-18 is a sample of a sale of business contract.

EXHIBIT 18-18 Sample sale of business contract (sale and purchase agreement with bill of sale)

SALE AND PURCHASE AGREEMENT

This SALE AND PURCHASE AGREEMENT ("AGREEMENT") is made and entered into effective the 1st day of October, 2011, at Dallas, Dallas County, Texas, between Ray Charleston ("Seller"), and Dustin Mancini ("Purchaser").

WITNESSETH:

WHEREAS, Purchaser desires to purchase Seller's interest in the business being conducted under the name of "ABC Cleaners" located at 11800 Dallas Parkway, Dallas, Texas 75245 and assets pertaining thereto, as more particularly described herein, upon terms and conditions hereinafter set forth; and

WHEREAS, the parties agree that the subject of the Sale and Purchase Agreement is the pick-up store located at 11800 Dallas Parkway and NOT any other businesses operating under the name of ABC Cleaners; and

WHEREAS, Seller desires to sell his interest in only the pick-up store business being conducted under the name "ABC Cleaners," located at 11800 Dallas Parkway, Dallas, Texas 75245, and assets thereto, as more particularly described herein, upon the terms and conditions hereinafter set forth;

NOW, THEREFORE, in consideration of the premises, TEN AND NO/100 DOLLARS ($10.00) and other good and valuable consideration, and the mutual promises and

agreements of the parties hereto, one to the other, receipt and sufficiency of which are hereby acknowledged by each of said parties, and expressing their intent to be legally bound, the parties hereto agree as follows:

1. **PURCHASE AND SALE.** Seller shall sell to Purchaser and Purchaser shall purchase from Seller upon the terms and conditions hereinafter set forth in this Agreement, the items set forth in Exhibit "A", attached hereto and incorporated herein by reference for all purposes ("Assets"), and more particularly described as:

(a) all the stock in trade and merchandise of the pick-up dry cleaning store business only;
(b) all the fixtures, equipment, and other tangible assets of the pick-up store business;
(c) all the trade, goodwill, and other intangible assets of the pick-up store business; and
(d) all leases, licenses, and permits of the business.

2. **PURCHASE PRICE.** The total purchase price (herein called "Purchase Price") to be paid by Purchaser for all the Assets described in Exhibit "A" to this Agreement shall be FIFTEEN THOUSAND DOLLARS ($15,000.00).

3. **ALLOCATION OF PURCHASE PRICE.** Purchase Price shall be allocated as required by Section 1060 of the Internal Revenue Code of 1986, as amended from time to time.

(a) The Seller and Purchaser further agree that $1,000.00 has been paid to Seller prior to the closing.
(b) The remaining balance of $14,000.00 shall be tendered to Seller in a certified or cashier's check at the time of closing.

4. **WARRANTIES AND REPRESENTATIONS.** As a material inducement to Purchaser to enter into this Agreement, and to close the contemplated transaction, Seller represents, warrants, and covenants to Purchaser that the following are true and correct as of when made, and will be true and correct through the Closing, as if made on that date:

(a) Seller has taken, or will take, prior to the Closing Date, all action necessary to perform his obligation hereunder. Upon execution and delivery of this Agreement, this Agreement will be the legal, valid, and binding obligation of the Seller enforceable in accordance with its terms.

(b) Neither the execution nor performance of this Agreement, nor the other agreements contemplated hereby, nor the consummation of the transactions contemplated hereby or thereby, will (i) conflict with, or result in a breach of the terms, conditions, and provisions of, or constitute a default under any agreement to which Seller is a party or under which Seller is obligated in any matter whatsoever, or (ii) violate or conflict with any judgment, decree, order, statute, rule, or regulation of any court or any public, governmental, or regulatory agency or body having jurisdiction over Seller or the properties or assets of Seller.

(c) The financial records of the Seller have been reviewed by Purchaser and are a complete and actual record and account of the financial affairs of the Seller for the periods indicated, are in accordance with the books and records of the Seller, present an account of the financial affairs of Seller for the periods indicated, the present financial condition of

Seller at such dates and the results of its operations for the periods therein specified, and truthfully set forth all liabilities, assets, and other matters pertaining to the fiscal and financial condition of the business through September 30, 2010, subject to year-end adjustments consistent with generally accepted accounting principles with respect to the statements.

(d) There have not been material changes in Seller's business that adversely affect the business.

(e) No litigation, actions, or proceedings, legal, equitable, or administrative, through arbitration or otherwise ("disputes"), are pending or threatened which might adversely affect the value of the Assets of Seller's business.

(f) Seller owes no obligations and has contracted no liabilities affecting his business or which might adversely affect the value of the Assets or the consummation of the purchase and sale.

(g) All assets listed in Exhibit "A" which are being sold pursuant to this Agreement are in good condition and repair, reasonable wear and tear excepted, and none of the equipment being sold is obsolete or no longer marketable. Seller shall execute and deliver to Purchaser such Bills of Sale with General Warranty and other instruments reasonably necessary or convenient to transfer to Purchaser all the Assets being sold pursuant to this Agreement, free and clear from all debts, obligations, liens, and encumbrances.

(h) Seller is operating under the assumed name "ABC Cleaners," which is located at 11800 Dallas Parkway, Dallas, Texas 75245.

(i) Seller is not a party to any contracts, written or oral, concerning the ownership and the Assets being sold pursuant to this Agreement.

(j) The Assets sold under this Agreement are not subject to community property rights or the assignment of community property rights, or a lien to secure community property rights, judgment rights, or any other community property rights.

(k) Neither Seller nor any party acting on Seller's behalf has agreed to pay any party a commission, finder's fee, or similar payment concerning this matter or any mater related hereto, or has taken any action on which a claim for any such payment could be based.

(l) Seller has duly filed tax returns required to be filed and has paid all federal, state, and local taxes required to be paid with respect to the periods covered by such returns. All taxes, including but not limited to sales taxes, liquor taxes, personal property taxes, withholding, and FICA, FUTA, and SUTA, owing, and which, with the passage of time, will become due and owing, and which are unpaid and would have any material adverse effect on the Assets, shall be paid by the Seller when due.

(m) There are no governmental licenses, federal, state, or local, or any other licenses required to own and/or operate the business of the Seller that could have any material adverse effect on the value of the Assets.

(n) No representation, written or oral, warranty or statement of Seller, whether in this Agreement or in any document or exhibit furnished or made to Purchaser, contains or omits a material fact which makes the representation, warranty, or statements misleading. All such representations, warranties, or statements of the Seller are based upon current, accurate, and complete information as of the time of the making of this Agreement, as is available to the Seller.

(o) "Goodwill" is not an asset of the business for purposes of this agreement.

5. **ACCOUNTS RECEIVABLES.** Purchaser shall be entitled to all cash receipts and accounts receivable after September 30, 2010, and Seller shall be divested of any rights or entitlement to any cash receipts or receivables. However, the parties agree that all inventory receipts in the pick-up store prior to October 1, 2011, shall be divided equally between the parties. As a condition to closing, Purchaser shall pay to Seller one-half of the receipts of the inventory as of the close of business on September 30, 2011.

6. **COMPLIANCE WITH BULK SALES ACT.** Seller and Purchaser do not waive compliance with the Bulk Sales Act.

7. **CLOSING.** The term "Closing," as used in this Agreement, shall mean the consummation of the sale of the Assets and items set forth in this Agreement. The Closing shall take place at such time, date, and place as may be agreed upon by the parties ("the Closing Date").

8. **THE LEASE.** Purchaser acknowledges that the premises are leased. Seller agrees to assign any and all rights under its lease agreements to Purchaser. Attached hereto as Exhibit "B" is a copy of the Assignment of Lease. The parties acknowledge that Seller is still primarily liable on the original lease between Bonjour Limited Partnership, a Texas limited partnership, and Raymond Charleston, and has not been released by the landlord. In the event Purchaser fails to make a lease payment by the 10th of the month, Seller has the right to enter the premises and reclaim possession of the business without recourse from the Purchaser. In such event, Purchaser shall be divested of all rights, little, and interest in the pick-up store and will waive any rights to any monies from the business located at 11800 Dallas Parkway, Dallas, Texas 75245, and Purchaser acknowledges that he is not entitled to any reimbursement of the purchase price from Seller. Nonpayment of the rent is considered an event of default whereby Seller can exercise any and all rights he has by law.

9. **COSTS AND EXPENSES.** All costs and expenses incurred in the purchase and sale described in this Agreement in the manner prescribed by this Agreement shall be borne by Purchaser and Seller in the following manner:

(a) Each party shall pay his own attorney expenses related to this matter.

(b) All other closing costs and expenses shall be borne by the parties in equal proportions.

(c) All taxes related to the business and the premises shall be paid by Purchaser from the date of closing and any tax statements received which accrued before the date of closing shall be borne by Seller and prorated accordingly.

(d) All sales taxes arising because of the sale pursuant to this Agreement of the fixtures and equipment of said business to Purchaser shall be paid by Purchaser.

10. **INDEMNITY AGREEMENT BY PURCHASER.** Purchaser shall indemnify and hold Seller (including the Assets of the Seller's business) harmless from any and all claims, losses, damages, injuries, and liabilities arising from or concerning the operation of said business by Purchaser after the Closing or ownership of any Assets of the business.

11. **INDEMNITY AGREEMENT BY SELLER.** Seller shall indemnify and hold Purchaser (including the Assets of Purchaser's business) harmless from all claims, losses, damages, injuries and liabilities arising from or concerning the operation or ownership of any Assets of the business by Seller prior to Closing.

12. **NONCOMPETITION PROVISION.** There is NO noncompetition provision between the parties. Purchaser acknowledges that Seller can freely compete in the dry cleaning business or related business. There are no geographical or time restrictions between the parties.

13. **MISCELLANEOUS.** The following miscellaneous provisions apply:

(a) This agreement is intended to be performed within the State of Texas and the County of Dallas and shall be governed by and construed and enforced in accordance with the laws of the State of Texas. The agreement shall be deemed to have been executed at Dallas County, Texas, and its performance is deemed to have been called for in Dallas County, Texas. To the extent permitted by law, exclusive venue shall be in Dallas, Dallas County, Texas, in any dispute concerning this agreement [Note: Some states require this notice provision to be printed in all capital letters.]

(b) This agreement may be amended only by a written instrument signed by each party hereto. From and after the closing date, the parties agree to execute any additional instruments and to take such actions as may be reasonably necessary to effectuate the transaction herein described. Further, the parties agree to cooperate in fulfillment of the post-closing agreements required hereunder.

(c) All notices required to be given pursuant to this Agreement shall be deemed given when given in person, or when mailed certified mail, return receipt requested, to the following at the following addresses:

PURCHASER:	Dustin Mancini 1719 Palm Street Garland, Texas 75040
SELLER:	Raymond Charleston 11800 Dallas Parkway Dallas, Texas 75245
WITH COPY TO	Jane Attorney Attorney at Law 500 Main Street Dallas, Texas 75202

(d) Each party acknowledges that he has carefully read this instrument and fully understands it. Each party further acknowledges that this Agreement is fair, just, and equitable; that the Agreement is being entered into freely and voluntarily, and that each party has had the opportunity to seek the advice of counsel concerning the terms and conditions of this Agreement before executing the same.

(e) This Agreement shall be binding upon and shall inure to the parties and their respective successors, assigns, legal representatives, heirs, and executors.

(f) If any provision of this Agreement shall be adjudicated to be invalid or unenforceable in any action or proceeding in which Purchaser and the Seller are parties, then such provision shall be deemed to be rewritten to the maximum extent permitted by law, so that any invalid or unenforceable provision shall be valid and enforceable to the extent that any such invalid or unenforceable provision shall be deemed deleted or amended, as the case may be, from

this Agreement in order to render the remainder of the paragraph, subparagraph or part of such paragraph or subparagraph as both valid and enforceable.

(g) Time is of the essence.

(h) Should any litigation be commenced between the parties to this Agreement, the prevailing party in such litigation shall be entitled, in addition to such other relief as may be granted, to a reasonable sum as attorney fees which shall be determined by the court in such litigation, or in a separate action brought for that purpose.

(i) This Agreement constitutes the entire agreement between the parties respecting the matters set forth in this Agreement.

(j) Whenever the context requires herein, the gender of all words used herein shall include the masculine, feminine, and neuter, and the number of all words shall include the singular and plural.

(k) All titles and/or subtitles in this Agreement are for the convenience of the parties only, and are not substantive in nature.

(l) All Exhibits attached to this Agreement are incorporated into this Agreement as if fully set out in writing in this Agreement.

(m) This Agreement shall be governed by and construed in accordance with the laws of the State of Texas.

14. **COUNTERPARTS.** This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, and all of which together shall constitute the same instrument.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the date first above written.

SELLER:
By: _____
Ray Charleston

PURCHASER:
By: _____
Dustin Mancini

BILL OF SALE

KNOW ALL MEN BY THESE PRESENTS:

The undersigned (Seller) does hereby sell, transfer, and deliver unto Dustin Mancini (Buyer) his right, title, and interest in and to the following described: See Schedule "A". The Buyer of said equipment is responsible for all unbilled personal property taxes to the Seller on the equipment. The Seller hereby warrants that he is the lawful owner of said equipment; that he has the right to sell the same and that it is free from all liens and encumbrances except lien in favor of: None.

Signed this 5th day of October, 2011.

ABC Cleaners
By: _____
Ray Charleston, Owner

ACKNOWLEDGMENT

STATE OF TEXAS)
)
COUNTY OF DALLAS)

On this 5th day of October, 2011, before the undersigned, a Notary Public, personally appeared Ray Charleston, the owner of ABC Cleaners, known to me to be the person whose name is subscribed to the within instrument, and acknowledged that he executed the foregoing Sale and Purchase Agreement on behalf of the corporation as his voluntary act and deed, and under authority duly granted by the corporation for him to so act.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

_____
Notary Public

_____
My Commission Expires

SUMMARY

18.1 A general contractual agreement should contain certain basic provisions: identity of the parties, definitions, representations and conditions, duration, termination, performance, time of performance, payment, indemnification, limitation of liability, time of the essence, liquidated damages, restrictive covenants, arbitration, merger, choice of law, assignability, notice, signatures of the parties, and date.

18.2 A sales contract is used in the purchase and sale of goods. Some general provisions to consider are description of goods, quantity, price, payment, title, delivery, warranties, credit, remedies, and the miscellaneous standard provisions. When provisions are omitted, the U.C.C. will usually provide for them under the rule of law.

18.3 Some often encountered general contracts are employment contracts and contracts for the sale of a business. Some provisions to include in an employment contract are term of employment, compensation, duties and responsibilities, vacation, sick leave, termination, covenants against competition, nondisclosure of trade secrets, modification, miscellaneous provisions, and signatures. In a contract for the sale of a business, include such items as the purchase price, warranties, accounts receivable, bulk sales compliance, closing date, indemnification, noncompetition covenants, general miscellaneous provisions, and signatures.

KEY TERMS

installment
acceleration clause
force majeure
indemnification clause
indemnitor
exculpatory clause
arbitration
merger clause (integration clause)
venue
assignee
notary public
negotiable
nonnegotiable

REVIEW QUESTIONS

1. What general provisions should be included in a contract?
2. Why is the representations section important?
3. What is an option in a contract and in what provision will it be found?
4. What is an indemnification clause?
5. What elements should a restrictive covenant include?
6. What is the purpose of a merger clause?
7. What general provisions should be included in a sales contract?
8. List some of the conditions that may be included in a payment provision.
9. How can a warranty be excluded in a sales contract?
10. What are the general provisions in an employment contract? In a contract for the sale of a business?

EXERCISES

1. Mr. St. Johns wanted to hire Harvey Charles as an employee. Harvey was to work for one year with two weeks of vacation and five sick days. His compensation is to be $50,000 per year, paid the 15th and last day of each month. The contract is renewable annually by the employer with a 30-day notice to Harvey. Draft the employment contract between the parties.

2. Your attorney has just been retained by a large computer company. One of the client's concerns is employees using important information after they leave employment with the company. Your attorney has asked you to draft a nondisclosure and noncompetition provisions for review. Tailor the provisions in accordance with your jurisdiction's laws.

3. Sports Company U.S.A. wants to purchase 500 T-shirts of the following types:

100	Chicago Bulls
200	Super Bowl Champions
100	Yankees
50	Dodgers
10	L.A. Lakers
10	San Francisco 49ers
10	Detroit Lions
10	Philadelphia Phillies
10	Boston Red Sox

Delivery is to be made 30 days after confirmation of the order. A down payment of $2,000 is to be tendered prior to shipment. An inspection must occur within 24 hours of receipt of the T-shirts, upon which payment of $10,000 has to be tendered to All Around T-Shirts, Inc. Draft the sales contract between the parties.

4. In Exercise 3 above, the Seller, All Around T-Shirts wants an exclusion of warranty clause in the sales contract. Specifically, it wants to exclude the warranty of merchantability and fitness for a particular purpose. Draft a warranty exclusion provision for this contract.
5. Using the facts from Exercise 3, All Around T-Shirts is concerned about getting sued and its overall liability. They want a clause in the contract which excludes all consequential and incidental damages and expenses. Draft a provision which would cover All Around's requirements.
6. Garry Repard designs costumes for film and Broadway. He uses a lot of sequins and feathers in many of the costumes, especially the ones for the Broadway shows. He needs to find a vendor who can supply him as much sequins and feathers as he requires. Since he does not know who will be his supplier, he has come to your office to have a template created for him to use when he locates vendors who can supply him the goods he needs for his costumes. Prepare the type of contract template Garry needs.
7. It is 7 p.m. and you forgot that you needed to prepare a simple sales contract for the sale of your collection of M&M figurines and dispensers. You hate to part with them, but you need the money. You place an advertisement on Craig's List and find a buyer, Alec Wynston. The cost of the collection is $2,500, which includes shipment to the buyer's home in Provo, Utah. Prepare the sales contract between yourself and the buyer.
8. Garry, our designer from Exercise 6, wants to finally have a Web site where he can show his designs and expand his business. Of course, Garry knows nothing about creating a Web site, so he decides to hire Leigh Yu of Web site Creations to handle the design and maintenance of the Web site. He needs a professional services contract between him and Leigh. The fee for start-up of the site is $5,000, which does not include the domain name. The contract will be for one year and can be renewed. The monthly maintenance of the site will be $450. Prepare a contract between Garry and Leigh.
9. Daniel and Frankie Patrofski need their house repainted. It has not been done in over 10 years and it is starting to show the wear and tear. Daniel heard from one of his friends that Professional Paints and Landscape do a good job. Daniel met with one of the owners, Marty Billings, and they agreed that the job would cost $1,400 plus the cost of paint. Marty and Daniel shook hands on the deal. Marty was going to start in 10 days. Daniel asked if there was a contract to sign, but Marty assured him that they did not need one. If there was a problem, they would just work it out. Daniel is uncomfortable with not having a written document. What happens if the paint peels or their workmanship is poor? What

is his recourse? Daniel decides that he wants a very simple agreement documenting his deal with Marty. Daniel comes to your firm because his brother is one of the partners. Prepare a simple agreement that will protect Daniel in the event there is a problem with the paint job.

10. You have just been hired by Morrison and James, LLC. You are really excited. The partner, Oliver Morrison, wants to test out your paralegal skills, but does not tell you that. He says that they want to have an employment contract with you, but want you to draft the document. Your salary is $50,000 to start. Nothing else was discussed other than you will have health care coverage and two weeks of vacation. Oliver wants you to prepare your "dream" employment contract. Draft the employment agreement that you would submit to Morrison and James.

CASE ASSIGNMENTS

1. Your law firm has been hired by Central Health Community Clinics which is funded by both your local government and the federal government. They have been looking for an Executive Director for almost a year and finally have selected a candidate with whom they intend to make an offer. The candidate's name is Vennessa Chou. The clinic is located in Baltimore, Maryland. The salary for the position is $125,000 with four weeks of vacation and two weeks of sick leave annually. They are willing to pay for two conferences each year and pay for membership in two professional associations. The clinic has never sought the advice of an attorney before, but the last contract that they prepared was such a mess that they believed it was time for some professional advice. Based upon the facts, what additional provisions should the Community Clinic consider including in its contract of employment with Ms. Chou?

    a. What provisions should be included in the contract and why? Explore different types of contract provisions for Clinic Executive Directors and Hospital Chief Executive Officers. Do not limit yourself to the provisions suggested in this text. Think about the relationship between the parties and how each is best served in the contract. Check the law in Maryland if you are considering any restrictive provisions.
    b. Draft the employment agreement between Central Health Community Clinics and Vennessa Chou.

2. Patrick MacApple is about to be married to Sandra Golddigger. Patrick has adult children who are worried about their inheritance. Patrick made it big in the technology business and was one of the founding partners of what is now considered one of the leading software companies in the world. Sandra is 30 years younger than Patrick and wants to desperately start a family with Patrick after they are married. Patrick would love this. But, he is aware that he must protect not only his assets but those of his adult children in the event the marriage does not work. Patrick is a realist and has no illusions, although Sandi keeps assuring him that this is the real thing and forever. As the long-time attorneys for Patrick,

they want to have a prenuptial agreement prepared. This is Patrick's third marriage. Patrick's net worth is approximately $300,000,000. They plan on living in Boston, Massachusetts where they currently reside. He wants an airtight prenuptial agreement. He wants a provision that provides for monetary increments based upon the length of the marriage—the longer the marriage, the more Sandi would be entitled. He thinks five year increments would be fine. If he dies, Sandi would be taken care of in a will.

a. What other issues should Patrick consider including in the prenuptial agreement and why?
b. Prepare a draft agreement for Patrick's review.

Sandi does not have an attorney and does not want to sign the agreement. Be sure to include provisions in the agreement to protect Patrick from later challenges to the document.

Chapter 19

Analyzing a Contracts Problem: Putting Theory into Practice

Just Suppose . . .

A husband and wife contact your supervising attorney, asking to see her regarding a sensitive contract matter. An appointment is set for the next day at 3 p.m. at which time you listen to the following story:

Katerina and Alesandr Smirnikoff are now citizens of the United States. But during the Cold War era, they both lived in their native Russia. Alesandr was a diplomat for the country and Katerina was a professor. At some point, the Central Intelligence Agency, CIA, made contact with the Smirnikoffs, persuading them to remain in Russia and conduct espionage for the United States for a period of time. In exchange for "spying," the CIA agreed to arrange travel to the United States and provide financial and personal security for them. After many years of spying and providing valuable information, the Smirnikoffs were brought to the United States, given new identities, citizenship, employment, and financial assistance. As the Smirnikoffs became more financially independent, the CIA began decreasing their financial assistance. However, in 2007, Alesandr was laid off from his job as a computer engineer at a firm in Seattle, Washington. Alesandr contacted the CIA for financial assistance since this is what was promised to them. The CIA essentially communicated that they had done everything that was promised and refused to continue providing any additional assistance under their earlier agreement. The Smirnikoffs want to sue the United States government for breach of contract and any other remedies to which they may be entitled.

Your supervising attorney is intrigued by the Smirnikoffs' plight and wants to help them; it seems like a simple breach of contract case. Your firm agrees to represent the Smirnikoffs.

Outline

The Smirnikoffs' facts are an example of the kind of situation that may present itself for review and analysis, although an unusual situation. The question is "Where do I begin my analysis of the facts presented." It is the "Now what?" point in your quest to becoming a paralegal. You have learned all this information about contracts, but do not know exactly what to do with it when presented with an assignment from a supervising attorney. Panic? Absolutely not. That is what this chapter is all about. You will be presented with a step-by-step approach to analyzing contracts, identifying the questions you should be asking and the next steps once you know the direction of your problem. We will work through different contracts problems including the facts in the introductory paragraph of this chapter. It is important to learn to work through a fact situation and offer reasoned solutions based upon the law. So, let's tackle Katerina and Alesandr's problem.

19.1 UNDERSTANDING THE FACTS: QUESTIONS AND ANSWERS

Before you can begin analyzing a contracts problem, you must understand and know the facts of the situation you are being asked to review. In the beginning we all are a bit intimidated with our surroundings especially in a new job. We want to do a good job, but in the beginning we are not sure how to approach many legal problems or tasks. Whether a new attorney or a new paralegal, we all have the same concerns about our level of competency. It is a gradual and learned process. Remember, Rome was not built in a day and therefore, you cannot know everything about the law or how to approach a project in one day. A way to alleviate some of the uncertainty is to ask questions. Get clarification of a problem or issue. Do not be afraid of your supervising attorney or your boss. If you do not know or are unclear on the facts of an assignment, how can you proceed and get it right if you are unsure of the basics? Thus, step one in any assignment is: understand the facts; understand the assignment; understand the goals. If you do not know the information to get the assignment done, how can you get it done?

What all this means is ask questions. Sometimes you will be observing an interview of a client and your attorney will ask you to research an issue or prepare a document; other times your attorney will simply send you a memorandum with the details of an assignment. If something is unclear, ask for clarification. You do not want to spend hours of time and a client's money (remember, your time will be billed like your attorney's) working on an assignment only to find out that you did not understand what the attorney needed. So, the first step in analyzing a contracts problem is understanding it.

With understanding the assignment comes some other important questions, such as "Am I on a time deadline?" "Is there a particular format my attorney wants me to use in responding to the assignment?" Find out the answers to these questions as well. You do not want to spend weeks on an assignment only to find out that your attorney needed the information in 48 hours. What this all boils down to is *communication*. Communication is the key. If you are not communicating with your superiors then you may find yourself treading

a path that was not only unintended but also wasteful. Therefore, if your supervising attorney wanted you to work on the Smirnikoff case, some immediate questions you should ask are:

1. How long do I have to research or prepare the assignment?
2. What are my deadlines?
3. In what format do you want the assignment?
4. What are the objectives of the assignment?
5. Are there any documents which need to be collected or reviewed prior to beginning the research?
6. If I have additional questions, how should I communicate them?

Now that you have clarified the assignment, your next step is determining what law applies. Determining the answer to this question is sometimes easy and straightforward; other times it involves considerable analysis and strategy. The next step addresses this issue.

19.2 DETERMINING THE TYPE OF TRANSACTION: WHAT LAW APPLIES TO THE ASSIGNMENT?

There a few ways to approach determining what type of transaction is involved and what law applies to the problem. Let's approach our problem by first determining the type of transaction that appears to be involved. Does our problem involve the common law of contracts, the Uniform Commercial Code, or a mixed transaction? Ask yourself "is the transaction about services or the sale of goods?" If you can answer that question you will be provided with a good starting point. For example, in our spy case, the facts clearly indicate that the Smirnikoffs provided a service to the United States government—espionage. There definitely was not a sale of goods involved. Therefore, at first blush, the common law of contracts rather than the U.C.C. would apply to the transaction.

Mixed Transactions: The Predominant Purpose Test

When a contracts problem appears to involve both a common law contract issue, such as a contract for a service and a sale of a good, the question is which body of law applies. The approach to a "mixed transaction" is normally what the courts call "the predominant purpose." Under this approach, a court will evaluate the transaction and determine whether the predominant purpose of the transaction was for the sale of goods or a service. If the predominant purpose in the case is the sale of goods, the U.C.C. will apply. On the other hand, if the transaction was primarily for a service, then the common law of contracts would apply to the transaction. As you might guess, this is not always an easy question to answer. Consequently, the best approach would be to research the law in the state (or jurisdiction) which applies to your transaction and examine the approach the courts' have taken. For example, Vinny decides that the time has come to splurge on a new music and entertainment system for his home—the works. He looks around and decides to buy a sound surround system and a 60-inch HD TV which has a built in DVD Blue-ray. He purchases the entire package from Stan's Electronics, a local merchant, for $8,050.00. Stan's is located in Newark, Delaware. As a service of Stan's, they provide people who

will install all the new electronics for a flat fee of $400. Since Vinny purchased so much equipment, he decides it is a good idea to use Stan's professionals to install all the electronic equipment. If a problem arose with the equipment, the U.C.C. would apply because the primary purpose of the transaction was for the sale of goods and the installation was simply incidental to the transaction.

Now, determining the type of contract transaction you have is only the beginning. You also need to determine what body of law—state or federal—applies to the transaction. Thus, determining what law applies to your set of facts encompasses two issues: jurisdiction and the applicable choice of law. Each concept goes hand in hand with one dependent upon the other. In order to properly analyze a contract problem—or any legal problem for that matter—an initial, or at least a preliminary, determination needs to be made as to the jurisdictional law that applies. This involves learning, for example, where the parties reside, where the transaction was consummated, whether the case is a federal or state claim and in some cases whether a statute determines the jurisdiction or applicable law. Another possibility is that the parties could contractually agree to the choice of applicable law. These are complex questions and are beyond this text, but a brief and encapsulated introduction is warranted to assist in preparing your analysis.

19.3 JURISDICTION: CHOOSING THE APPLICABLE LAW GOVERNING THE TRANSACTION

choice of law
Legal rules that apply to a transaction

Critical to understanding your assignment is deciding what legal rules apply to the transaction. This is known as **choice of law**. Choice of law governs the legal rules that apply to the transaction and how the issues in your assignment (or dispute) will be resolved. Choosing which law applies to a transaction requires analysis and information.

Choice of law occurs under a number of different legal scenarios. The most common scenario is a dispute between parties of the same state. In this case, the state law of that jurisdiction would apply. Here you would examine such areas as where the dispute arose; where the contract was executed; where the performance occurred; and whether the contract was oral or written.

venue
Place to file a lawsuit

After you determine which state law applies then you would ask yourself a narrower question which is what **venue** applies to the transaction. Venue is the place where the dispute is filed—the legal forum that will decide the issues, which is a court. By narrowing down your choice of law and forum, you will be determining the applicable law for that transaction. Using the Stan's Electronics example as our guide, we determined that the predominant purpose of the transaction was a sale of goods. The Uniform Commercial Code would apply. We also know that the transaction occurred in Delaware. Therefore, Delaware law would apply to the transaction. The dispute took place in Newark, so the forum for the dispute would be a court in Newark (or a nearby area).

Now, let's change our Stan's Electronics example and assume that Vinny resides in Pennsylvania. (There is no sales tax in Delaware.) The sound system is installed in his townhouse in downtown Philadelphia. A problem arises with the speakers. Which body of law applies? Here's where your research is important. You now have two possible bodies

of law that apply. If your firm represents Vinny, you want to have Pennsylvania law apply to the transaction. One of the reasons is that it is more convenient for Vinny to enlist a challenge on his home turf. However, the point is you must analyze the problem under the applicable legal standards to determine the best approach to the problem. And, that may be the best that you and your attorney can do, which is determine "the best approach." If every problem was easy and straightforward, there would be no case law and no work for us!

Yet another possibility exists for the applicable body of law in this transaction. Does the transaction involve state or federal law or both? In this context, you would be required to examine whether the dispute presents constitutional issues or diversity of the parties.

Federal Court Jurisdiction

Cases involving a constitutional question, a U.S. Treaty, federal law or the U.S. Government are considered federal questions. When a federal question is involved, federal law applies and a lawsuit would be filed in federal court, thus a **federal question jurisdiction**. Another type of federal jurisdiction is known as **diversity jurisdiction**. Diversity jurisdiction arises between citizens of different states, citizens of a state and foreign country where the amount in controversy is above $75,000. Under a diversity claim, federal or state law may apply. These types of cases are fact driven in determining the applicable law.

federal question jurisdiction
Jurisdiction involving the U.S. Constitution, federal statute or U.S. Government

diversity jurisdiction
Federal jurisdiction involving parties from different states or another country with a minimum of $75,000 in controversy

State Jurisdiction

Under most circumstances, your state's common law will apply to a contracts transaction. To determine this, remember to ask yourself the following questions:

(1) Where did the parties form the contract?
(2) Where did the dispute occur?
(3) Where do the parties reside?

Additional questions may arise when real property or a corporation is involved. If this is the case, then ask yourself:

(1) Is there real property involved?
(2) Where is the property located?

If a corporation is involved,

(1) Is a corporation a party to the case?
(2) Where is the corporation's place of business located?
(3) Does the corporation have more than one place of business (such as a national retailer)?

Answers to the above questions will determine which law applies and which court has the authority to hear the case. A court must have **personal jurisdiction** and **subject matter jurisdiction** over your case to make a determination. Personal jurisdiction involves a court's authority over a person or business in a state. Personal jurisdiction can extend to a nonresident of a state if it can be shown that the party had contacts or did business within the state. The quality of the contact with the jurisdiction is important to establishing a nexus

personal jurisdiction
Court's authority over a person in a lawsuit

subject matter jurisdiction
Court's authority to hear specific types of lawsuits, usually determined by state or federal statute

for a nonresident to be subject to the laws of that state. This type of jurisdiction extends to corporations, limited liability corporations, and other kinds of business entities.

Subject matter jurisdiction encompasses a court's authority to hear particular types of cases, such as divorce, probate, civil, or criminal cases. Most courts can hear a variety of different types of disputes; these are courts of **general jurisdiction**. When a court has the authority to only hear a certain kind of case, this is **limited jurisdiction**.

general jurisdiction Court's authority to hear any type of claim

limited jurisdiction Court's authority to hear only certain types of cases

Now, let's return to our spy case from the introductory fact pattern and examine how you would approach a choice of law issue. The Smirnikoffs want to sue the federal government for a breach of contract. There are two choices here. Does federal law apply, or state law? It appears to be a common law contract issue, which normally would apply the state law where the injury occurred, except for the fact that one of the party's is the federal government and there may be federal questions involved. It is possible to have both federal and state claims in the same transaction. Therefore, we still have not determined where the Smirnikoffs should file their claim.

State versus Federal law

Most contract situations arise under state common law or state statutory law. However, there are situations where a federal statute may be involved, a constitutional issue or a controversy between parties from two different states or parties from the United States and a party from another country.

An issue that arises when both federal and state law applies to a transaction is **judicial economy**. You do not want to have two lawsuits, for example, filed in two different courts about the same set of facts. The law provides a solution to this problem allowing state issues to be heard in a federal court. This is called **pendent jurisdiction**. This is when the state's claim "piggy-back" on the federal claim. For judicial economy, a court wants to hear one case involving the same set of facts rather than two different cases. You also run the risk of inconsistent results, so it is even more important to have claims arising from the same set of facts be heard in the same case.

judicial economy Doctrine which allows court to hear both state and federal claims in the same lawsuit to avoid multiple court cases

pendent jurisdiction Court's ability to hear state claims in federal court as facts of case arise from same occurrence; state claims "piggy back" on related claims

Therefore, if there is a choice of where to bring a claim, it is considered **concurrent jurisdiction**, which in our case means that both a federal and state court could have jurisdiction. However, we have not made the final determination yet. On the other hand, if only one jurisdiction is the proper place for the claim then that court has **exclusive jurisdiction**, of the matter. Returning to the Smirnikoffs and their case against the U.S. Government, it is highly likely that either the U.S. Constitution or a federal statute dictates where the dispute must be filed. Consequently, it is most likely that the case would be presented in a federal court applying either federal or Washington state law since that is where the injury occurred and the Smirnikoffs live.

concurrent jurisdiction More than two types of courts' authority to hear the same type of case

exclusive jurisdiction Authority of only that court to hear cases of the subject matter in controversy, i.e. bankruptcy court

Property Disputes

Lastly, courts have jurisdiction over real or personal property within their borders. This type of jurisdiction is known as **in rem jurisdiction** referring to jurisdiction over the thing or property. Therefore, disputes over real property or personal property are proper within that state even if the owners of the property reside in another jurisdiction.

in rem jurisdiction Court's jurisdiction over real or personal property

By Contractual Terms

Often times the law that applies to the transaction will be determined by the language in the contract itself. The parties to the contract predetermine what law or what jurisdiction applies to the transaction and include a provision in the contract agreeing to the jurisdictional law that will apply. For example, the parties may provide in their contract the following:

> (1) The parties agree that jurisdiction is exclusive in the state of Alabama. The laws of the state of Alabama shall apply to interpretation of the terms and conditions within this contract.
>
> (2) Choice of Law and Jurisdiction. If there is a dispute arising out of the service provided under this contract, the parties agree that such dispute will be governed by the laws of New Jersey, without regard to its conflict of law provisions and the parties expressly agree and consent to the exclusive jurisdiction and venue of the state of New Jersey in Camden County for the resolution of any dispute.

Cybercises

Locate examples of choice of law and forum selection clauses from services or sales transactions from your everyday life, such as your cellular telephone agreement, Internet provider, or home appliance.

In situations where the parties agree to the applicable law, your job is to find law that supports your position based upon the choice of law. Of course, there are situations where parties may challenge the agreed choice of law provision (such as unconscionability), but at least in the beginning, that is the law that will apply to the transaction. Contractual choices of law provisions are quite common in contractual transactions.

Laws of Other Countries

With contract transactions so prevalent in the global world, we must address the possibility that international laws may apply to a contract transaction, especially in the sales arena. This may occur if your firm represents clients who have international businesses which are even more likely in today's global economy. What if your firm represents a designer who sells their product to a vendor from a foreign country? What law applies? Under these set of circumstances, if the contract does not provide for the choice of applicable law, the CISG may apply to the transaction, which was discussed in Chapter 12. Details of this international law are beyond the scope of this text, but suffice it to say, be aware that many issues arise when determining which law applies to a contracts transaction. *Crummey v. Morgan,* 965 So. 2d 497 (La.App. 1st Cir. 2007) is an example of a choice of law issue when none was provided in the contract. Pay close attention to the court's analysis and why it applied one state's law over the other. Because this case involves eBay, it is a common problem that could affect us all.

Line of Reasoning

A Louisiana resident, Daniel Crummey, purchased a recreational vehicle (RV) from sellers, the Morgans, in Texas after viewing numerous photos of the RV on eBay. Crummey made a down payment of $800.00 by credit card, subject to an inspection and testing of the RV. The sellers offered to bring the RV to Crummey in Louisiana, but he wanted to test the RV by driving it home. He arrived in

Texas to pick up his purchase. He paid the remaining balance of $3,023 to the sellers and drove off. Within 40 miles of the sellers' home, the RV broke down. The RV had to be towed away. Crummey called the sellers' representative and communicated that he intended to rescind the sale. Crummey only was refunded $3,023 with a check marked paid in full. The sellers' kept the $800 down payment and charged Crummey another $500 for their representative's trouble. Crummey sued the sellers in Louisiana. In his complaint, Crummey stated that the sellers' description of the RV on eBay stated that "Everything works great on this RV and will provide comfort and dependability for years to come. This RV will go to Alaska and back without problems!" Apparently, during various conversations, the sellers made various misrepresentations as to the quality of the RV. The main issue that the sellers raised was that Louisiana did not have jurisdiction over them and no court in that state could hear the case. In its analysis, the Louisiana court reviewed the seller's contacts and business relationship to the state of Louisiana. The trial court looking to its own long arm statutes—a jurisdictional statute—stated that it had jurisdiction over nonresidents who did business within its border and caused an injury or damage to one of its residents. The Louisiana appeals court focused on the constitutional issues of due process focusing on one of the most famous procedural jurisdiction cases, *International Shoe Co. v. State of Washington*. In that U.S. Supreme Court case, the court set forth the criteria for asserting jurisdiction over a nonresident. It opined that a nonresident must have such minimum contacts so not to offend traditional notions of fair play and justice. Did the nonresident purposely conduct business and avail itself of a transaction within the forum state? If the answer to these questions is "yes" then a lawsuit can be maintained in that state. In a careful and deliberate analysis of the history of the case law on the subject, the Louisiana court found that since the sellers had used eBay to market and sell the RV to a Louisiana buyer, their actions were deliberate and not passive. In making its determination, the court looked to the telephone contacts between the parties, use of a credit card from within Louisiana, and use of a website to consummate a sale with a Louisiana resident. These were sufficient contacts for jurisdiction over a Texas resident. Thus, jurisdiction was proper and the lawsuit could proceed against the nonresident Texas defendants for the sale of the RV.

Questions for Analysis

Review *Crummey v. Morgan*. What facts would have changed the court's result? What is the reasoning in the dissent of this case and why did the judge disagree with the majority opinion? Does this mean that anyone who uses the Internet to sell a product can be sued anywhere in the United States? Why or why not?

State Your Case

Celia decided to take a road trip with her two boys Evan and Mason. They live in Montana and decided they wanted to see the Grand Canyon. When they arrived at the Grand Canyon, they decided to join a trail tour by donkey. Prior to beginning the tour, Celia signed a release of liability contract in the event that something happened while on the trail. The release stated that "Canyon Tours is not responsible for any injuries and that all participants in the tour do so at their own risk." Celia and the boys began the tour. About half way

through, Celia's donkey lost its footing on the trail causing Celia to fall off and hit her head. Celia suffered a concussion. Celia wants to sue for her injuries.

1. Where would Celia file her lawsuit? What defenses would Canyon Tours argue?
2. Assume that as part of the contract that Celia signed, the following clause was included: "Any claims that participants may have against Canyon Tours must be filed in Grand Canyon, Arizona. The laws for the state of Arizona shall apply to any claims of participants." The clause was not conspicuous and was simply part of the preprinted document? What arguments could Celia advance to argue that Montana law applied to the contract?

Making a determination as to the applicable law and jurisdiction early on is important. Recall that the common law of contracts and the U.C.C. differ in how the law is applied in particular circumstances. For example, the mirror image rule in the common law of contracts requires that the offer and acceptance mirror each other, otherwise there is no contract. This is not the case under the U.C.C., however. If you do not determine which body of law applies and the applicable jurisdiction to the transaction, you may wind up with an incorrect response to the assignment. Once again, if you are not sure which law applies or simply want confirmation that you are on track, ask your supervising attorney for guidance. Once you determine what law applies to the transaction, you must determine what kind of contracts problem you have. Is it a formation issue? Is it a breach of contract issue? What is the problem facing the client?

19.4 DETERMINING THE CONTRACT ISSUES INVOLVED: WHAT IS THE PROBLEM?

The next step in our analysis involve multiple steps within the same basis concept: substantive contract issues. Step three, four, and five in our analysis involve determining the substantive issues surrounding the facts. Was there a problem in the formation, such as valid consideration, or did the contractual transaction need to be in writing as required under the Statute of Frauds, for example? Was there a breach in performance? Is a party entitled to a legal or equitable remedy? These are some of the problems that will arise in this part of the analysis.

Formation of the Contract

When faced with a substantive contracts problem, begin your analysis by commencing a contracts review. You remember from our beginning chapters—offer, acceptance, consideration, mutual assent, capacity, and legality. First examine the formation stage. Determine the following

(1) Whether there is a valid offer.
   a. Intent
   b. Terms definite
   c. Communicated to offeree

(2) Whether there is a valid acceptance.
   a. Revocation
   b. Rejection
   c. Lapse of time
(3) Whether the parties have exchanged valid consideration.
   a. Preexisting duty
   b. Past consideration
   c. Illusory promise
   d. Gift
(4) Whether all the terms of the contract have been mutually agreed upon. Was there mutual assent?
(5) Whether valid defenses exist to the formation of the contract. Did the parties have capacity to contract? Did the contract have a legal purpose?
(6) Whether the contract requires a written document. Was the contract oral or written? Does the Statute of Frauds apply to the transaction?

If the answer to these issues is "no," then you probably do not have a formation issue. However, if the issue deals with the adequacy of the documentation or an oral contract, you may have a Statute of Frauds issue. If that is the case, then you should be gathering all the documentation from the client, if there is any, and review it. Sometimes as you review the documentation and perform the legal analysis, new issues may surface, presenting new avenues and approaches to the transaction. Be flexible. Problems are often complex and may involve more than one area. If initially there does not appear to be a formation issue, then move to the next possibility—enforcement.

Enforceability of the Contract

The next set of questions you should ask yourself is if the contract is properly formed, are there any impediments to its enforceability? Here, you may have some overlap of issues. Recall that a contract may be unenforceable because it is illegal or the parties to the contract do not have the legal capacity to enter into the contract. Sometimes there are public policy reasons for a contract's unenforceability. And of course, the Statute of Frauds may prevent a contract from being enforceable. You should ask yourself:

(1) Does the contract have a legal purpose and legal subject matter?
(2) Do the parties have the capacity to enter into the contract?
   a. Age: Adult or minor
   b. Drugs
   c. Intoxication
   d. Mental incapacity
(3) Has any party committed mistake, fraud, misrepresentation, duress, undue influence or violated a public policy?
   a. Is the mistake unilateral or mutual?
   b. Is there a statute which protects the parties from the actions of another party?

(4) Did the contract have to be in writing?
   a. Real property
   b. Consideration of marriage
   c. Contracts that cannot be performed within one year
   d. Contracts to pay the debt of another
   e. Contracts involving executors or administrators of an estate
(5) If the contract needed to be in writing, was the written document specific enough?
   a. Identity of parties to the contract
   b. Subject matter of contract
   c. Material terms
   d. Consideration
   e. Signatures

These questions form the basis of step three, which includes an inquiry into contract formation and enforceability. Let's work with our "spy case." Katerina and Alesandr claim to have entered into a contract for espionage services in exchange for the U.S. Government providing lifetime financial support and security. Is that a legal subject matter and a legal purpose? Are there any public policy reasons why the contract would be unenforceable? This poses some interesting questions for us to ponder. Are there reasons why such a contract should not be enforceable? It is starting to look like we may have enforceability issues with our "spy case." However, before we reach a conclusion, let's continue with our analysis.

The next step in our analysis, step four, addresses whether there has been a breach of contract. Has one of the parties to the contract failed to perform any of its duties and obligations under the contract?

Knowing your Employer's Internet Policies

This chapter has focused on how to analyze a contracts problem. Such an exercise becomes difficult, even futile, if you do not have the information available to you. Many firms and businesses have e-mail policies where an e-mail is deleted from the system after a period of time. This policy is in place for a number of reasons but more often than not it is a practical reason—the old e-mails take up valuable space in the system. Some firms or businesses may delete the e-mails after a month; others may delete the e-mails after two weeks. The point is that so many of us read the e-mails we receive filled with important information but never print them for the file. We all know this a bad practice, even though we all have done it at one time or another. The point being if the firm or business with whom you are employed does have an e-mail policy, be sure you do not lose valuable information because you failed to make a hard copy of the e-mail or saved it in your computer. It is pretty safe to say that the technological trends are toward paperless environments. But with a paperless environment you must have a back-up system or back-up plan to preserve valuable client, firm and business information. When problems arise in a case,

and they do and will, having all your documentation organized and in a safe place is essential. Therefore, know what your employer's policies are regarding e-mail preservation or deletion because that policy may affect your job and ultimately the outcome of a case.

Breach of Contract and Performance

Performance is important to any contract. The hope is that all the parties to a contract perform in accordance with the terms of the contract, but we know that is not always the case and if it was, many of us would be out of a job. Failure to perform duties and obligations that have been promised causes a breach of contract. There are many reasons for a breach of contract and thus, in this step we tackle when and how a breach may occur. You must ask yourself in analyzing a breach of contract problem the following:

(1) Were all the terms and conditions performed under the contract?
   a. Condition precedent
   b. Concurrent condition
   c. Condition subsequent
(2) Was performance under the contract possible?
   a. Impossibility of performance
   b. Frustration of purpose
   c. Impracticability
   d. Excuse
(3) Did any party repudiate the contract?
(4) Did any party abandon contractual duties under the contract?

Your answers to the above questions will depend upon what type of contract issue you may have. Again, be mindful that you could have multiple issues in a contracts problem or you could have a simple breach of contract case. The point is keep analyzing the facts to determine what issues you may have. Now back to our spy case. From the facts given to us by Katerina and Alesandr, there may be a breach of contract on the part of the Government. Can the U.S. Government breach a contract for espionage services of ex-spies? On the face, it looks like the Smirnikoffs have a claim for breach of contract against the U.S. Government. Here it is important to narrow the issues, but do not fail to consider what the other side may have to say about the situation, which always can be a significant variable. At least we are beginning to see the issues formulate in our spy case.

Remedies: To What is the Client Entitled?

The final step in our substantive analysis is if a breach occurred, is the injured party entitled to a remedy, either legal or equitable? That is step five. Here, you must analyze what

is going to make a party whole again: damages in the form of money or equity in the form of specific performance, for example. Under a remedy analysis, ask yourself:

(1) What is the injured party's expectation?
(2) What type of remedy will adequately compensate the injured party?
(3) Is the appropriate remedy a legal remedy or equitable remedy?

In this case, you will have to analyze whether money damages are adequate because remember if money damages can compensate an injured party, then an equitable remedy would not be appropriate. Think about what your client wants to accomplish and the best means to accomplish those goals. Once again, you may have to consult your attorney in this area because remedies can be very complex. Remember, communication is key to your success and time is money—often the client's!

To conclude, let's determine whether Katrina and Alesandr Smirnikoff have a case against the U.S. Government. *Tenet v. Doe,* 544 U.S. 1, 125 S. Ct. 1230, 161 L. Ed. 2d 82 (2005) is instructive.

Line of Reasoning

This is the real case upon which our introductory fact pattern is based. It is a recent U.S. Supreme Court case. A husband and wife, John and Jane Doe (fictitious names to protect their real identity) filed a lawsuit for breach of an espionage contract with the Central Intelligence Agency and the U.S. Government (collectively the Government). An interesting note about this case is that the Government never acknowledged knowing the plaintiffs or their allegations. They did not deny them either. The facts as presented by the Does are that they were citizens of a foreign country considered an enemy of the U.S. They were approached by CIA agents after the Does expressed interest in defecting to the U.S. According to the Does, John was a high ranking diplomat for the foreign country in which they lived. The CIA persuaded the Does to stay in their home country and provide information to the U.S. in exchange for safe passage to the U.S. along with financial and personal security for life. The Does performed the high risk espionage service for years. After some time the Does were brought to the U.S. given new identities, U.S. citizenship, employment, and financial assistance. John Doe became employed in the State of Washington and became financially self-sufficient. During that time period, the U.S. Government discontinued its financial assistance. However, in 1997, John was laid off from his employment because of a corporate merger. Because John was restricted as to the type of employment he could hold in the United States, he contacted the CIA for financial assistance. The CIA denied any further assistance. The Does filed a lawsuit because they could not provide for themselves; additionally, if they returned to their homeland, they would be faced with extreme sanctions. In the suit, the Does wanted the CIA to resume assistance and wanted a means to bring their claims before the CIA through due process.

An interesting aspect of this case is that by the time this case reached the U.S Supreme Court, the Does had been successful in the two lower courts. The U.S. District Court found for the Does, as did the U.S. Court of Appeals for the Ninth Circuit. Both lower court decisions discussed a case from 1876, *Totten v. United States*, 92 U.S. 105, 23 L.Ed 605 (1876) where a Civil War spy sued the U.S. Government to enforce its obligations under a secret espionage

agreement. Both lower courts dismissed this case as inapplicable. The U.S. Government lost at each level.

In its opening line of the case, Chief Justice Rehnquist for a unanimous court stated that the precedent for cases such as the Doe's was decided under the *Totten* case in 1876 holding that a Civil War "spy" could not bring a suit against the U.S. Government to enforce obligations under an espionage agreement. The Supreme Court applied this precedent and found that the Does could not bring a case for breach of espionage contract because of national security interests. In its reasoning, the court went into great detail about the *Totten* case. The *Totten* court reasoned that indeed the President had the authority to enter into "secret" contracts with "secret agents" and the essence of the contract was to be secret and remain so. As the *Totten* Court stressed:

> Both employer and agent must have understood that the lips of the other were to be forever sealed respecting the relation of either to the matter. This condition of the engagement was implied from the nature of the employment, and is implied in all secret employments of the government in time of war, or upon matters affecting our foreign relations, where a disclosure of the service might compromise or embarrass our government in its public duties, or endanger the person or injure the character of the agent.

The Rehnquist opinion then observed that "we thought it entirely incompatible with the nature of such a contract that a former spy could bring suit to enforce it." The court also advanced two important reasons for the nondisclosure of the relationship and the contract: public policy and the state secrets privilege. The public policy considerations forbid such lawsuits because of the highly confidential relationship between the parties. And, the state's secrets privilege—declared in *Totten*—prevents any lawsuit from ever reaching a question of evidence because the privilege trumped any claim. As the Court observed: "No matter the clothing in which alleged spies dress their claims, *Totten* precluded judicial review . . . where success depends upon the existence of their secret espionage relationship with the government." Case dismissed.

Questions for Analysis

Review *Tenet v. Doe.* Should the Does have had a legal remedy in their case? Why or why not? What would the result have been had the court overruled the precedent in *Totten*? Should the state secret privilege override contract considerations? Why or why not?

The *Tenet* case is important for a number of reasons. First, with all the analysis of contract formation, performance, and breach, there are other considerations which may preclude the enforcement of a contract. Two, the two lower courts—U.S. District Court and Ninth Circuit Court of Appeals—both found in favor of the Does, either ignoring or misapplying past U.S. Supreme Court precedent. Third, sometimes all the research in the world will not present a conclusive answer. And finally, sometimes your research does show a conclusive answer, but a Court may ignore it, distinguish it or create new law. The point being that not all your research will give you "the answer." All you can do and all your supervising attorney can do is present the best arguments and analysis possible for the client. Be creative and fearless, but truthful and professional in advancing a client's position.

State Your Case

Soriya lived in Iraq as a high school teacher. During the Gulf Wars, she was approached by some U.S. military personnel who enlisted Soriya to help them fight off Saddam Hussein's government. The military offered asylum in the United States to Soriya in exchange for her help. Soriya and the military representative hand wrote the following:

> As a member of the U.S. military, I am authorized to offer you, Soriya Hassan, assistance in coming to the United States. We will provide you with a new home, a job and financial assistance for 10 years. You must not disclose this

relationship to anyone. When we are satisfied that you have performed as agreed, we will arrange for you to be brought to the United States.

s/ Soriya Hassan

s/ Col. *********

Soriya provided the military with very valuable information. After two years of providing information, she was contacted by undisclosed U.S. military personnel. She was told she could seek refuge in the United States within the month. Soriya quietly left Iraq. She was provided a home and financial assistance, and worked as a teacher in the D.C. area for the first five years she was in the United States. When Soriya became ill and had to resign her position at the school, she contacted the Department of Defense for continued assistance. They refused and told her that they had fulfilled their end of the bargain. Soriya contacts your law firm to sue the U.S. government based upon the memorandum she signed. What arguments can Soriya make that the agreement is enforceable?

19.5 ANALYZING A PROBLEM UNDER THE UNIFORM COMMERCIAL CODE: A SALES PROBLEM

Analyzing a sales problem is much the same as a common law contract issue. The difference is that there is a specific statutory body of law which applies. You still need to analyze the basic contract issues, such as formation, enforceability, performance and remedies, except under the Uniform Commercial Code. As you have learned, the results are often quite different than a common law contracts scenario. Therefore, when analyzing a sales problem be sure to consider the following:

1. Who are your parties?
   a. Merchants
   b. Merchants and a consumer
   c. Consumers
2. Are there any Code definitions that must be considered?
3. Is there a firm offer? Acceptance?
   a. Does the Code provide guidance if additional terms exist?
   b. What is the parties' course of dealing with each other? Custom?
4. Are all the terms in writing?
   a. Has the Statute of Frauds been satisfied?
   b. What documentation is available?
5. Have all parties performed under the agreement?

6. Is there a breach?
    a. Who breached?
    b. Was the breach before or after acceptance of the goods?
7. What remedies are available?
    a. Consider remedies provisions in Article 2, Part 7.
    b. Seller's Remedies.
    c. Buyer's Remedies.

Remember that in a sales problem, the U.C.C. provides different applications and rules than the common law of contracts. The Code also provides a variety of different remedies for both the seller and buyer that are not provided under the common law. That is why it is critical to assess at the outset the applicable body of law that applies to your client's facts. As we have learned, the applicable body of law will determine many outcomes. With the U.C.C., there is more flexibility, such as in the formation stages. What clearly would not be a contract under common law contract principles is a contract under the U.C.C. In the case that follows, *Olé Mexican Foods, Inc. v. Hanson Staple Company*, 285 Ga. 288, 676 S.E. 2d 169 (2009), the court analyzed a sales transaction with an interesting twist.

Line of Reasoning

Olé Mexican Foods entered into a sales agreement with Hanson Staple to purchase $300,000 worth of packaging which was specially manufactured for it. Hanson claims that Olé failed to do this and filed a breach of contract claim. Olé claims that Hanson shipped defective product and in turn breached the contract. At some point after the filing of the lawsuit, the two parties entered into a hand written settlement agreement. Their attorneys were not involved. The settlement provided that Olé would purchase a minimum of $130,000 worth of current inventory from Hanson and "test the remainder inventory and . . . purchase additional inventory if it meets quality expectations." The trial court enforced the settlement agreement and found that the future purchases would be governed by the U.C.C. The appeals court reversed the trial court decision finding that among other things that the U.C.C did not apply to a settlement agreement because the primary purpose of the dispute involved the settlement not a sale of goods. Furthermore, the trial court attempted to apply the implied warranty provisions of the U.C.C to the settlement agreement mixing the warranty of merchantability with the obligations under the settlement agreement. The Georgia Supreme Court agreed to hear the case and determine "if and when the implied warranties found in the U.C.C. apply to settlement agreements involving the sale of goods." The court found that "implied warranties are applicable to such an agreement only if its predominant purpose is the sale of goods and not the settlement of litigation." In its analysis, the court determined that this case involved a hybrid contract. The court observed that in blended contracts, Article 2 only applies if the predominant purpose reflects a sales transaction. The court noted that here the case was the "settlement" of a sales transaction, and therein lies the added crinkle to the analysis. Even though the underlying transaction involved a sale of goods, the purpose of the settlement agreement was to settle litigation, not consummate a sale. Thus, the court concluded that the U.C.C.'s implied warranties of merchantability and fitness for a particular purpose apply to a settlement

agreement only if its predominant purpose was for the sale of packaging, which it was not. Additionally, the court looked to the intentions of the parties in that they did not intend to consummate a sale, but a settlement of their dispute. Any sale of goods—the $130,000 of packaging product—was only incidental to the settlement of the claims. The U.C.C. did not apply.

Questions for Analysis

Review *Olé Foods v. Hanson*. Are there facts which would have changed the court's result and found the U.C.C. applicable? What if Olé was required to buy $230,000 of product from Hanson? Would the predominant purpose have changed the focus of the settlement agreement? Explain your response.

19.6 COMMENCING YOUR LEGAL RESEARCH

You have analyzed your facts, determined your approach, and focused your issues. Step six in the process actually may be concurrent with your analysis, which is beginning your research to support your facts. In Chapter 1, an overview of the various legal resources in the contracts arena was presented. Use this chapter as a guide to begin your examination of your assignment addressing your client's legal problems or concerns. Be thorough and be complete with your research. Do not be surprised that your research may turn up additional issues that you initially did not contemplate or anticipate. Do not worry if this happens as this is very normal in the process. As you research and become more educated with the law of your facts, your inevitably becomes more refined and creates more issues. Embrace the fact that the research identified other legal issues. It will only make your final product more complete.

primary sources
Legal resources that include constitutions, cases, statutes, administrative rules and regulations, and court rules

mandatory primary source
Legal authority that must be followed by a court

persuasive primary source
Legal authority that is from another jurisdiction and is not required to be followed by the deciding court

secondary source
Legal resource that interprets a primary source or presents an opinion

Know the Sites You are Using

The accuracy and quality of your research counts—it is your reputation. Westlaw and Lexis are the most well known fee-based legal research sites, but of course there are others such as Versuslaw and Loislaw which are less comprehensive. Know whether the information you are relying upon comprises primary or secondary source materials. This matters as you know that some legal sources are weighed heavier than others. Consequently, are you using **primary sources** that are mandatory or persuasive? Recall from your legal research course that primary sources are either mandatory or persuasive. A **mandatory primary source** must be followed by a court; a **persuasive primary source** does not have to be followed and is usually offered to bolster a legal position when there is no case law in a jurisdiction on that subject or used to offer an alternative or change in position. Regardless of the type of primary source you are reviewing, you want to rely on primary sources rather than secondary sources. Recall that a **secondary source** is a source where someone, often a recognized professional in the area, presents an interpretation or opinion of primary sources. Unless a highly regarded treatise, these sources should not be the basis of your legal research and the sole sources for an assignment.

Therefore, the type of authority you use dictates its weight with your attorney and more importantly a court. Government and court Web sites have unedited and unannotated versions of cases and statutes, which is fine to use and rely upon. However, and this is a big however, the Internet has opened the door for an undetermined number of Web sites whose accuracy is unknown. Be mindful of the information you are using and its origins.

Additionally, general encyclopedia sites, such as Wikipedia, are excellent resources with one flaw—they are edited by the public and are not necessarily checked for accuracy. People have been known to deliberately input information that is inaccurate simply because they can. If Wikipedia cites a case, then find a copy of the case and read the complete case. Do not rely on the wiki's analysis; verify the information for yourself. Shortcuts are great, but on those occasions when the information is wrong or inaccurate, your work suffers and ultimately the client's case.

This text is not a legal research text but recall from your legal research class the importance of Shepardizing and KeyCite. Verifying the history and treatment of a case or statute is a necessary step in your process. If you are citing a primary source, take the time to check that it is still good law. Citing a bad case or repealed version of a statute is disastrous. Always be thorough in your research and verify your work.

Cybercises

Using your jurisdiction's legal research resources, locate five sources that will assist you in analyzing a contract's problem.

Strictly Speaking: Ethics and the Legal Professional

Our basic premise is that paralegals and nonlawyers cannot practice law. Under most circumstances in most jurisdictions any argument to the contrary is a non-starter. However, under certain specific and limited circumstances, paralegals and nonlawyers are authorized to represent and appear before boards, commissions, or administrative bodies on behalf of a client or other party. It seems a bit confusing and it is. There are areas carved out in federal and some state statutes that permit nonlawyers to represent individuals. These settings are very regulated and narrow. Areas such as immigration, social security, and tax law such as dealing with the Internal Revenue Service, permit nonlawyers to appear and "represent" parties before them. There are strict statutory guidelines, but once they are met, representation is not considered the unauthorized practice of law. On the flip side, states follow a more limited view in allowing nonlawyers to represent parties in the administrative setting. California is one jurisdiction that does allow nonlawyers to represent parties in some administrative settings. Others such as Michigan and the District of Columbia also have circumstances where nonlawyers represent a party before administrative bodies. In the state context, nonlawyers representing a party are clearly the exception and not the rule. What this means for you is that you need to research your state's position on the issue by reviewing the available statutory authority or administrative rules and regulations. Most bar associations have Advisory Legal Opinions on the subject and checking your state's bar association's position on the issue is time well spent, especially for those of you who may become independent contractors. The rules on this issue are developing and knowing the statutory requirements for practicing before an administrative body, whether federal or state, is critical.

Cybercises

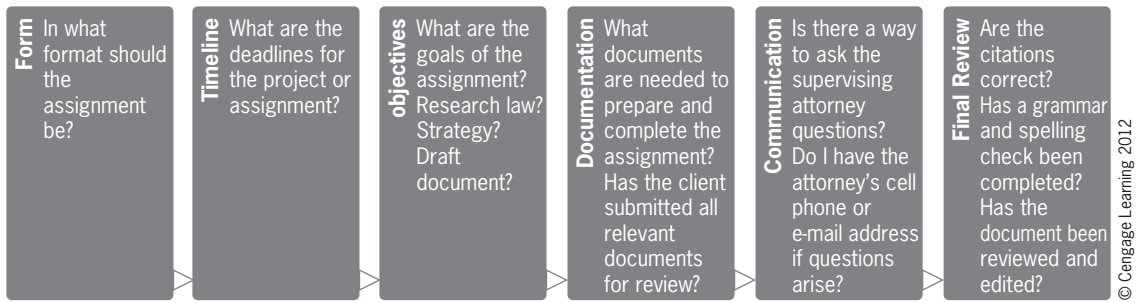
(1) Locate five federal administrative agencies which permit nonlawyers to represent a party in an administrative action and the conditions the nonlawyer must meet to appear before that administrative body. (2) Determine whether your jurisdiction permits nonlawyers to represent individuals in administrative actions.

19.7 PREPARING YOUR DOCUMENT

The final step in any assignment is preparing the legal document to submit to your supervising attorney. Usually your attorney will tell you in what form to submit your analysis. If that is not the case, ask, of course! Your final document may take the form of an interoffice memorandum to your attorney, a more formal memorandum of law to a court, a formal brief to a court such as an appeal or even a letter to a client detailing the results of the research and likelihood of success if legally pursued. Knowing the form your attorney expects is an important element in the process. You know what to do if you are not sure what he or she wants—ask.

Researching your assignment and writing down the results is only part of the process. You must draft, review, and edit your work. Usually one time will not suffice. You must be sure your grammar is correct, your citations are proper, and typographical errors are eliminated. This may seem like stating the obvious, but how you present your final document is a reflection on you—your work ethic. Sloppy work instills a negative impression on your boss—one which is difficult to erase if consistent. Therefore, take the time to perfect your document and review it. To be sure, have someone else review the document. When we work on a document for too long, we often do not see the errors any longer. A fresh eye is always good. If a colleague does not have time to review the document, then set aside the document for awhile. Take a break and then pick up the document again. Exhibit 19-1 is a checklist of questions to consider or ask your supervising attorney about an assignment.

EXHIBIT 19-1 Checklist of questions and general areas for an assignment



Additionally, be mindful that computer checks are not always foolproof. Sometimes they miss grammatical errors and absolutely do not catch errors of omitted words or words correctly spelled but misused. Watch out! We have all prepared a document and meant to say something in the negative but forgot to type in the word "not" in the sentence or somehow the "t" is left off the word, which completely changes the meaning of the sentence or argument. Read a document aloud. That may help catch errors as well. That's it!

19.8 PRACTICAL APPLICATION: A WALK-THROUGH

To complete our chapter, let's use a simple set of facts and analyze the problem together. The facts are as follows:

> Jason Rider was a student at State College located in Fargo, North Dakota on a hockey scholarship. As part of the preseason conditioning program, Jason was required to run in a 10 kilometer race that was sponsored by the State Organization for the Disabled ("SOD"). Prior to the race, Jason signed a release in the race registration form, which provided as follows:
>
> I am entering this event at my own risk and assume all responsibility for injuries I may incur as a direct or indirect result of my participation. For myself and my heirs, I agree not to hold the participating sponsors and their directors, employees, and/or agents responsible for any claims. I also give permission for the free use of my name and/or picture in a broadcast, telecast, or other account of this event.
>
> During the race Jason became dehydrated and suffered damage to his kidneys. Because of the race, Jason required numerous surgeries including one kidney and two liver transplants. Although Jason sued SOD for negligence, SOD defended based on contract.

In analyzing the above facts, let's assume you are representing Jason. The first question to ask yourself is: Are we dealing with a common law contracts issue or a sale of goods—a U.C.C. issue? This case clearly does not involve the sale of goods therefore, the common law of contracts applies.

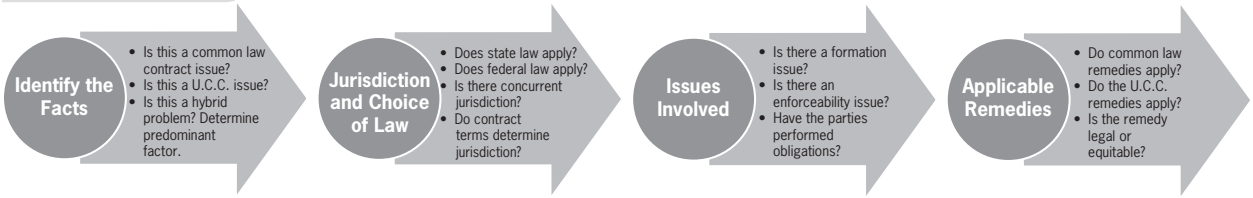
The next question is what law applies—state or federal. Here, the transaction involves a race in North Dakota and does not involve a federal question or diversity. Therefore, state law applies and since only North Dakota is involved, the laws of North Dakota would apply.

Now that we have that out of the way, what type of transaction do we have? There appears to be an offer, acceptance, and consideration. On its face, there appears to have been mutual assent, but the question is whether Jason was forced to sign the release freely or whether its enforcement would be unconscionable. Here, we have an overlap of formation and enforcement issues. Thus the question is, if there is mutual assent, is the release and "exculpatory clause" enforceable against Jason? In our facts, it states that he was required to run the race to be on the team. Could he have walked away from the race and still been on the team? Did that fact destroy mutual assent? Are there public policy reasons for not enforcing the exculpatory clause? Probably at this stage you would begin to research the issue in North Dakota and see what the case law is on the issue. Are there any other facts you need to know that may help you present a more complete analysis?

As part of your analysis, remember to consider the other side's argument. Of course, the sponsor of the race would argue that the "exculpatory clause" is reasonable and enforceable. Jason could have walked away from the race. The sponsors would present a straight contract argument where Jason would attempt to set aside the document he signed and

pursue his negligence claims. Exhibit 19-2 is a chart detailing the process of how to analyze a contracts problem.

EXHIBIT 19-2 Process for analyzing a contracts problem



As you can see, there is a "back and forth" that goes into your analysis. You make your best arguments and set forth your position with legal support. Easy, right?

Of course, the answer to the question is "not really." This all takes hard work, with some problems easier to analyze than others. Practice and experience do make the process easier and, at the very least, more familiar. As you begin your paralegal career, be mindful that slow and steady rules the day. Be professional and keep your integrity intact. That paves the way for a successful career.

State Your Case

Using our facts from above, determine whether Jason has a case by researching the law in the state of North Dakota.

SUMMARY

19.1 Before beginning the analysis of a contracts problem know your facts. Always ask questions for clarification. Do not proceed with an assignment if you are confused or unclear about what you need to do. Communication with your supervising attorney is critical.

19.2 It is important to any analysis to determine whether you are presented with a common law contracts problem or a sale of goods problem—a U.C.C. issue. Making this determination early in the process will determine the applicable body of law. In those cases where the problem is mixed, then determine the predominant purpose of the transaction.

19.3 Choice of law determines which state or federal law applies to a transaction. This can be determined by a contract provision; however, when this does not occur then look to factors such as where the contract was created, executed, or performed. These factors should be considered when the contract involves parties from different states as well. Different rules apply to transactions depending on the applicable state or federal laws. For judicial economy, state and federal claims,

arising out of the same set of facts, can be heard in the same court. Considerations should be given to the type of contract claim as that will determine not only the body of applicable law, but also the court where the claim is filed.

19.4 Once the applicable law is determined, then begin analyzing the facts to figure out what type of issue is presented. Begin by analyzing whether there is a formation issue followed by whether there is an enforcement issue. If the answers to these questions are in the negative then consider the performance and breach issues. Finally, determine what remedy is available for the problem determined by your analysis of the contract facts. Remember that most situations are not just one issue and can overlap. Be open to all possibilities.

19.5 Analyzing a sales transaction is much like a common law contracts issue. However, the body of law that applies is statutory—the Uniform Commercial Code. This distinction is important because under the U.C.C. the outcomes are often different than under a common law contracts approach. Follow the same analysis as in a common law problem, except focus on the concepts, including the definitions, included in the U.C.C. in reaching a conclusion.

19.6 When researching a contracts problem, use primary sources of the law. This will mainly include cases, statutes, and constitutions. When primary sources are not available in your state, looking to other jurisdictions law is helpful. Remember that a court does not have to follow another jurisdiction's decisional law as it is only persuasive authority. When using the Internet, know the sources that you are using and their accuracy. When possible, verify a secondary source with the primary source upon which it relies or is analyzing. Be thorough with your research and Shepardize and KeyCite the sources you cite in an assignment.

19.7 In preparing your final document be sure you review it. Check grammar and spelling. Review sentence structure. Edit your work and revise it. It usually requires more than one draft to reach the final product.

KEY TERMS

choice of law
venue
federal question jurisdiction
diversity jurisdiction
personal jurisdiction
subject matter jurisdiction
general jurisdiction
limited jurisdiction
judicial economy
pendent jurisdiction
concurrent jurisdiction
exclusive jurisdiction
in rem jurisdiction
primary sources
mandatory primary source
persuasive primary source
secondary source

REVIEW QUESTIONS

1. What questions should you ask before commencing an assignment?
2. Why is it important to determine the applicable law in a contracts transaction?
3. What is choice of law?

4. How would you analyze which body of law, state or federal, applies to a contracts problem?
5. Can state and federal claims be considered in one lawsuit? What is the concept called?
6. How would you commence an analysis of a common law contracts problem?
7. Contrast three differences between the common law of contracts and the Uniform Commercial Code.
8. What legal resources should you rely upon when researching a contracts problem and why?
9. What is the difference between a primary and secondary source?
10. In preparing your final document for your attorney, what tasks should you complete?

EXERCISES

1. Innovative Corporation is an advertising agency. Luxe Spas, Inc. is an all purpose spa chain that caters to individuals who want a total spa experience from the latest massage therapies to nutritional advice. Luxe wanted to create a new brochure and requested a number of advertising agencies to offer a mock-up for their review. Innovative was chosen to prepare the new brochure and advertising campaign. The estimated costs of the brochure were $10,000 including the labor, layout, copy, edit, and design. The parties signed a purchase order which included the purchase of 20,000 brochures to start. The purchase order which was on Luxe Spas letterhead stated:

   > Order is to be in accordance with the description below including delivery, prices, and specifications: 15-page full color brochure which includes, design, copy, edit, layout, typesetting, and materials. The total cost is $10,000.
   >
   > s/ Luxe Spas by its President
   > Arlene Springfield

   Both Innovative and Luxe worked together to create a brochure that was cutting edge. After both parties agreed on the basic text and presentation of the brochure, Innovative began presenting the design mock-ups for a 15-page brochure. At least five mock-ups were sent to Luxe, all of which were rejected. Luxe was not pleased with any of the mock-ups and sent Innovative a letter cancelling the contract. The letter stated that they would complete the brochure in house. What Innovative later found out was that Luxe hired another company who charged only $6,500 for the brochures. Luxe used most of Innovative's design. Innovative sent Luxe an invoice for $7,500 representing the cost of the labor, materials, and taxes for the work performed to date. Luxe refused to pay.

   a. What law applies to this transaction—the common law of contracts or the Uniform Commercial Code?
   b. Did Luxe Spas breach the contract?
   c. Would Innovative be entitled to any damages?

   Explain in detail the basis of your responses.

2. Plaintiff, Smithson Books, is a national book seller. Sometimes the plaintiff creates "cocktail books" and hires a publisher to assist in the development. Smithson wanted to produce a commemorative edition of great rock stars including information about their lives on and off the stage. Smithson was concerned about accuracy and wanted final approval of any text. Therefore, Smithson contracted with Doubletime Publishers. The two parties signed a contract for the production of a book entitled *The Lives and Times of the Greats of Rock 'n' Roll.* As part of the contract terms, Smithson was to have final approval of the text and content. Doubletime required a $25,000 down payment prior to commencing the work. The parties signed a contract on April 29, 2010. As part of the contract, Smithson would purchase 30,000 copies of the book for sale. The contract contained the following clause:

   > Doubletime shall either make or cause to be made such changes or deletions as may be necessary, in the opinion of such Smithson or Smithson's counsel, to make the work fit and acceptable for publication, or else Smithson shall have the absolute right to terminate this Agreement and recover the amount of the downpayment.

   Doubletime turned over the manuscript and after review, rejected it outright. Smithson demanded the return of the down payment.

   a. What law applies to this transaction and why?
   b. What issues can Doubletime raise in defense of keeping the down payment and why?
   c. Were Smithson's actions in terminating the contract appropriate?
   d. Does Article 2-718 of the Uniform Commercial Code apply to this transaction?
   e. Would any of your responses change if Doubletime resold the book to another publisher?

   Explain your answers.

3. Furnishings Depot is a home supply and design store. It supplies both installation and product from kitchens to bathrooms. Its staff helps customers pick products and then contracts for their installation if necessary. The Miltons wanted new carpeting and venetian blinds to update their home. They purchased carpeting for their living and dining rooms along with specially designed blinds. The total cost of the supplies and installation was $8,000. The Miltons financed the project with Furnishings Depot where they were required to pay $500 a month until the balance was paid. A dispute arose as to whether the alcove in the dining area was included in the price. Furnishings Depot claims it was not. The Miltons stopped paying on the installment contract. In an effort to settle the matter, the parties agreed to include the alcove for another $300. Furnishings thought they had an agreement, but the Miltons failed to pay any further payments. The agreement for the additional $300 was not in writing. Furnishings sued the Miltons. What issues can be raised by the parties to the transaction?

4. Assume the same facts from Exercise 3 above except that the Miltons tender a check in the amount of $5,000 and wrote on the back "Full and final payment of all obligations with Furnishings Depot." Furnishings crossed out the language the Miltons wrote on the back of the check and cashed it. Was the contract between the parties discharged? What would each party argue to a judge? Explain your response.

5. Samuel Biel contracted with Epoxy Coating Services to install an epoxy floor at his Sports Bar—the Racing Stripe. Under the contract, Epoxy would charge $6,000 to install the floor; there was a one-year warranty on the work. Epoxy Coating subcontracted with The Floorings Source for all its materials. When Epoxy began installing the flooring, it encountered problems. Epoxy brought in The Floorings Source to help. They all tried to correct the problem by installing a new floor free of charge. But, the floor was never right. Biel sued both Epoxy and The Floorings Source for breach of contract, damages, and lost profits.

   a. Was there a valid contract between Biel and Epoxy and The Floorings Source?
   b. Are there any limitations to the damages, if any, that Biel can claim?
   c. Draft warranty language that would protect or limit Biel's recovery from Epoxy?

   Explain in detail your responses.

6. Amanda and Jake Hathaway are in a real predicament. They want to live their life as husband and wife, but Amanda's evil boyfriend, Derrick, has a secret hanging over their heads. Derrick and Amanda have a child together. Amanda has been living with Derrick to keep the secret but it's wreaking havoc on her marriage with Jake. Derrick knows this and makes the following offer to Amanda: "If you agree to have another child with me, I will allow you to live with your husband Jake and I will give you joint custody of our children." Derrick also told Amanda that she would have to continue living with him until the baby is born and that she cannot see or go near Jake during her pregnancy. After much thought, Amanda agrees and signs the contract that Derrick presents her. Of course, Derrick was just tricking Amanda because right after she has the baby, Derrick refuses to allow Amanda to go home to Jake. Amanda has had enough and wants to sue Derrick in court.

   a. Do Amanda and Derrick have an enforceable contract?
   b. What defenses does Derrick have against Amanda's claims?

   Analyze all issues for this exercise.

7. Gracey's is a large department store chain, having stores all over the United States. Gracey's, along with Classic Productions, sponsors a talent search for the lead in a new rendition of the musical "Oliver." Gracey's publicized the search in local newspapers calling it "Where Dreams are Realized—The Search for Broadway's New Oliver." The ad stated:

   > If you are a boy between the ages of 7 and 11 years old, you could star in the Broadway production of "Oliver." Get an application at any Gracey's store

and bring it to the auditions at our flagship store in Philadelphia. The director will pick one lucky actor for callbacks in New York. The production will tour on the road and then open on Broadway.

Katherine picked up an application for her son, Marcus. On the back side of the application the "Official Rules" were set forth. One of the rules stated that "If a contestant/participant is chosen, it is within the sole discretion of the Broadway Company to determine contestant/participant's suitability to perform on Broadway." Additionally, the rules stated "The Producers or Gracey's makes no representations as to whether the winner of the contest would perform on Broadway or a road production only that the winner would be given the opportunity to perform in front of the Producers."

Marcus made it through the Philadelphia auditions and was asked to perform before the New York producers along with other children from around the country. After two days of auditions, Marcus was chosen to be the new Oliver. Gracey's announced Marcus's success to the public. Through his parents, Marcus signed a standard contract which stated that the producers reserve the right to replace Marcus so long as he is paid through the term of the contract. Marcus played Oliver during the road tour run, but one month before the musical was to open on Broadway, the producers informed Marcus that his services would no longer be needed.

Marcus's mom sued the producers and Gracey's.

a. What claims in contract does Marcus have against the producers and Gracey's? What are the defenses from Gracey's and the producers?
b. What were the terms of the contract that was formed between the parties?
c. Marcus's parents claim that the contract was ambiguous. What is the basis of such a claim?

Discuss the issues that may apply. As part of your analysis, examine what is required under a claim of ambiguity.

8. Robert Cantoni was employed with Software Specialists beginning in 1995. Over the years the company has had its share of lawsuits from employees and therefore beginning in 2002, the company required all employees to sign an employment agreement. Within the employment agreement was a clause that stated that "all disputes between the parties shall be resolved by arbitration." Along with all his colleagues, Robert signed the employment agreement. Had he not signed the agreement he would have been terminated from his job. In 2010, Robert had become disillusioned with the company and organized the employees to unionize. Before this could occur, Robert was terminated because the company was downsizing. Robert wants to sue for wrongful discharge and breach of contract basically alleging that the company only terminated him because he was assisting in unionizing the employees. Robert sues in the Superior Court in Connecticut. Software Associates immediately files a motion to dismiss the lawsuit based on the arbitration clause. What arguments can

Robert assert that the contract is invalid? What arguments will Software Associates advance in favor of the contract provisions enforceability?

9. Ned's Grocery Stores is located in California. Ned's contracts to buy 500 bushels of apples from Washington's Best Apple Orchards on September 4, 2010. The total price for the apples is $10,000. Ned's pays a deposit of $2,000 for Orchards' to process the shipment. The shipment is brought to the shipping carrier in Seattle on September 1, 2010. The apples are loaded in a container aboard the Carolina ship. While in transition, the ship is destroyed by a fire. Nothing on the ship survives. Washington's Best sends a letter explaining what happened regarding the incident. Ned's wants the return of its $2,000 deposit and the replacement of apples. Washington's Best states that Ned's is responsible for the shipment. What are the possible results of the dispute? What law applies to the transaction and why?

10. Wilson Royce purchases a Game Boy for his son on the Internet. He purchases the product over the Internet on www.discounterelectronicsforyou.com. Prior to his purchase, a pop-up box appears requesting that he accept the terms and conditions of purchase. He clicks "I accept" without scrolling down to read any of the terms. When Wilson receives the game boy, he tests it out. He attempts to charge it, but nothing happens. He even takes it over to a local electronics store to test it out—nothing. Wilson contacts the Web site through e-mail to tell them that the game boy does not work and he needs instructions for its return. Wilson receives a computer-generated response which states that the site where he purchased the game boy is not responsible for any repairs or replacement of any electronic products sold through the Web site. Wilson needs to deal directly with the manufacturer. Unbeknownst to Wilson, there was a pamphlet in the box in which the game boy was packaged which stated that "This product is "as is" and is at a special discounted price. Manufacturer makes **no warranties as to merchantability and fitness for a particular purpose**." Wilson never saw the pamphlet and claims that it was not included in the box. None of this information was posted on the Web site as well. Wilson now comes to your firm for advice on how to proceed with the return of the product. What law applies to the transaction? Are the Internet contracts enforceable against Wilson? What claims can Wilson assert against the website retailer and the manufacturer? What remedies, if any, does Wilson have against the Web site retailer and the manufacturer? Analyze all issues.

CASE ASSIGNMENTS

1. RetroCountry Records, RCR, is a new label. Under its President, Slim Daultry, its mission was to bring the new sound of country to a broader audience. To do so, Slim hired T. Man Flattery as his new vice president. Slim's marching orders to T. Man was to hire three executives who could find the best and most innovative talent in the industry. T. Man found just the men in Sandy Lords, Hatch Tompson, and Devin Morassey, all top executives from competing labels.

T. Man offered Sandy, Hatch, and Devin multi-year contracts which were to begin on October 1, 2010. All three executives quit their jobs at their respective record labels in anticipation of beginning work with RCR. Two weeks before the three were to begin, they received the following letter from the Human Resources director of RCR:

September 15, 2010

Dear Gentlemen:

In the event you received an offer of employment from T. Man Flattery, our former Vice President of Operations and Development to work for RCR, the proposed new country music label, the offer of employment is hereby revoked. Due to business concerns, the project is on hold indefinitely. We appreciate your interest in our company.

Sincerely,

N.B. Holcolm
Vice President of Human Resources
RCR Entertainment Industries, Inc.

The three men are stunned. They quit their jobs in reliance on the offer from T. Man. Someone has to pay and pay big. The men want to sue and have hired your law firm. In the first meeting, you learn that nothing was in writing. Prepare an outline of the questions and issues you need to develop to assist your supervising attorney in filing a lawsuit. As part of your outline, list the legal issues and counterarguments that can and will be made by both your clients and the potential defendants. Use your jurisdictional law as the basis for your research.

2. Linda Denton is a new and very important client. She is heartbroken over the recent passing of the "King of Country Music," Slim Preston. Although Linda is married, she had planned to divorce her husband, Kenny, to marry Slim. All the parties live in Tennessee. Linda tells this story to your attorney:

   Linda and Slim had been dating for a few years and they fell in love. Slim asked Linda to marry her, but before she could do that she had to get a divorce from her husband Kenny. To help Linda and entice Kenny to finalize the property settlement, Slim promised to pay off Linda's mortgage on her home. Unfortunately before Slim paid off the mortgage, he died of an apparent heart attack. The world was devastated to hear of Slim's passing, but no one more than Linda. Linda tried to contact the representative of Slim's estate

to pay off the mortgage as Slim had promised, but the representative refused. The representative simply offered his condolences to Linda and told her continued reliance on that promise was unreasonable and completely unjustified on her part. Linda continued her story by stating that Slim had installed a pool in her backyard, paid for landscaping of the house and bought her numerous other gifts. Nothing was in writing, but Linda had executed a settlement agreement with Kenny where she paid him $10,000 for his share of the equity in their home. The court approved the settlement after Slim's death. Linda assumed the mortgage debt herself under the assumption that Slim would pay the mortgage off when they were married. She owes $ 100,000 on the property with the monthly payments around $800.00 Now, Linda, who does not have a job, is faced with paying the monthly mortgage payments, which she cannot afford. She wants to know whether there is something your firm can do to enforce Slim's promise to pay off the mortgage.

a. What issues are raised by Linda's case and why?
b. What additional questions should be asked of Linda to assist in the analysis of her case?
c. What issues could be raised by Slim's estate to avoid enforcement of the promise?
d. What is the law in Tennessee on the issues you have identified as possible causes of action for Linda and the likelihood of success? Explain in detail your responses and prepare a memorandum for your attorney's review.

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Glossary

A

acceleration clause A clause in a note, mortgage, or other contract that provides that the entire debt will become due if payment is not made on time or if other conditions of the agreement are not met

acceptance The assent by the person to whom an offer is made. Acceptance is a fundamental element of a binding contract

accommodation An obligation undertaken, without consideration, on behalf of another person

accord Compromise or agreement between parties

accord and satisfaction An agreement between two persons, one of whom has a cause of action against the other, in which the claimant accepts a compromise in full satisfaction of a claim

adhesion contract A contract prepared by the dominant party (usually a form contract) and presented on a take-it-or-leave-it basis to the weaker party, who has no real opportunity to bargain about its terms

administrative law Body of laws that are imposed on administrative agencies by the courts or legislatures

administrator A person who is appointed by the court to manage the estate of a person either who died without a will or whose will failed to name an executor

affiant Person attesting to affidavit

affidavit Any voluntary statement reduced to writing and sworn to or affirmed before a person legally authorized to administer an oath or affirmation; a sworn statement

agent One of the parties to an agency relationship, specifically the one who acts for and represents the other party, who is known as the principal

alien Any person present within the borders of the United States who is not a U.S. citizen

antenuptial (prenuptial agreement) Written contracts executed prior to marriage which divide the parties' real and personal property in the event of divorce.

anticipatory breach (anticipatory repudiation) The announced intention of a party to a contract that it does not intend to perform its obligations under the contract

arbitration A method of settling disputes by submitting a disagreement to a person (an arbitrator) or a group of individuals (an arbitration panel) for decision instead of going to court

arbitrator Person(s) who hears arbitration case

assignee A person to whom a right is assigned

assignment 1. A transfer of property, or a right in property, from one person to another 2. A designation or appointment

assignor A person who assigns a right

B

bailee The person to whom property is entrusted in a bailment

bailor The person who entrusts property to another in a bailment

beneficiary 1. A person who receives a benefit from a contract 2. A person who is entitled to the proceeds of a life insurance policy when the insured dies

benefit Anything that adds to the advantage or security of another

bilateral contract A contract in which each party promises performance to the other, the promise by the one furnishing the consideration for the promise from the other

biometrics Records a person's signature and then through software compares the signature against future signatures. It captures the unique qualities of how each person signs, such as pressure and duration in the signing process, and uses that information to authenticate a signature, similar to a fingerprint

black letter law The fundamental and well-established rules of law

boilerplate Language common to all legal documents of the same type; standardized language

breach Failure of a party to perform contract obligations

browsewrap agreement Internet agreement posted on web page which binds user by act of browsing

buyer A person or entity who makes a purchase

C

C & F Cost and freight

capacity 1. Competency in the law. 2. A person's ability to understand the nature and effect of the act in which he or she is engaged

case headnotes Short case summary at the beginning of a case that identifies a point of law within a case; prepared by the publisher and is not part of the formal court opinion

case summary Section at the beginning of a case that summarizes general information about the case; it is usually prepared by the publisher of the case and the court

cause of action Circumstances that give a person that right to bring a lawsuit and to receive relief from a court

choice of law Legal rules that apply to a transaction

choice of law clause Selection of jurisdiction by parties as to place of filing of case where dispute arises

C.I.F. Cost, insurance, and freight

CISG Governs international sales between merchants

clickwrap agreement Internet contract that requires a person to click "I accept" to accept online

closing Completing a transaction, particularly a contract for the sale of real estate

common carrier A person or company engaged in the business of transporting persons or property from place to place, for compensation

common law Law found in the decisions of the courts rather than statutes; judge-made law

compensatory damages (actual damages) Damages recoverable in a lawsuit for loss or injury suffered by the plaintiff as a result of the defendant's conduct. Also called actual damages

complaint The initial pleading in a civil action, in which the plaintiff alleges a cause of action and asks that the wrong done be remedied by the court

compromise and settlement agreement Amount agreed to by parties in settling disputed claims

concurrent conditions Conditions that occur at the same time

concurrent jurisdiction More than two types of courts' authority to hear the same type of case

condition precedent A condition that must first occur for a contractual obligation (or a provision of a will, deed, or the like) to attach

condition subsequent In a contract, a condition that divests contractual liability that has already attached upon the failure of the other party to the contract to comply with its terms

consequential damages Indirect losses; damages that do not result from the wrongful act itself, but from the result or the aftermath of the wrongful act

consideration That which is given in exchange for performance or the promise to perform; the price bargained and paid; the inducement. Essential element of a valid and enforceable contract

conspicuous Clearly visible: easily seen

constitutions Documents that set out the basic principles and general laws of a country, state, or an organization

constructive condition (implied in law condition) A condition that is implied by a court to avoid an injustice or unfairness

copyright The right of an author, granted by federal statute, to exclusively control the reproduction distribution, and sale of literary, artistic, or intellectual productions for the period of the copyright's existence

counteroffer A position taken in response to an offer, proposing a different deal; new offer

covenant not to compete (restrictive covenant) A provision in a contract that restricts a party's ability to compete. Arise in employment or business contracts

cover A remedy under the U.C.C., which allows a buyer, if the seller has breached a contract of sale, to purchase the goods elsewhere (the "cover") and hold the seller liable for the difference between the cost of the cover and the original contract price

creditor beneficiary A creditor who is the beneficiary of a contract made between the debtor and a third person

custom A practice that has acquired the force of law because it has been done that way for a long time

cybercrimes Crime committed on the Internet, through cyberspace or through any electronic method of communication

D

damages The sum of money that may be recovered in the courts as financial reparation for an injury or wrong suffered as a result of breach of contract or a tortuous act

decedent A person who has died

deed A document by which real property, or an interest in real property, is conveyed from one person to another

defendant The person against whom an action is brought

delegation The act of conferring authority upon, or transferring a duty, to another

detriment Undertaking some responsibility one is not legally bound to undertake or in refraining from exercising some right one would otherwise have been entitled to exercise

dicta (dictum) Part of a case decision that is not directly related to the reasoning of the court in reaching the result of the case

digital signatures A signature captured by an electronic fingerprint or coded message that is unique to the signer of the document

directed verdict A verdict in which the judge takes the decision out of the jury's hands; the judge decides the case rather than the jury based upon the evidence presented

disaffirmance The refusal to fulfill a voidable contract; disavowal; renunciation

discharge Release from a contract either by agreement or carrying out the obligations

diversity jurisdiction Federal jurisdiction involving parties from different states or another country with a minimum of $75,000 in controversy

divisible contract A contract whose parts are capable of separate or independent treatment; a contract that is enforceable as to a part which is valid, even though another part is invalid and unenforceable

document of title A document evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods to which it pertains

donee A person to whom a gift is made

donee beneficiary Third-party beneficiary to a contract. The benefit is in the form of a gift which may be revoked

dowry Under the Code Civil, the property a woman brings to her husband when she marries

draft An order in writing by one person on another (commonly a bank) to pay a specified sum of money to a third person on demand or at a stated future time

duress Coercion applied for the purpose of compelling a person to do, or to refrain from doing, some act

E

election of remedy A requirement in the law that a party to a lawsuit must choose between different types of relief allowed by law on the same set of facts. The adoption of one has the effect of barring use of the others

encryption A process that converts plaintext or disguises it so it can only be read by the intended user

equitable relief (equitable remedy) Relief other than money damages

E-SIGN Federal law that addresses electronic signatures and records

estoppel (estoppel by contract) A prohibition against denying the validity or significance of acts done in performance of a contract

ex parte Refers to an application made to the court by one party without notice to the other party

ex-ship A term that refers to goods that are shipped by sea

exclusive jurisdiction Authority of only that court to hear cases of the subject matter in controversy, i.e. bankruptcy court

exculpatory clause A clause in a contract or other legal document excusing a party from liability for a wrongful act

executed contract A contract whose terms have been fully performed

executor A person designated by a testator to carry out the directions and requests in the testator's will and to dispose of [the testator's] property according to the provisions of his or her will

executory contract A contract yet to be performed

express condition A condition that is stated

express contract A contract whose terms are stated by the parties

express warranty A warranty created by the seller in a contract for sale of goods, in which the seller, orally or in writing, makes representations regarding the quality or condition of the goods

F

F.A.S. Free along side

federal question jurisdiction Jurisdiction involving the U.S. Constitution, federal statute or U.S. Government

fiduciary relationship A relationship between two persons in which one is obligated to act with the utmost good faith, honesty, and loyalty on behalf of the other

firm offers Under the Uniform Commercial Code, a merchant's written offer to buy or sell goods that will be held open for a period of time without requiring consideration to be valid

F.O.B. Free on board

force majeure A provision in a contract that excuses nonperformance because of the occurrence of an unforeseeable event, such as an act of God

form A printed instrument with blank spaces for the insertion of such details as may be required to make it a complete document

formal contract 1. A signed, written contract, as opposed to an oral contract. 2. A contract that must be in a certain form to be valid

formbook Multivolume set of books that contains examples or templates of legal documents to assist in drafting

forum selection clause Clause requiring consent to jurisdiction in another place other than home state

four corners doctrine The face of a document or instrument; relates to the act of construing a document based upon the document alone, without recourse to extrinsic evidence

fraud Deceit, deception, or trickery that is intended to induce, and does induce, another to part with anything of value or surrender some legal right

frustration of purpose An event that may excuse nonperformance of a contract because it defeats or nullifies the objective of the parties under which they entered into the contract

full warranty A warranty that is not confined to specified defects and that covers labor as well as materials

G

general jurisdiction Power of state court to hear a case; usually granted by statute or state constitution

gift A voluntary transfer of property by one person to another without any consideration or compensation

goods All personal property or movables, commodities, including futures and fungibles

guarantor A person who makes or gives a guaranty

guardian A person empowered by the law to care for another who, by virtue of mental capacity, is legally unable to care for himself or herself

H

holding The legal principle that a case stands for; the result

hornbook Legal book that summarizes a legal subject; usually used by law students

I

illusory promise A promise whose performance is completely up to the promisor; the promise cannot form the basis of a valid contract

implied condition (implied in fact condition) A condition that is inferred by the law from the acts of the parties

implied in fact contract A contract in which the law infers from the circumstances, conduct, acts, or relationship of the parties rather than from their spoken words

implied in law contracts Quasi contracts are those imposed by the law, usually to prevent unjust enrichment

implied warranty A warranty by the seller, inferred by law (whether or not the seller intended to create the warranty), as to the quality or condition of the goods sold

impracticability Excuses a party from an obligation in a contract that has become unrealistic because of unforeseen circumstances

in rem jurisdiction Court's jurisdiction over real or personal property

incidental beneficiary A person to whom the benefits of a contract between two other people accrue merely as a matter of happenstance. An incidental beneficiary may not sue to enforce such a contract

indemnification The act of or agreeing to pay or compensate someone for their loss

indemnitor A person who indemnifies another

informal contract A contract not in the customary form, often an oral contract

injunction A court order that commands or prohibits some act or course of conduct; form of equitable relief

installment A payment of money due, the balance of which is to be paid at other agreed-upon times

installment contract A contract that requires or authorizes the delivery of goods in separate lots

insurable interest An interest from whose existence the owner derives a benefit and whose nonexistence will cause him or her to suffer a loss

integrated contract A written contract that contains all the terms and conditions of the parties' agreement and cannot be modified by parol evidence

intended beneficiary third party who will specifically benefit from a contract

irrevocable offer An offer made in a signed writing, which, by its terms, gives assurance that it will be held open and not terminated by the offeror

J

judicial economy Doctrine which allows court to hear both state and federal claims in the same lawsuit to avoid multiple court cases

leading object rule (main purpose rule) The rule that a contract to guarantee the debt of another must be in writing does not apply if the promisor's "leading object" or "main purpose" in giving the guaranty was to benefit himself or herself

lease A contract for the possession of real estate in consideration of payment of rent

legal remedy A remedy available through legal action

legal treatise Scholarly book on a specific legal subject; usually multivolume

legalese Legal jargon; legal or archaic language

legality The condition of conformity with the law; lawfulness

lessee The person receiving the right of possession of real property, or possession and use of personal property, under a lease. A lessee is also known as a tenant

letter of credit A written promise, generally by a bank, that it will honor drafts made upon it by a specified customer so long as the conditions described in the letter are complied with

license legal mechanism to use a product without ownership

limited jurisdiction Court's authority to hear only certain types of cases

limited warranty A warranty that is limited in duration or confined to specified defects

liquidated claim Specific sum owed to a person

M

Magnuson-Moss Warranty Act Federal law that applies to warranties for transactions for products used by a household, family or individuals

mailbox rule Rule in contract law that acceptance of an offer is effective upon dispatch (i.e., mailing) by the offeree and not upon receipt by the offeror

mandatory authority Legal authority that must be followed by a court

mandatory primary source Legal authority that must be followed by a court

merchant A person who regularly trades in a particular type of goods

merger clause (integration clause) A clause in a contract that integrates all prior agreements into the contract with any prior contradictory terms or conditions excluded from the final contract of the parties.

minor A person who has not yet attained his or her majority

misrepresentation A misstatement of fact designed to lead one to believe that something is other than it is; a false statement of fact designed to deceive

mistake An error, a misunderstanding; an inaccuracy in contract formation

mitigation of damages A doctrine in the law which requires an injured party to avoid or lessen the consequences of the other party's wrongful act

motion An application made to a court for the purpose of obtaining an order or rule directing something to be done in favor of the applicant. Motions may be written or oral, depending on the type of relief sought on the court in which they are made

mutual assent A meeting of the minds; consent; agreement

mutual mistake A misconception common to both parties to an agreement, each laboring under the same set of facts with respect to a material fact justifying reformation of the contract or rescission

mutuality Two persons having the same relationship toward each other with respect to a particular right, obligation, burden, or benefit

N

necessities Things reasonably necessary for maintaining a person in accordance with his or her position in life, i.e., shelter, food, clothing, and medical care

negligence The failure to do something that a reasonable person would do in the same circumstances, or the doing of something a reasonable person would not do

negotiable Transferable by indorsement or delivery

no arrival, no sale A term in a contract for sale of goods; if the goods do not arrive at their destination, title does not pass to the buyer and no liability for the purchase price

nominal damages Damages awarded to a plaintiff in a very small or merely symbolic amount

nonnegotiable A document or instrument not transferable by indorsement or delivery

notary public A public officer whose function is to attest to the genuineness of documents and to administer oaths

novation The extinguishment of one obligation by another; a substituted contract that dissolves a previous contractual duty and creates a new one

O

obligor the person who owes an obligation to another; a promisor

offer A proposal made with the purpose of obtaining an acceptance, thereby creating a contract

offeree A person to whom an offer is made

offeror A person who makes an offer

option contract An offer, combined with an agreement supported by consideration not to revoke the offer for a specified period of time

output contract Contract where seller/offeror agrees to sell all its product to one buyer/offeree

overreaching Taking unfair advantage in bargaining

P

parol evidence rule Rule that written contracts may not be varied, contradicted, or altered by any prior or contemporaneous oral declarations

past consideration Something for value given, which the giver calls consideration in an attempt to create a valid contract

patent The exclusive right granted by the federal government to a person who invents or discovers a device or process that is new and useful

pendent jurisdiction Court's ability to hear state claims in federal court as facts of case arise from same occurrence; state claims "piggy back" on related claims

performance The doing of that which is required by a contract at the time, place, and in the manner stipulated in the contract, according to the terms of the contract

permanent injunction An injunction granted after a final hearing on the merits

personal jurisdiction Court's authority over a person in a lawsuit

persuasive authority Legal authority that may be followed by a court; usually from another jurisdiction or secondary source

persuasive primary source Legal authority that is from another jurisdiction and is not required to be followed by the deciding court

plain meaning The rule that in interpreting a contract whose wording is unambiguous, the courts will follow the "generally accepted meaning" of the words used

plaintiff A person who brings a lawsuit

pleadings Formal statements contained within a legal document by the parties to an action setting forth their claims or defenses

precedent Prior decisions of the same court or a higher court that a judge must follow

preliminary injunction An injunction granted prior to a full hearing on the merits. Its purpose is to preserve the status quo until the final hearing

preliminary negotiation Parties who commence the contracting or bargaining process. A form of solicition

prenuptial agreement An agreement between two independent individuals prior to marriage that sets forth the terms and conditions of the division of property in the event of a divorce

primary sources Legal resources that include constitutions, cases, statutes, administrative rules and regulations, and court rules

principal In an agency relationship, the person for whom the agent acts and from whom the agent receives his or her authority to act

privity An identity of interest between persons, so that the legal interest of one person is measured by the same legal right as the other; continuity of interest; successive relationships to the same rights of property

probate The judicial act or process whereby a will is adjudicated to be valid

procedural rules Rules established by courts and legislatures that parties must follow

procedural unconscionability Circumstance where one party to a contract lacks meaningful choice or assent to a contract

promisee A person to whom a promise is made

promisor A person who makes a promise

promissory estoppel Legal principle that a promisor will be bound to a promise, even though it is without consideration, if he or she intended that the promise should be relied upon or to prevent injustice

puffing Exaggerating or "talking up" of a product based on opinion

punitive (exemplary) damages Damages that are awarded over and above compensatory damages because of the wanton, reckless, or malicious nature of the wrong done by the plaintiff

Q

quantum meruit The doctrine of quantum meruit makes a person liable to pay for services or goods that he or she accepts while knowing that the other party expects to be paid, even if there is no express contract, to avoid unjust enrichment

quasi contract An obligation imposed by law to achieve equity, usually to prevent unjust enrichment

R

ratification Approval of a previous act; A person expressly promising to be bound by a contract through an act or conduct

reasoning A court's legal basis for deciding a case

reformation An equitable remedy available to a party to a contract provided there is proof that the contract does not reflect the real agreement

rejection Any act or word of an offeree, communicated to an offeror, conveying his or her refusal of an offer

release The act of giving up or discharging a claim or right to the person against whom the claim exists or against whom the right is enforceable

reliance Remedy to prevent unjust enrichment; quantum meruit

replevin An action by which the owner of personal property taken or detained by another may recover possession of it

requirements contract Contract where buyer/offeree agrees to purchase all required supply from seller/offeror while contract in force

rescission The abrogation, annulment, or cancellation of a contract by the act of a party. May occur by mutual consent of the parties

Restatements A compilation of general areas of the law by the American Law Institute

restitution In both contract and tort, a remedy that restores the status quo; returns a person who has been wrongfully deprived of something to the position occupied before the wrong occurred

revocable The ability to cancel or withdraw

revocation A cancellation, or withdrawal of an offer

S

sale A transfer of title to property for money or its equivalent from seller to buyer

satisfaction Payment of the agreed amount

seal An imprint made upon an instrument by a device such as an engraved metallic plate, or upon wax affixed to the instrument. The seal symbolizes authority or authenticity

secondary source Legal resource that interprets a primary source or presents an opinion

seller A person or entity who sells property it owns; a vendor

shrinkwrap agreement Legal agreement inserted into product box, such as software, which by opening indicates assent to terms and conditions

solicitation Invitation to negotiate a contract

specific performance The equitable remedy of compelling performance of a contract where damages are an inadequate remedy

speculative damages Damages that have yet to occur and whose occurrence is doubtful

stare decisis "Stand by the thing decided"; related to the concept of precedent; rule that a court should apply the same legal principle to the same set of facts and apply it to later cases that are similar

statute of frauds A statute, existing in one or another form in every state, that requires certain classes of contracts to be in writing and signed by the parties. Its purpose is to prevent fraud or reduce the opportunities for fraud

statute of limitations Federal and state statutes prescribing the maximum period of time during which various types of civil actions and criminal prosecutions can be brought after the occurrence of the injury or the offense

stoppage in transit A right that a seller of goods on credit has to retake them while they are in the possession of a carrier or other intermediary, upon discovering that the buyer is insolvent

strict construction doctrine A narrow or literal construction of written material

strict liability Liability for an injury whether or not there is fault or negligence; absolute liability

subject matter Jurisdiction Court's authority to hear specific types of lawsuits, usually determined by state or federal statute

substantial performance Less than full performance of a contract; performance with minor defects or deviations in performance

substantive unconscionability Circumstance where contract terms are overly harsh or oppressive against one party

surety A person who promises to pay the debt or to satisfy the obligation of another person (the principal)

surrogacy contract A situation where a woman who "hosts" the fertilized egg of another woman in her womb or who is artificially inseminated with the sperm of a man who is in a relationship with someone else agrees to assign her parental rights to the donors

T

template Generic form of a document

temporary restraining order (TRO) Relief that the court is empowered to grant, without notice to the opposing party and pending a hearing on the merits, upon a showing that failure to do so will result in "immediate and irreparable injury, loss or damage"

term of art Technical words are words or expressions that have a particular meaning in a particular science or profession

termination A method of discharging or ending contractual obligations

third-party beneficiary contract A contract made for the benefit of a third person

title A document that evidences the rights of an owner; i.e., ownership rights

tort A wrong involving a breach of duty and resulting in an injury to the person or property of another

trademark A mark, design, title, logo, or motto used in the sale or advertising of products to identify them and distinguish them from the products of others

treble damages A form of punitive damages or exemplary damages authorized by statute in some circumstances if warranted by the severity of the violation or the seriousness of the wrong

U

UCITA Uniform law drafted by the NCCUSL to address electronic and Internet transactions; not widely used or accepted in commercial world

UETA A uniform act passed by most states addressing electronic signatures and records

unconscionability A form of contract where a dominant party has taken unfair advantage of a weaker party and has imposed terms and conditions that are unreasonable and one-sided

undue influence Inappropriate pressure exerted on a person for the purpose of causing a person to substitute his or her will for the will or wishes of another

Uniform Commercial Code One of the uniform laws, which has been adopted in much the same form in every state. It governs most aspects of commercial transactions

unilateral contract A contract in which there is a promise on one side only; a unilateral contract is an offer that is accepted not by another promise, but by performance

unilateral mistake A misconception by one, but not both, parties to a contract with respect to the terms of the contract

unjust enrichment The equitable doctrine that a person who unjustly receives property, money, or other benefits may not retain them without some compensation to the other party

unliquidated claim Sum owed unknown or disputed

usage of trade Any practice or method of dealing having regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question

usury Charging a rate of interest that exceeds the rate permitted by law

V

valid title Legal or lawful ownership

value The worth of a thing in money, material, services, or other things for which it may be exchanged

venue The county or judicial district in which a case is to be tried

void contract A contract that has no legal effect

void title Title without legal effect; a nullity

voidable contract A contract that may be avoided or cancelled by one of the parties

W

waiver The intentional relinquishment or renunciation of a right, claim, or privilege that a person has

warranty A promise, either express or implied by law, with respect to the quality, fitness or merchantability of an article of sale

warranty of title A warranty by the seller, implied by law, that it has ownership to the goods

will An instrument by which a person makes a disposition of his or her property to take effect after his or her death

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