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# CONTRACT LAW

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# FORMATION OF CONTRACT

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## TYPES OF CONTRACTS

A contract is a legally enforceable agreement. There are three basic requirements for a valid contract to come into formation;

- 1) **Mutual assent** which is
  - a) offer
  - b) acceptance
- 2) **Consideration** or its substitute
- 3) **No defenses** to the formation or enforceability of the contract.

## GENERAL CONTRACT INFORMATION

- A contract can be **express** (written or spoken words) or it can be **implied** (this is where the terms of the contract are imputed at least in part, by conduct.)
- A contract can be **bilateral** - this is where the offer is open as to method of acceptance, or it can be a **unilateral** contract - this is where the offer specifies performance as the only permitted method of acceptance.

A contract will always be a bilateral contract unless the contract specifically requires performance for acceptance, or the offer is in regard to a reward or prize.

A **quasi contract** is an equitable remedy that is not based on contract law. It occurs when a plaintiff has conferred a benefit on the defendant and reasonably expects to get paid but can not enforce payment under strict contract rules. Because the defendant would be unjustly enriched if the plaintiff was not compensated, under quasi contract law, the plaintiff can enforce up to the contract price in recovery.

Quasi contract also comes in to play where pursuant to a contract, one party makes a payment to another party in expectation of performance by that other party. If through no fault of either party, the contract is avoided and the recipient of the money has now gained a benefit at no cost to himself (because the contract was avoided), under quasi contract law he will have to return the payment/benefit, to prevent unjust enrichment.

All contracts are governed by common law unless they relate to the **sale of goods** in which case they fall under **ARTICLE 2 of the UCC**.

- A sale of goods contract is governed by Article 2 even if the sale is a one-off sale by a non-merchant.
  - Goods include large objects that are built to order; for example a contract to have a boat built is a sale of goods.
- The sale of property is governed by common law and not Article 2 because real property is not a sale of goods.

- Where a contract is drawn up for the provision of both service and goods (for example, a contract to paint a house that includes both the services of a painter and the provision of paint), we look to see whether the main provision is the goods or the service. The main provision will determine whether the contract is treated as one for a sale of goods or one for the provision of services.
- **Article 2A** governs the **lease of goods**. It is mainly similar to Article 2.

## OFFER

An offer is a manifestation of an intent to enter into a contract. The test of whether words constitute an offer is usually whether a reasonable person would believe that his acceptance of the words would create a contract. The person making the offer is the offeror and the person to whom the offer is made is the offeree.

### Certainty of terms of the offer

#### **General terms of the offer**

Though we use the term **offer**, the following section on uncertain terms, applies equally to agreements, whether they are at the offer stage, or at the completed signed contract stage.

An offer that does not contain or clarify all relevant terms is not necessarily an unenforceable offer. Generally, if the missing/unclear term is not a material term, the courts will, if necessary, impose a reasonable interpretation on the term.

#### **Price**

##### *Offer is Silent about the price*

Under the common law, where the offer does not mention a price, the offer will not be valid. For offers governed by the UCC, if the offer does not mention a price, the courts will impose a reasonable price upon the offer, providing the circumstances infer that the offeror intended to be bound (or in the case of a completed contract, providing the circumstances infer that the parties intended to form an enforceable agreement).

##### *Offer is Vague about the price*

Both under the UCC and the common law, where an offer is **vague** about the price, the offer will not be enforceable. For example, if A offers to sell his car to B for a “fair price”, this will not be a valid offer.

##### *Offer specifies that parties will clarify price at a later time*

For offers governed by the **common law**, an agreement to clarify a term of the offer at a later time does not make the offer voidable unless the term is a material term such as price or quantity. For offers governed by the **UCC**, an offer containing an agreement to clarify a term at a later time does not make the offer voidable, even if the term is a material term such as price. The courts will impose a reasonable price upon the offer providing the circumstances infer that offeror intended to make an enforceable offer (or in the case of a completed contract, providing the circumstances infer that the parties intended to form an enforceable agreement).

## Subject of an offer

Where the **subject** of an offer is vague, this does not invalidate the offer, as evidence can be brought to show what was meant by the offer. This applies to offers governed by both the common law and by the UCC.

## Quantity

An offer for sale of goods that does not mention specific quantity but rather talks in terms of the **buyers' requirements**, or the **sellers output**, is a valid and enforceable offer. For example, an offer from A to buy all of B's wood is a valid offer. Similarly an offer by B to supply all of A's wood requirements for the next three years is valid. The buyer or seller will be in breach of contract if they do not supply or buy the goods as contracted provided that the parties' demands are proportionate to the original agreement. Thus if A bought 1000 tons of woods from B in the first three years, he can't hold B in breach of contract if he then orders 200,000 tons the next years and B cannot supply him with that much.

## Context

An **advertisement is generally not an offer** and nor is a general price quotation. However if someone quotes a price in response to an individual enquiry this would be an offer. Similarly an advertisement that specifies the quantities available and who may accept the offer would be a valid offer.

## Termination of Offer (Four Methods)

After an offer has been extended but before an offer has been accepted, there are four methods of terminating an offer. Once an offer has been terminated, the offeree cannot then try and accept the offer.

### Method 1     *Words or conduct of offeree rejecting offer*

**Rejection** If the offeree tells the offeror that he is not interested in accepting the offer, this would terminate the offer.

**Counter-offer** If the offeree responds to an offer with a counter-offer, this will terminate the original offer and the offeror is no longer bound to his original offer. For example, if A offers to sell his watch to B for \$10 and B responds by saying "I'll give you \$8," then B has rejected the offer at \$10 and has made his own offer to buy the watch at \$8. If A were to accept the counteroffer, B would be obligated to buy at \$8. Either way, once the counter offer is made, A is no longer obliged to sell at \$10 because his offer to sell at \$10 was rejected by B.

**A counteroffer is different from a plea or bargain** - This is where A offers to sell his watch to B for \$10 and B responds by saying "will you accept \$8" - B has not rejected the offer at \$10, rather, he has made a plea to buy the watch at \$8. If A were to reject the plea of \$8, B can still force A to stand by his original offer at \$10.

**Conditional acceptance** If the offeree accepts but make it clear that his acceptance is dependant on certain terms not mentioned in original offer, it is considered a new counter-offer.

(Similarly) Adding terms to a contract under common law. If the offeree accepts, but adds a new term not included in the original offer, it has the effect of a new counter-offer. See below, how this rule contrasts with the rule governing the sale of goods under Article 2.

**Adding terms to a contract for sale of goods – Article 2 UCC** Where there is an offer for sale of goods, a response to an offer with additional terms does not void the offer, but rather is considered an acceptance of the offer (sometimes referred to as a seasonable expression of acceptance).

With respect to the additional terms added in by the offeree, if both parties are merchants, the general rule is that the additional clauses become part of the contract unless the offeror expressly objects to the additional clauses **or** the additional clauses materially change the offer.

Where one or both of the parties are not merchants, the general offer stands, but the offeror is not bound by the additional terms of the offeree unless he expressly accepted them.

### **Method 2      *Lapse of time***

Where the offer fails to specify how long it is being kept open for, the general rule is that a lapse of a few months will terminate the offer.

### **Method 3      *Words or conduct of offeror revokes offer***

- a) The offeror can terminate the offer if he clearly **tells the offeree** of his unwillingness or inability to continue the offer. Of course, this option is only open to the offeror, prior to the time the offeree has accepted the offer. If the offeree has already accepted the offer, the offeror can not withdraw the offer.
- b) The offeror can terminate the offer if he clearly **shows by his conduct** his unwillingness or inability to continue the offer **and the offeree is made aware of this conduct**. The offeree need not learn of this conduct directly from the offeror himself, she may learn of it because she was told by a third party. For example if A offers to sell B his car and the next day B sees C driving that car and C tells B that A has sold him the car, than B has been shown conduct of A that clearly shows that A has revoked his original offer to her. However if B were to be told that A has offered the car to C as well and that C had not yet accepted but was thinking it over, then this would not constitute a notification of a revocation of A's offer to her but simply notification that A was extending the same offer to C and that either B or C could accept the offer.

Note, that a public offer must be revoked in a similar way to that in which it was extended - i.e. if A advertises in the NY Times a reward for finding a dog, if he wishes to revoke this offer, he should do so publicly in the NY Times.

**A revocation of an offer sent through the mail is not effective until received by the offeree**

#### **Method 4      *Death of a party prior to acceptance***

The death or incapacity of either party prior to an acceptance terminates the offer. Thus if A offers to sell his watch to B on Sunday and dies on Monday, if B mails an acceptance on Tuesday not knowing that A has died, there will be no contract as A's death terminates his offer, even if B does not know of the death prior to accepting the offer. There are only two exceptions to this rule and they are if B has an **option on the offer** or **has started performance on a unilateral contract**.

Thus, it is always crucial to check whether the offeror terminated the offer before it was accepted by the offeree. In general an offer can always be revoked before it has been accepted. There are four exceptions to this rule:

1)      **Option**

If the offeror **promises** to keep an offer open **AND** has received **consideration** from the offeree in exchange for this promise, (this is known as an option), such an offer cannot be revoked.

2)      **Firm offer rule**

Under Article 2 UCC an offer cannot be revoked for up to three months if

a.      The offer was for the **sale of goods**

b.      There is a **signed written** promise to **keep the offer open**. If the promise was to keep the offer open for less than three months, than this will be the length of time for which the promise must be kept open. If the promise was for a period of time exceeding three months, under this rule there is only a requirement to keep the offer open for three months. If the promise is silent as to the length of time the offer is to be kept open for, then it will be irrevocable for a reasonable time up to three months.

c.      **By a merchant**

(Note that no consideration by the offeree is required under this rule. Also a written offer does not suffice, the written offer must also promise to **keep the offer open**)

**NEW YORK DISTINCTION**      In NY all **signed written** promises to keep an offer open, even those not relating to the sale of goods, are irrevocable for the period stated or a reasonable period where no period is stated.

3)      **Detrimental reliance**

An offer cannot be revoked if there has been detrimental reliance by the offeree that was **reasonably foreseeable**.

4)      **Start of performance of unilateral contract**

(Multi-state only - in NY start of performance does not make offer irrevocable).

If the offeree, pursuant to a unilateral contract that permits acceptance by performance only, starts to perform, the offeror cannot revoke the offer. For example if A offers B \$1,000 to paint his house and contracts that this offers is accepted only when B starts to paint, then if B does in fact begin the work, A

cannot revoke the offer. (Note - in many cases starting performance would trigger rule #3 anyway).

Note that start of performance of a bilateral contract would almost certainly constitute acceptance of an offer, in which case the offeror would also not be able to revoke. However, this would be because the initiation of performance on a bilateral contract by the offeree is considered an acceptance of the offer. Here, we are talking about where an offeror cannot revoke an offer before it has been accepted.

## ACCEPTANCE

In general, **an offer can only be accepted by the person to whom the offer was made and only if he is aware of the offer.** Although options can be assigned, offers cannot.

Thus if A posts a reward for finding his dog, and B returns it not knowing of the offer, he cannot hold A to the reward because he could not accept an offer that he did not know of.

Similarly if A offers to sell B his car for \$100, C cannot hold A to that offer.

There are **five** ways of accepting an offer.

### 1. Starting Performance

Starting performance will be considered acceptance in bilateral contracts. Thus if A offers B \$1 to paint his house and B starts painting but is then offered \$2 by C to paint C's house, because B has started performance, and part performance is considered an acceptance of an offer in a bilateral contract, A can enforce the contract against B. Similarly, if A wanted to change his mind and scrap the project, B could enforce the contract against A because B has already accepted A's offer and it is thus too late for A to revoke.

On the other hand if it is a unilateral contract, i.e., A has specified that it can only be accepted by performance, then part performance by B will not constitute acceptance and A will not be able to bind him to the contract.

### 2. Offeree promises to perform

With the exception of unilateral contracts that require performance as the method of acceptance, a promise to perform is a valid acceptance.

### 3. Offeree accepts through the mail

The **general rule** is that where the offeree by implication or by express words is allowed to accept through the mail, his **acceptance becomes effective as soon as it is mailed.** This is different to revocation of an offer that is effective when the offeree receives it. Consider an example where A offers to sell his watch to B on Jan 1st and on Jan 2nd sends B a letter revoking the offer which B receives on Jan 4th. In the meantime on Jan 3rd B sends A a letter accepting the offer, B's acceptance will be valid even though A mailed the revocation before B mailed the acceptance.

## Exceptions to rule

- (i) Offer expressly requires receipt  
The rule that the acceptance is effective once mailed does not apply where the offer specifically states that the acceptance is not effective until received.
- (ii) Rejection than acceptance  
If the offeree rejects the offer but then accepts the offer, the acceptance is not effective when mailed - whichever arrives first controls - i.e., if the acceptance arrives before the rejection, the acceptance is effective, and if the rejection arrives first, that causes the offer to terminate and when the acceptance arrives it is too late.
- (iii) Acceptance then rejection  
The mailbox rule will apply so that if the acceptance was mailed before the rejection letter, the offeror can enforce the offeree's acceptance as soon as the acceptance letter hits the mailbox, even if he saw the rejection before he found out about the acceptance. However, the offeree cannot necessarily hold the offeror to this and thus if the offeror saw the rejection letter first and relied on the rejection, i.e., he made plans on the basis that the offeree had rejected the offer, the offeree cannot enforce the contract by using the mailbox rule.
- (iv) Option contracts  
Where there is an option to keep a contract open, the acceptance is only effective upon receipt.

## 4. Accepting goods

Where the buyer makes an offer to buy a good from the seller and the seller ships the wrong goods in response and acceptance of the offer, the seller has accepted the buyer's offer and is in breach of the contract for sending the wrong goods. However if the seller sends the wrong goods with an explanation saying he hopes that the alternative goods he has sent will suffice, this has the effect of rejecting the initial offer relating to the original good and instead it is considered to be a submission of a counteroffer to sell the substitute goods. Thus if the buyer accepts the shipment he has accepted the new offer and if he rejects them he is simply rejecting the counteroffer and no one has committed a breach.

## 5. If the offeree is silent

The general rule is that silence in the face of an offer is not an acceptance unless the **offeree** provides that his silence should be construed as an acceptance. For example, "if you don't hear from me by Friday then assume that I have agreed to your offer." The reverse is not true. So without the offeree's express agreement, a stipulation by the **offeror** that silence from the offeree will constitute an acceptance does not bind the offeree.

## CONSIDERATION OR ITS SUBSTITUTE

Consideration is

- 1) **Bargained for exchanged**
- 2) **of legal value.**

In other words the promisee must give or do something (either tangible or intangible) that the **promisor** has asked for. Legal value is generally considered to be **detriment suffered by the promisee**. Most courts do not require that the detriment suffered be of benefit to the promisor. However the promisor must have offered the bargain to induce the promisee to suffer the detriment. A detriment is when the promise, at the promisor's request, does or forbears from doing anything that he had a legal right to do (or not to do). It does not matter if the promisee does not mind incurring the detriment, or even if he would have committed the same act without the bargain offered by the promise. For example, A promises B \$5 if he does not smoke for a week. Even if B hates smoking and had no intention of smoking that week, if he refrains from smoking for that week, he has suffered a legal detriment. He has refrained from doing something he had a legal right to do. Hence detriment is more to do with the state of mind of the promisor than the promisee. Did the promisor offer the bargain in order to induce the promisee to suffer the detriment? If he did, than the promisee, by suffering the detriment, gives bargained for legal value.

This is different from a conditional gift. For example, A says to B "come to my house and I will give you a television." Although B suffers a detriment by going to A's house, A did not bargain for this detriment, i.e., A does not promise to give B the TV because he wants B to come to his house but rather he was explaining to B how B could claim his gift. Someone who makes a promise of a gift is free to retract that promise and change his mind. Therefore, even if B comes to A's house, and therefore technically suffered a detriment, she can not force A to give him the television. Why not? Because as explained above, the detriment was not bargained for. A did not offer the television as an inducement to B to come to his house but rather, A was simply explaining to B how B could claim the gift of the television. However, let's say A has a crush on B and promises B the television if B will come and hang out with him for an hour, than A would be offering the television as an inducement to B and hence if B turned up at A's house as requested, she could force A to give her the television. Thus, we see that whether something is a bargained for detriment is determined by the state of mind of the offeror.

#### PAST CONSIDERATION

The general rule is that a promise cannot be supported by consideration that has already happened - i.e. if A saves B's life and then B promises A money in gratitude, this would not be a binding promise because A has not provided consideration. The saving of B's life took place before the promise of money and is therefore past consideration. However, if B asked A to save his life knowing that A would expect to get paid for his time, and then B promises money to A, this promise would be binding.

**In NY**, past consideration is good consideration if there is a written promise acknowledging the past consideration.

## **PRE-EXISTING CONTRACTUAL OR STATUTORY DUTY TO ACT**

### **Common law**

Where a person is acting out of a pre-existing duty, under common law such acts could not constitute consideration. For example, A was under a contractual duty to perform a concert but then threatened not to perform in breach of contract. B thus promised to pay A extra money to perform. The promise would not be enforceable because the subsequent performance is not considered valid consideration as the artist had a pre-existing duty to perform. The exception to this is if there was an unforeseen circumstance that would have excused the performance. In such a case, a promise of payment for the performance will be binding. This is because the performance will be considered valid consideration. Even though there was an initial pre-existing duty to perform, this was taken away by the unforeseen circumstance, and so now the only reason why performance occurred was because of the promise of extra payment.

### **Article 2**

For contracts under Article 2 – i.e. sale of goods, there is no pre-existing legal duty rule. Instead a promise to pay additional consideration on an existing contract will only be enforceable when the demand for additional consideration is made in good faith - i.e. circumstances change making the original asking price impractical etc.

## **PAYMENT BY THIRD PARTY WHERE THERE IS CONTRACTUAL OR STATUTORY DUTY TO ACT**

In such a case, the performance will be deemed consideration with regard to the promise of payment by the third party. Even though the artist was under a duty to perform, he did not owe this duty to the third party and thus the subsequent performance by the artist was a valid act of consideration with regard to the third party.

**In NY a written modification** to a contract that promises additional benefit for performance of a pre-existing duty will be enforceable even **without** new consideration.

## **PART PAYMENT AS CONSIDERATION FOR RELEASE OF DEBT**

If the debt is **undisputed** and is **due**, then part payment cannot be consideration for release of debt.

## **PROMISSORY ESTOPPEL**

Sometimes even where a promise is not supported by consideration, the promise will still be upheld because of the doctrine of promissory estoppel. This is a valid substitute for consideration. This occurs where due to a promise by the offeror; the offeree has **reasonably and foreseeably relied** on the promise, such that if the promise was not enforced, he would suffer a detriment. Such a promise will be enforced if it is necessary to **avoid an injustice**. For example, A promises B that he will not foreclose on B's mortgage. B then paints her house in reliance of this - this would be a case of promissory estoppel and the promise will be enforced.

## ILLUSORY PROMISES

***EXAM TIP:*** on the multi state exam, an option which has illusory promise as the answer is almost always wrong.

An illusory promise is where A pretends to commit to doing something but allows himself complete discretion to back out. For example, “I will buy your car tomorrow unless I decide not to” or A promises to supply B with “as many peaches as he requires” and B promises to buy “as many as I decide to” because B has not committed himself to anything, this is an illusory promise and hence B has failed to provide consideration.

## MISCELLANEOUS RULES

A written promise to pay a debt for which there is a legal defense, for example if the statute of limitations has expired, is enforceable without consideration from the recipient. For example if A writes a letter to B, saying “I know I owe you \$1000 and I promise I will pay you the money” - this promise is enforceable.

A written promise to release someone from a **breach of contract claim** is **enforceable** without consideration.