Business Law I

BUSINESS LAW I

MELANIE MORRIS

MEGAN DEMPSEY

Business Law I Copyright © 2024 by Melanie Morris is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License, except where otherwise noted.

CONTENTS

About this Book xi

Chapter 1 - Introduction to Law and Legal Systems 1

1.1 What Is and Why Study Law? 1

1.2 Schools of Legal Thought 2

1.3 Basic Concepts and Categories of U.S. Positive Law 6

1.4 Sources of Law and Their Priority 10

Activity 1A 13

Activity 1B 16

1.5 Legal and Political Systems of the World 17

1.6 Read A Sample Case 18

A Sample Case 19

Chapter 2 - Courts and the Legal Process 24

2.1 General Perspectives on Courts and the Legal Process 24

2.2 The Relationship between State and Federal Court Systems in the United States 25

Activity 2A 29

2.3 Subject Matter Jurisdiction – Original versus Appellate Jurisdiction 31

2.4 Personal Jurisdiction 34

Case 2.1 35

2.5 Venue 38

Activity 2B 38

2.6 How a Case Proceeds in Court 39

Case 2.2 46

Activity 2C 50

2.7 When Can Someone Bring a Lawsuit? 50

2.8 Relationships with Lawyers 51

Chapter 3 - Alternative Dispute Resolution 55
3.1 General Perspectives on Alternative Dispute Resolution 55
3.2 Negotiation 57
3.3 Mediation 58
3.4 Arbitration 60
Activity 3A 62
Activity 3B 65
3.5 Other Methods of Alternative Dispute Resolution 66
3.6 Public Policy, Legislation, and Alternative Dispute Resolution 67
Activity 3C 69

Chapter 4 - Introduction to Tort Law 72
4.1 Purpose of Tort Laws 72
4.2 Types of Torts 73
4.3 Intentional Torts 76
Case 4.1 77
Activity 4A 80
Activity 4B 82
Activity 4C 84
4.4 Negligence 85
Case 4.2 86
Case 4.3 89
4.5 Strict Liability 94
Activity 4D 94
Case 4.4 95

Chapter 5 - Introduction to Contract Law 99
5.1 General Perspectives on Contracts 99
5.2 Sources of Contract Law 101
5.3 Objective Theory of Contracts 104
5.4 Classifications of Contracts 104
Case 5.1 105
Case 5.2 107
Activity 5A 111

Chapter 6 -The Agreement 115
6.1 The Agreement 115
6.2 The Offer 116
Case 6.1 117
Case 6.2 121
6.3 Duration of Offer 124
6.4 The Acceptance 128
Activity 6A 131
Case 6.3 132
Activity 6B 133

Chapter 7 - Consideration 136
7.1 General Perspectives on Consideration 136
7.2 Requirements of Consideration 137
Activity 7A 138
Case 7.1 140
Case 7.2 142
Case 7.3 145
7.3 Promises Enforceable without Consideration 151
Activity 7B 153

Chapter 8 - Capacity 157
8.1 General Perspectives on Capacity 157
8.2 Minors (or "Infants") 158
Activity 8A 162
8.3 Persons Who Are Mentally Incapacitated 162
Activity 8B 163
8.4 Persons who are Intoxicated 164
Case 8.1 165
8.5 The Sword and Shield Doctrine 166
Activity 8C 167
Activity 8D 168

Chapter 9 - Legality 170
9.1 General Perspectives on Illegality 170
9.2 Agreements in Violation of Statute 171
Activity 9A 172
Case 9.1 174
9.3 Bargains Made Illegal by Common Law 176
Case 9.2 177
Activity 9B 180
Case 9.3 181
Activity 9C 185
9.4 Exceptions to Illegality 185

Chapter 10 - Real Assent 189
Case 10.1 192
Case 10.2 195
Case 10.3 198
Activity 10B 201
10.4 Nonfraudulent Misrepresentation 202
Case 10.4 204
References 208

Chapter 11 - Form and Meaning 210
11.1 General Perspectives on the Statute of Frauds 210
11.2 Contracts that must be Written under the Statute of Frauds 212
Case 11.1 214
Activity 11A 215
Case 11.2 218
Activity 11B 221
11.3 Sufficiency of the Required Writing 221
11.4 Exceptions; Oral Rescission 223
11.5 The Parol Evidence Rule 224
Case 11.3 227
11.6 Interpretation of Written Agreements 229
Activity 11C 231

Chapter 12 - Third-Party Rights 234
12.1 General Perspectives on Third-Party Rights 234
12.2 Assignment of Contract Rights 235
Case 12.1 238
Case 12.2 241
12.3 Delegation of Contract Duties 244
12.4 Third-Party Beneficiaries 246
Case 12.3 248
Activity 12A 250

Chapter 13 - Performance and Discharge 253
13.1 Discharge of Contract Duties by Performance or Breach 253
Case 13.1 254
Activity 13A 259
13.2 Discharge by Conditions 260
Activity 13B 261
13.3 Discharge by Agreement 262
Case 13.2 263
13.4 Discharge by Operation of Law when Performance Becomes Very Difficult 265
Case 13.3 267
Activity 13C 270

Chapter 14 - Remedies 274
14.1 Theory of Contract Remedies 274
14.2 Promisee's Interests Protected by Contract 276
Activity 14A 277
14.3 Legal Remedies: Damages 278
Case 14.1 280
Case 14.2 283
Activity 14B 286
14.4 Equitable Remedies 287
Case 14.3 288
Activity 14C 291
14.5 Limitations on Contract Remedies 292
Case 14.4 294
Activity 14D 299

Glossary 303

ABOUT THIS BOOK

This text is a revision and update to several Chapters taken from *Business Law and the Legal Environment* (2012) released by The Saylor Foundation under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensee.

The author/contributor on the revision is Melanie R.B. Morris, JD, MBA, with design and editorial support from Megan Dempsey, MSLIS, MA. The work was funded through a generous RVCC Foundation donor grant.

These materials are released under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International license.

CHAPTER 1 - INTRODUCTION TO LAW AND LEGAL SYSTEMS

Learning Objectives

After studying this chapter, you should be able to:

1. Distinguish different philosophies of law—schools of legal thought—and explain their relevance.
2. Describe the purpose of a functioning legal system.
3. Identify the sources of law and which laws have priority over other laws.
4. Explain the basic differences between the U.S. legal system and other legal systems.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=23#h5p-4

1.1 WHAT IS AND WHY STUDY LAW?

WHY STUDY BUSINESS LAW?

The materials in this text are created for future business managers and leaders, shaping a foundation for understanding legal issues that those in these career paths will encounter in the workplace. The overarching goal of any course in **Business Law** is to develop the critical thinking skills that those in business professions will need to navigate and resolve legal conflicts.

As a basic text in Business Law, these materials will focus mostly on aspects of the **law** that impact business and commercial transactions. Because many areas of the law touch on business transactions, so, too, will these materials, in terms of topical coverage, in terms of examples, and in terms of questions and exercises. An important outcome in any Business Law course is one of protection. Knowing what is and isn't lawful, and where to get accurate and credible sources of legal information, is paramount to protecting one's products, one's employer, and one's employees. On the other hand, being unaware of the boundaries of lawful conduct can cause a manager to run afoul of the law, and expose the organization to complaints, lawsuits, and costly damage awards.

With this in mind, look for this course and these materials to provide knowledge and inquiry to aid in

shaping the business leader you want to become. In order to start this journey, these materials assume no prior knowledge and start with very basic information about the law and the U.S. legal system.

WHAT IS LAW?

Black's Law Dictionary may well be the most popular and widely used legal dictionary in the United States. *Black's Law Dictionary* says that law is "a body of rules of action or conduct prescribed by controlling authority, and having binding legal force. That which must be obeyed and followed by citizens subject to sanctions or legal consequence is a law." Simply put, law is a system of rules that we, as members of society, live by.

To recognize a rule of law, there are several things that you can look for to help distinguish law from some other type of rule in our society. Determine where the rule comes from. Laws will come from a "controlling authority" such as a government body. Ask yourself if you can find the rule written somewhere. Laws that we must abide by are written down since law must be predictable. Finally, figure out if there is a consequence to not following the rule. If there is a consequence or detriment to ignoring or refusing to follow the rule that can be enforced by the government, you are likely dealing with a law.

Most likely, your favorite retail establishment has a return policy. That policy may be enforced without exception at that store, but that policy isn't a law because it isn't created by a controlling authority. If you go to another retail shop, the return policy may be different, or there may be no policy, leaving a store clerk to decide on a case by case request for a return. A business establishment that makes policies for its operations would not be making law. Contrast that example with a customer smoking inside your favorite retail establishment. In New Jersey, this would be a violation of a law because the New Jersey Smoke Free Air Act (the "Act") states that "Smoking is prohibited in an indoor public place or workplace …" Written and voted on in our state legislature, signed by Governor Codey in 2006, subjecting smokers to fines for violating the Act – this is a good example of a law that impacts business.

FUNCTIONS OF THE LAW

Generally, the law can serve to (1) keep the peace, (2) maintain the status quo, (3) preserve individual rights, (4) protect minorities against majorities, (5) promote social justice, and (6) provide for orderly social change. Some legal systems are able to serve these purposes better than others. Still other legal systems might rebalance or remove one or more of these functions. For instance, there are some nations that do not have as a legal priority the function of preserving individual rights. Outside of the United States, some legal systems may incorporate other functions to promote a particular way of life, such as the maintenance of authoritarian rule, or to incorporate religious doctrine within the rule of law.

1.2 SCHOOLS OF LEGAL THOUGHT

There are different schools (or philosophies) concerning what law is all about. Philosophy of law is also called jurisprudence, and the two main schools of thought which are most influential in how people think about the law are legal positivism and **natural law**.

LEGAL POSITIVISM: LAW AS SOVEREIGN COMMAND

As legal philosopher John Austin concisely put it, "Law is the command of a sovereign." Law is only law, in other words, if it comes from a recognized authority and can be enforced by that authority, or sovereign—such as a king, a president, or a dictator—who has power within a defined area or territory. Positivism is a philosophical movement claiming that science provides the only knowledge precise enough to be worthwhile. But what are we to make of the social phenomena of laws?

We could examine existing **statutes—executive orders**, **regulations**, or **judicial decisions**—in a fairly precise way to find out what the law says. For example, we could look at the posted speed limits on most U.S. highways and conclude that the "correct" or "right" speed is no more than fifty-five miles per hour. Or we could look a little deeper and find out how the written law is usually applied. Doing so, we might conclude that sixty-one miles per hour is generally allowed by most state troopers, but that occasionally someone gets ticketed for doing fifty-seven miles per hour in a fifty-five miles per hour zone. Either approach is empirical, even if not rigorously scientific. The first approach, examining in a precise way what the rule itself says, is sometimes known as the "**positivist**" school of legal thought. The second approach—which relies on social context and the actual behavior of the principal actors who enforce the law—is akin to the "**legal realist**" **school of thought** discussed below.

Positivism has its limits and its critics. New Testament readers may recall that King Herod, fearing the birth of a Messiah, issued a decree that all male children below a certain age be killed. Because it was the command of a sovereign, the decree was carried out (or, in legal jargon, the decree was "executed"). Suppose a group seizes power in a particular place and commands that women cannot attend school and can only be treated medically by women, even if their condition is life-threatening and women doctors are few and far between. Suppose also that this command is carried out, just because it is the law and is enforced with a vengeance. People who live there will undoubtedly question the wisdom, justice, or goodness of such a law, but it is law nonetheless and is generally carried out. To avoid the law's impact, a citizen would have to flee the country entirely. During the Taliban rule in Afghanistan, from which this example is drawn, many did flee.

The positive-law school of legal thought would recognize the lawmaker's command as legitimate; questions about the law's morality or immorality would not be important. In contrast, the natural-law school of legal thought would refuse to recognize the legitimacy of laws that did not conform to natural, universal, or divine law. If a lawmaker issued a command that was in violation of **natural law**, a citizen would be morally justified in demonstrating civil disobedience. For example, in refusing to give up her seat to a white person, Rosa Parks believed that she was refusing to obey an unjust law.

NATURAL LAW

The **natural-law** school of thought emphasizes that law should be based on a universal moral order. **Natural law** was "discovered" by humans through the use of reason and by choosing between that which is good and that which is evil. Here is the definition of natural law according to the *Cambridge Dictionary of Philosophy*: "Natural law, also called the law of nature in moral and political philosophy, is an objective norm or set of objective norms governing human behavior, similar to the **positive laws** of a human ruler, but binding on all people alike and usually understood as involving a superhuman legislator."

Both the U.S. Constitution and the United Nations (UN) Charter have an affinity for the natural-law outlook, as it emphasizes certain objective norms and rights of individuals and nations. The U.Ss Declaration of Independence embodies a natural-law philosophy. The following short extract should provide some sense of the deep beliefs in natural law held by those who signed the document.

Figure 1.1 Excerpt from the Unanimous Declaration of the Thirteen United States of America

> July 4, 1776
>
> When in the Course of human events, it becomes necessary for one people to dissolve the political bands which have connected them with another, and to assume among the powers of the earth, the separate and equal station to which the Laws of Nature and of Nature's God entitle them, a decent respect to the opinions of mankind requires that they should declare the causes which impel them to the separation.
>
> We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the Pursuit of Happiness. That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed.…

The natural-law school has been very influential in American legal thinking. The idea that certain rights, for example, are "unalienable" (as expressed in the Declaration of Independence and in the writings of John Locke) is consistent with this view of the law. Individuals may have "God-given" or "natural" rights that government cannot legitimately take away. Government only by consent of the governed is a natural outgrowth of this view.

Civil disobedience—in the tradition of Henry Thoreau, Mahatma Gandhi, or Martin Luther King Jr.—becomes a matter of morality over "unnatural" law. For example, in his "Letter from Birmingham Jail," Martin Luther King Jr. claims that obeying an unjust law is not moral and that deliberately disobeying an unjust law is in fact a moral act that expresses "the highest respect for law": "An individual who breaks a law that conscience tells him is unjust, and who willingly accepts the penalty of imprisonment in order to arouse the conscience of the community over its injustice, is in reality expressing the highest respect for law.…One who breaks an unjust law must do so openly, lovingly, and with a willingness to accept the penalty."

Legal positivists, on the other hand, would say that we cannot know with real confidence what "natural" law or "universal" law is. In studying law, we can most effectively learn by just looking at what the written law says, or by examining how it has been applied. In response, natural-law thinkers would argue that if we care about justice, every law and every legal system must be held accountable to some higher standard, however hard that may be to define.

It is easier to know what the law "is" than what the law "should be." Equal employment laws, for example, have specific statutes, rules and decisions about racial discrimination. There are always difficult issues of interpretation and decision, which is why courts will resolve differing views. But

how can we know the more fundamental “ought” or “should” of human equality? For example, how do we *know* that “all men are created equal” (from the Declaration of Independence)? Setting aside for the moment questions about the equality of women, or that of slaves, who were not counted as men with equal rights at the time of the declaration—can the statement be empirically proven, or is it simply a matter of a priori knowledge? (*A priori* means “existing in the mind prior to and independent of experience.”) Or is the statement about equality a matter of faith or belief, not really provable either scientifically or rationally? The dialogue between natural-law theorists and more empirically oriented theories of “what law is” will raise similar questions. In this book, we will focus mostly on the law as it is, but not without also raising questions about what it could or should be.

OTHER SCHOOLS OF LEGAL THOUGHT

The **historical school of thought** believes that societies should base their legal decisions of today on the examples of the past. **Precedent** would be more important than moral arguments.

The **legal realist** school flourished in the 1920s and 1930s as a reaction to the historical school. Legal realists pointed out that because life and society are constantly changing, certain laws and doctrines have to be altered or modernized in order to remain current. The social context of law was more important to legal realists than the formal application of precedent to current or future legal disputes. Rather than suppose that judges inevitably acted objectively in applying an existing rule to a set of facts, legal realists observed that judges had their own beliefs, operated in a social context, and would give legal decisions based on their beliefs and their own social context.

The legal realist view influenced the emergence of the **critical legal studies (CLS) school of thought**. The “Crits” believe that the social order (and the law) is dominated by those with power, wealth, and influence. Some Crits are clearly influenced by the economist Karl Marx and also by distributive justice theory. The CLS school believes that the wealthy have historically oppressed or exploited those with less wealth and have maintained social control through law. In so doing, the wealthy have perpetuated an unjust distribution of both rights and goods in society. Law is politics and is thus not neutral or value-free. The CLS movement would use the law to overturn the hierarchical structures of domination in the modern society.

Related to the CLS school, yet different, is the **ecofeminist school of legal thought**. This school emphasizes—and would modify—the long-standing domination of men over both women and the rest of the natural world. Ecofeminists would say that the same social mentality that leads to exploitation of women is at the root of man’s exploitation and degradation of the natural environment. They would say that male ownership of land has led to a “dominator culture,” in which man is not so much a steward of the existing environment or those “subordinate” to him, but is charged with making all that he controls economically “productive.” Wives, children, land, and animals are valued as economic resources, and legal systems (until the nineteenth century) largely conferred rights only to men with land. Ecofeminists would say that even with increasing civil and political rights for women (such as the right to vote) and with some nations’ recognizing the rights of children and animals and caring for the environment, the legacy of the past for most nations still confirms the preeminence of “man” and his dominance of both women and nature.

1.3 BASIC CONCEPTS AND CATEGORIES OF U.S. POSITIVE LAW

Most of what we discuss in this book is **positive law**—U.S. positive law in particular. However, we will also consider the laws and legal systems of other nations. But first it will be useful to cover some basic concepts and distinctions.

LAW: THE MORAL MINIMUMS IN A DEMOCRATIC SOCIETY

The law does not correct (or claim to correct) every wrong that occurs in society. At a minimum, it aims to curb the worst kind of wrongs, the kinds of wrongs that violate what might be called the "moral minimums" that a community demands of its members. These include not only violations of criminal law but also **torts** and broken promises. Thus, it may be wrong to refuse to return a phone call from a friend, but that wrong will not result in a viable lawsuit against you. But if a phone (or the Internet) is used to **libel** or **slander** someone, a tort has been committed, and the law may allow the **defamed** person to be **compensated**.

There is a strong association between what we generally think of as ethical behavior and what the laws require and provide. For example, contract law upholds society's sense that promises—in general—should be kept. Promise-breaking is seen as unethical. The law provides remedies for broken promises (in breach of contract cases) but not for all broken promises; some excuses are accepted when it would be reasonable to do so. For tort law, harming others is considered unethical. If people are not restrained by law from harming one another, orderly society would be undone, leading to anarchy. Tort law provides for compensation when serious injuries or harms occur. As for **property** law issues, we generally believe that private ownership of property is socially useful and generally desirable, and it is generally protected (with some exceptions) by laws. You can't throw a party at my house without my permission, but my right to do whatever I want on my own property may be limited by law; I can't, without the public's permission, operate an incinerator on my property and burn heavy metals, as toxic ash may be deposited throughout the neighborhood.

LAW AND POLITICS

In the United States, legislators, judges, administrative agencies, governors, and presidents make law, with substantial input from corporations, lobbyists, and a diverse group of nongovernment organizations (NGOs) such as the American Petroleum Institute, the Sierra Club, and the National Rifle Association. In the fifty states, judges are often appointed by governors or elected by the people. The process of electing state judges has become more and more politicized in the past fifteen years, with growing campaign contributions from those who would seek to seat judges with similar political leanings.

In the federal system, judges are appointed by an elected official (the president) and confirmed by other elected officials (the Senate). If the president is from one party and the other party holds a majority of Senate seats, political conflicts may come up during the judges' confirmation processes. Such a division has been fairly frequent over the past fifty years.

In most nation-states (as countries are called in **international law**), knowing who has power to make and enforce the laws is a matter of knowing who has political power; in many places, the people or groups that have military power can also command political power to make and enforce the laws.

Revolutions are difficult and contentious, but each year there are revolts against existing political-legal authority; an aspiration for democratic rule, or greater "rights" for citizens, is a recurring theme in politics and law.

THE COMMON LAW: PROPERTY, TORTS, AND CONTRACTS

Even before legislatures met to make rules for society, disputes happened and judges decided them. In England, judges began writing down the facts of a case and the reasons for their decision. They often resorted to deciding cases on the basis of prior written decisions. In relying on those prior decisions, the judge would reason that since a current case was pretty much like a prior case, it ought to be decided the same way. This is essentially reasoning by analogy. Thus, the use of **precedent** in common-law cases came into being, and a doctrine of **stare decisis** (pronounced STAR-ay-de-SIGH-sus) became accepted in English courts. *Stare decisis,* from Latin, means, "let the decision stand."

Most **judicial decisions** that don't apply legislative acts (known as **statutes**) will involve one of three areas of law—**property**, **contract**, or **tort**. Property law deals with the rights and duties of those who can legally own land (real property), how that ownership can be legally confirmed and protected, how property can be bought and sold, what the rights of tenants (renters) are, and what the various kinds of "estates" in land are (e.g., fee simple, life estate, future interest, easements, or rights of way). Contract law deals with what kinds of promises courts should enforce. For example, should courts enforce a contract where one of the parties was intoxicated, underage, or insane? Should courts enforce a contract where one of the parties seemed to have an unfair advantage? What kind of contracts would have to be in writing to be enforced by courts? Tort law deals with the types of cases that involve some kind of harm and or injury between the plaintiff and the defendant when no contract exists. Thus, if you are libeled or a competitor lies about your product, your remedy would be in tort, not contract.

The thirteen original colonies had been using English **common law** for many years, and they continued to do so after independence from England. Early cases from the first states are full of references to already-decided English cases. As years went by, many precedents were established by U.S. state courts, so that today a judicial opinion that refers to a seventeenth- or eighteenth-century English common-law case is quite rare.

Courts in one state may look to common-law decisions from the courts of other states where the reasoning in a similar case is persuasive. This will happen in "cases of first impression," a fact pattern or situation that the courts in one state have never seen before. But if the supreme court in a particular state has already ruled on a certain kind of case, lower courts in that state will always follow the rule set forth by their highest court.

STATE COURTS AND THE DOMAIN OF STATE LAW

In the early years of our nation, federal courts were not as active or important as state courts. States had jurisdiction (the power to make and enforce laws) over the most important aspects of business life. The power of state law has historically included governing the following kinds of issues and claims:

- **Contracts**, including sales, commercial paper, letters of credit, and secured transactions
- **Torts**

- **Property**, including real property, bailments of personal property (such as when you check your coat at a theater or leave your clothes with a dry cleaner), trademarks, copyrights, and the estates of decedents (dead people)
- Corporations
- Partnerships
- Domestic matters, including marriage, divorce, custody, adoption, and visitation
- Securities law
- Environmental law
- Agency law, governing the relationship between principals and their agents.
- Banking
- Insurance

Over the past eighty years, however, federal law has become increasingly important in many of these areas, including banking, securities, and environmental law.

CIVIL VERSUS CRIMINAL CASES

The distinction between **criminal law** and **civil law** in the U.S. legal system ensures that different types of **disputes** and **offenses** are handled appropriately. As related to laws that pertain to the operation of business, this text focuses principally on civil law. That said, criminal cases are certainly of interest to business, especially because it is possible for a business organization to break a criminal law. At the same time, it is important to understand the differences between a **criminal case** and a **civil** matter – the type that we will be studying here.

A criminal case involves a governmental decision—whether state or federal—to prosecute someone (named as a **defendant**) for violating society's criminal laws. The law establishes a moral minimum and does so especially in the area of criminal laws; if you break a criminal law, you can lose your freedom (in jail) or your life (if you are convicted of a **capital offense**). In a civil action, you would not be sent to prison; in the worst case, you can lose assets (usually **property** or money), such as when Ford Motor Company lost a personal injury case and the judge awarded $295 million to the plaintiffs or when Pennzoil won a $10.54 billion verdict against Texaco.

Some of the basic differences between civil law and criminal law cases are illustrated in the table below.

Figure 1.2 Differences between Civil Cases and Criminal Cases

	Civil Cases	Criminal Cases
Parties	Plaintiff brings case; defendant must answer or lose by default	Prosecutor brings case; defendant may remain silent
Proof	Preponderance of evidence	Beyond a reasonable doubt
Reasons	To settle disputes peacefully, usually between private parties	To maintain order in society To punish the most blameworthy To deter serious wrongdoing
Remedies	Money damages (legal remedy) Injunctions (equitable remedy) Specific performance (equity)	Fines, jail and forfeitures

You can often tell a civil case from a criminal case by looking at the caption of a case going to trial, because the caption of the case will show who the parties are. If the government appears first in the caption of the case (e.g., *U.S. v. Lieberman)*, it is likely that the United States is prosecuting a criminal case on behalf of the people. The same is true of cases prosecuted by state district attorneys (e.g., *New Jersey v. Seidel*). That said, this is not a foolproof formula as governments can also bring civil actions – say, for example, to collect debts from or settle disputes with individuals, corporations, or other governments. Thus *U.S. v. Mayer* might be a collection action for unpaid taxes, or a criminal case where the federal government is prosecuting the Defendant for committing a crime. Governments can be sued as well. People occasionally sue their state or federal government, but they can only get a trial if the government waives its **sovereign immunity** and allows such suits. *Warner v. U.S.*, for example, could be a claim for a tax refund wrongfully withheld or for damage caused to the Warner residence by a sonic boom from a U.S. Air Force jet flying overhead.

SUBSTANCE VERSUS PROCEDURE

Many **rules** and **regulations** in law are **substantive**, and others are procedural. We are used to seeing laws as substantive; that is, there is some rule of conduct or behavior that is called for or some action that is proscribed (prohibited). The substantive rules tell us how to act with one another and with the government. For example, all of the following are substantive rules of law and provide a kind of command or direction to citizens:

- Drive not more than fifty-five miles per hour where that speed limit is posted.
- Do not conspire to fix prices with competitors in the U.S. market.
- Do not falsely represent the curative effects of your over-the-counter herbal remedy.
- Do not drive your motor vehicle through an intersection while a red traffic signal faces the direction you are coming from.
- Do not discriminate against job applicants or employees on the basis of their race, sex, religion, or national origin.
- Do not discharge certain pollutants into the river without first getting a discharge permit.

In contrast, **procedural laws** are the rules of courts and administrative agencies. They tell us how to proceed if there is a **substantive-law** problem. For example, if you drive fifty-three miles per hour in a forty mile-per-hour zone on Main Street on a Saturday night and get a ticket, you have broken a

substantive rule of law (the posted speed limit). Just how and what gets decided in court is a matter of procedural law. Is the police officer's word final, or do you get your say before a judge? If so, who goes first, you or the officer? Do you have the right to be represented by legal counsel? Does the hearing or trial have to take place within a certain time period? A week? A month? How long can the state take to bring its case? What kinds of evidence will be relevant? Radar? (Does it matter what kind of training the officer has had on the radar device? Whether the radar device had been tested adequately?) The officer's personal observation? (What kind of training has he had, how is he qualified to judge the speed of a car, and other questions arise.) What if you unwisely bragged to a friend at a party recently that you went a hundred miles an hour on Main Street five years ago at half past three on a Tuesday morning? (If the prosecutor knows of this and the "friend" is willing to testify, is it relevant to the charge of fifty-three in a forty-mile-per-hour zone?)

In the United States, all state procedural laws must be fair, since the due process clause of the Fourteenth Amendment directs that no state shall deprive any citizen of "life, liberty, or property," without due process of law. (The $200 fine plus court costs is designed to deprive you of property, that is, money, if you violate the speed limit.) Federal laws must also be fair, because the Fifth Amendment to the U.S. Constitution has the exact same due process language as the Fourteenth Amendment. This suggests that some laws are more powerful or important than others, which is true. The next section looks at various types of **positive law** and their relative importance.

1.4 SOURCES OF LAW AND THEIR PRIORITY

SOURCES OF LAW

In the United States today, there are numerous sources of law. The main ones are (1) constitutions—both state and federal, (2) **statutes**, (3) agency **rules** and **regulations**, and (4) **judicial decisions**. In addition, chief executives (the president and the various governors) can issue **executive orders** that have the effect of law.

In addition to the above sources of United States laws, in international legal systems sources of law include treaties (agreements between states or countries) and what is known as customary **international law** (usually consisting of judicial decisions from national court systems where parties from two or more nations are in a dispute).

There are many sources of law, and it is possible for laws to sometimes conflict. For example, a state law may conflict with a federal law, or a federal law might be contrary to an international obligation. One nation's law may provide one substantive rule, while another nation's law may provide a different, somewhat contrary rule to apply. Not all laws, in other words, are created equal. To understand which laws have priority, it is essential to understand the relationships between the various kinds of law.

Constitutions

Constitutions are the foundation for a state or nation's other laws, providing the country's legislative, executive, and judicial framework. Among the nations of the world, the United States has the oldest constitution still in use. It is difficult to amend, which is why there have only been seventeen

amendments following the first ten in 1789; two-thirds of the House and Senate must pass amendments, and three-fourths of the states must approve them.

The nation's states also have constitutions. Along with providing for legislative, executive, and judicial functions, state constitutions prescribe various rights of citizens. These rights may be different from, and in addition to, rights granted by the U.S. Constitution. For example, the New Jersey Constitution serves as the foundational legal document that outlines the fundamental principles and structure of governance for the state of New Jersey. The current state of New Jersey Constitution is relatively young, adopted in 1947, and is the third Constitution that has been adopted in New Jersey. Like the federal Constitution, the state Constitution establishes the framework for the executive, legislative, and judicial branches, delineating their respective powers and responsibilities. The Constitution also includes state-specific provisions, and can offer the citizens of the state of New Jersey enhanced protection from its federal counterpart. As a living document, the New Jersey Constitution has been amended over time to address evolving societal needs and values.

Statutes

In Washington, DC, the federal legislature is known as Congress and has both a House of Representatives and a Senate. The House is composed of representatives elected every two years from various districts in each state. These districts are established by Congress according to population as determined every ten years by the census, a process required by the Constitution. Each state has at least one district; the most populous state (California) has fifty-two districts. Representation in the House of Representatives is therefore directly proportioned to population. In the Senate, there are two senators from each state, regardless of the state's population. Thus, Delaware has two senators and California has two senators, even though California is much larger and has far more people.

Each Congressional legislative body has committees for various purposes, including to discharge the lawmaking function of Congress. In these committees, proposed bills are discussed, hearings are sometimes held, and bills are either reported out (brought to the floor for a vote) or killed in committee. If a Bill is reported out to the full legislative body, it may be passed by majority vote. Because of the procedural differences between the House and the Senate, bills that have the same language when proposed in both houses may become different after approval by each body. If the House passes a different version of a Bill than the Senate passes, a conference committee will then be held to try to match the two versions. If the House and Senate can agree on identical language, the reconciled Bill will be sent to the president for signature or veto. The Constitution prescribes that the president will have veto power over any legislation. But the two bodies can override a presidential veto with a two-thirds vote in each chamber.

If the President signs the Bill, the Bill then becomes a **Statute**, part of federal law. The statutes of Congress are collected in codified form in the U.S. Code. The code is available online at http://uscode.house.gov.

State legislatures also enact statutes. The purpose of a state statute is to establish laws that govern various aspects of life within a specific state's jurisdiction. State statutes are legislative enactments passed by the state's legislative bodies (sometimes called assemblies) and signed into law by the governor. The process of passing a statute in New Jersey shares some similarities with the federal

legislative process but follows the specific process for legislative action set out in the state Constitution. Like the federal process, the state process of creating and amending, or changing, laws is filled with political negotiation and compromise.

On a more local level, counties and municipal corporations or townships may be authorized under a state's constitution to create or adopt **ordinances**, which are like **statutes**, but at the local level. The purpose of an ordinance is to regulate matters within the local government's jurisdiction. Ordinances are typically used to address local issues, policies, and regulations that are not covered by state or federal law. Examples of ordinances include local building codes, zoning laws, and misdemeanors or infractions such as skateboarding or jaywalking. They have the force of law within the geographic boundaries of the jurisdiction that passed them, and no force outside of those boundaries. For example, the Borough of Paramus New Jersey has laws prohibiting contracting on Sunday which require most retail establishments to be closed with the Borough (we'll study this more later in this course). Although no other animal is specifically prohibited, if you live in the Borough of Catasaqua, Pennsylvania, it is illegal to keep a pig, hog, or swine.

Treaties

In the United States, a **treaty** is a formal and legally binding agreement between the U.S. government and one or more foreign governments or international organizations. Treaties require approval from the U.S. Senate before they can be ratified and become legally effective.

When the Senate ratifies a treaty, it becomes part of federal law, with the same weight and effect as a statute passed by the entire Congress.

Rules and Regulations by Administrative Agencies

Although the U.S. Constitution does not expressly provide for administrative agencies, Congress has found it necessary and useful to create government agencies to administer various laws, and the U.S. Supreme Court has upheld this delegation of power. Using a statute called an **enabling act** or enabling law, Congress can therefore grant authority to an administrative agency, to carry out specific actions or functions. Typically, the **enabling statute** defines the scope of authority, responsibilities, and limitations of the agency it empowers.

Examples of administrative agencies would include the Occupational Safety and Health Administration (OSHA), the Environmental Protection Agency (EPA), and the Federal Trade Commission (FTC). Congress does not have unlimited authority to delegate its lawmaking powers to an agency. Instead, it must delegate its authority with some guidelines for the agency and cannot altogether avoid its constitutional responsibilities.

In order to carry out the functions delegated to them, administrative agencies issue **rules** and **regulations** which are directives by that agency. A rule created by an agency is a general statement that guides the behavior, actions, or conduct of individuals, organizations, or entities subject to the agency's jurisdiction. Rules are a form of administrative law that helps agencies fulfill their regulatory responsibilities. Rules are typically more specific and detailed than statutes and provide guidance on how to comply with legal requirements. Agencies propose rules in the Federal Register, published

each working day of the year. Rules that are formally adopted are published in the *Code of Federal Regulations*, or CFR, available online at http://www.access.gpo.gov/nara/cfr/cfr-table-search.html.

A regulation is a broader term that encompasses a range of directives issued by administrative agencies. Regulations can include rules, standards, policies, procedures and other types of requirements established by agencies to implement and enforce statutes. Regulations often have the force of law and carry legal consequences for non-compliance. They are a crucial tool for administrative agencies to carry out their statutory duties effectively.

Judicial Decisions: The Common Law

The role of the courts in making law is a central aspect of the judicial system within a legal framework. While the primary responsibility for creating laws lies with the legislative branch of government, courts also play a significant role in shaping and interpreting the law through their decisions and rulings. This process is often referred to as "**judge-made law**" or "common law."

In the United States legal system, courts are called upon to make decisions that require the interpretation of statutes, regulations, treaties, or even the Constitution. In addition to making these interpretations when necessary, courts also decide cases where there is no statutory or other codified law or regulation to be interpreted. These decisions make up what is called the "common law." For example, a state court deciding what kinds of witnesses are required for a valid will in the absence of a rule (from a statute) is making common law.

United States law comes primarily from the tradition of English common law. By the time England's American colonies revolted in 1776, English common-law traditions were well established in the colonial courts. English common law was a system that gave written judicial decisions the force of law throughout the country. Thus, if an English court delivered an opinion as to what constituted the common-law crime of burglary, other courts would stick to that decision, so that a common body of law developed throughout the country. Common law is essentially shorthand for the notion that a common body of law, based on past written decisions, is desirable and necessary.

In England and in the laws of the original thirteen states, common-law decisions defined crimes such as arson, burglary, homicide, and robbery. As time went on, U.S. state legislatures either adopted or modified common-law definitions of most crimes by putting them in the form of codes or statutes. This legislative ability—to modify or change common law into judicial law—points to an important phenomenon: the priority of statutory law over common law. As we will see in the next section, constitutional law will have priority over statutory law.

ACTIVITY 1A

Which is which?

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=23#h5p-1

PRIORITY OF LAWS

The Constitution as Preemptive Force in U.S. Law

As the supreme law of the U.S., the U.S. Constitution takes precedence over all statutes and **judicial decisions**, whether state or federal, that are inconsistent with the Constitution. For example, if Michigan were to decide legislatively that students cannot speak ill of professors in state-sponsored universities, that law would be void, since it is inconsistent with the state's obligation under the First Amendment to protect free speech. Or if the Michigan courts were to allow a professor to bring a lawsuit against a student who had said something about him that was derogatory but not defamatory, the state's judicial system would not be acting according to the First Amendment.

Statutes

Statutes must be consistent with the Constitution, but generally statutes have priority, or take precedence, over judge made law or agency rules and regulations. Historically, under common-law judicial decisions, employers could hire young children for difficult work, offer any wage they wanted, and not pay overtime work at a higher rate. But various statutes changed that. For example, the federal Fair Labor Standards Act (1938) forbids the use of oppressive child labor and established a minimum pay wage and overtime pay rules.

Treaties

A **treaty** or convention is considered of equal standing to a statute. Thus, when Congress ratified the North American Free Trade Agreement (NAFTA), any previous judicial decisions or s statutes that were inconsistent—such as quotas or limitations on imports from Mexico that were contrary to NAFTA commitments—would no longer be valid. Similarly, U.S. treaty obligations under the General Agreement on Tariffs and Trade (GATT) and obligations made later through the World Trade Organization (WTO) would override previous federal or state statutes. In these situations, the treaty takes priority because it is the most recent pronouncement of law, as long as the treaty is made through the Constitutional process.

Federal v. State

When there is a conflict between a law made by the federal government (like **rules** for the whole country) and a law made by a state (like rules just for that state), the federal law will take priority over state law due to the **Supremacy Clause** of the U.S. Constitution. At the same time, it is possible to have situations where state and federal laws can coexist or complement each other without conflict. In cases where federal and state laws cover different aspects of a particular issue, both

laws may apply. For example, both New Jersey and the federal government have laws pertaining to the preservation of wetlands and endangered species. The federal law sets a baseline standard that applies everywhere in the U.S., while the state law provides extra protections tailored to New Jersey's particular environment. Additionally, some legal matters are primarily under state jurisdiction, and state laws will naturally take precedence in those areas unless federal law explicitly preempts state regulation. For example, there is no federal law establishing an age to marry, so New Jersey's state law regarding the minimum age for marriage controls the marriage age within New Jersey's boundaries.

Causes of Action, Precedent, and *Stare Decisis*

No matter how wrong someone's actions may seem to you, the only wrongs you can right in a court are those that can be tied to one or more causes of action. Positive law is full of cases, treaties, statutes, regulations, and constitutional provisions that can be made into a **cause of action**. If you have an agreement with Harold Hill that he will purchase seventy-six trombones from you and he fails to pay for them after you deliver, you will probably feel wronged, but a court will only act favorably on your complaint if you can show that his behavior gives you a cause of action based on some part of your state's contract law.

An old saying in the law is that the law does not deal in trifles, or unimportant issues (in Latin, ***de minimis non curat lex***). Not every wrong you may suffer in life will be a cause to bring a court action. If you are stood up for a Saturday night date and feel embarrassed or humiliated, you cannot recover anything in a court of law in the United States, as there is no cause of action (no basis in the positive law) that you can use in your complaint. But, if you are engaged to be married and you are stood up at the altar, there are some states that actually do provide a legal basis on which to bring a lawsuit. Your cause of action is thus based on existing laws, including decided cases.

Decided cases can form legal **precedent**. Precedent refers to a legal principle or decision established in a previous court case that serves as a guide or rule for deciding similar cases in the future. Precedent plays a crucial role in the common law legal system, which relies on the accumulation of past court decisions to shape and interpret the law. How closely your case "fits" with a prior decided case raises the question of precedent. Several factors can impact whether a prior case is precedent, including how close the situation is to the legal issue in the case, and whether the Court deciding the precedential case is from the same jurisdiction.

The English common-law tradition placed great emphasis on precedent and what is called ***stare decisis***. A court considering one case would feel obliged to decide that case in a way similar to previously decided cases. Written decisions of the most important cases had been spread throughout England and judges hoped to establish a somewhat predictable, consistent group of decisions. The English legislature (Parliament) was not in the practice of establishing detailed statutes on crimes, **torts**, **contracts**, or **property**. Thus, definitions and rules were left primarily to the courts. By their nature, courts could only decide one case at a time, but in doing so they would articulate **holdings**, or general rules, that would apply to later cases.

Suppose that one court had to decide whether an employer could fire an employee for no reason at all. Suppose that there were no statutes that applied to the facts: there was no contract between the employer and the employee, but the employee had worked for the employer for many years, and now a

younger person was replacing him. The court, with no past guidelines, would have to decide whether the employee had stated a "cause of action" against the employer. If the court decided that the case was not legally actionable, it would dismiss the action. Future courts would then treat similar cases in a similar way. In the process, the court might make a holding that employers could fire employees for any reason or for no reason. This rule could be applied in the future should similar cases come up.

But suppose that an employer fired an employee for not committing perjury (lying on the witness stand in a court proceeding); the employer wanted the employee to cover up the company's criminal or unethical act. Suppose that, as in earlier cases, there were no applicable statutes and no contract of employment. Courts relying on a holding or precedent that "employers may fire employees for any reason or no reason" might rule against an employee seeking compensation for being fired for telling the truth on the witness stand. Or it might make an exception to the general rule, such as, "Employers may generally discharge employees for any reason or for no reason without incurring legal liability; however, employers will incur legal liability for firing an employee who refuses to lie on behalf of the employer in a court proceeding."

In each case (the general rule and its exception), the common-law tradition calls for the court to explain the reasons for its ruling. In the case of the general rule, "freedom of choice" might be the major reason. In the case of the perjury exception, the efficiency of the judicial system and the requirements of citizenship might be used as reasons. Because the court's "reasons" will be persuasive to some and not to others, there is inevitably a degree of subjectivity to judicial opinions. That is, reasonable people will disagree as to the persuasiveness of the reasoning a court may offer for its decision.

Reading written judicial opinions are thus a good playing field for developing critical thinking skills by identifying the issue in a case and examining the reasons for the court's previous decision(s), or holding. What *has* the court actually decided, and why? Remember that a court, especially the U.S. Supreme Court, is not only deciding one particular case but also setting down guidelines (in its holdings) for federal and state courts that encounter similar issues. Note that court cases often raise a variety of issues or questions to be resolved, and judges (and attorneys) will differ as to what the real issue in a case is. A holding is the court's complete answer to an issue that is critical to deciding the case and thus gives guidance to the meaning of the case as a precedent for future cases.

Beyond the decision of the court, it is in looking at the court's *reasoning* that you are most likely to understand what facts have been most significant to the court and what theories (schools of legal thought) each trial or appellate judge believes in. Because judges do not always agree on first principles (i.e., they subscribe to different schools of legal thought), there are many divided opinions in appellate opinions and in each U.S. Supreme Court term.

ACTIVITY 1B

Case Debate: Ladies Night?

"Ladies' Night" is a promotional event used by bars and restaurants where they offer special discounts, deals, or incentives targeted specifically toward women. Events such as these are designed to attract a female clientele to these establishments. Coastline, a restaurant and bar in Cherry Hill, New Jersey, hosted a Ladies' Night featuring free bar admission and reduced-price drinks for women. A man named David Gillespie went to the Coastline, and was charged five dollars for admission and full-price for drinks. He asked to be charged the reduced price, per the bar's "Ladies' Night" policy, but was refused. Gillespie believes his rights were violated.

- What sources of law do you think would apply to this case? In other words, what types of laws should Gillespie look at to determine whether his rights were violated?
- Would there be Constitutional laws that pertain to the case?
- Would you expect there be to any statutes that would govern this situation?
- Would there be an administrative agency involved in determining the outcome of Gillespie's claim?
- Under what circumstances would a court get involved in determining whether Gillespie's rights were violated?
- Do you think that Coastline would have any laws in it's favor? Why or why not?
- What if Coastline added a "Men's Night" on another night of the week, keeping "Ladies' Night" as is. Would this change the outcome of the case?

Debate the Case: Find and review one resource dealing with discrimination and "Ladies Night." Make sure the resource that you found discusses at least one source of law that applies. Do you think that the "Ladies' Night" claim should be dealt with using the U.S. legal process, or is this an insignificant case that should not be the subject of the laws we studied in this Chapter?

1.5 LEGAL AND POLITICAL SYSTEMS OF THE WORLD

Other legal and political systems are very different from the U.S. system, which came from English common-law traditions and the framers of the U.S. Constitution. Our legal and political traditions are different both in what kinds of laws we make and honor and in how disputes are resolved in court.

COMPARING COMMON-LAW SYSTEMS WITH OTHER LEGAL SYSTEMS

The common-law tradition is unique to England, the United States, and former colonies of the British Empire. Although there are differences among common-law systems (e.g., most nations do not permit their judiciaries to declare legislative acts unconstitutional; some nations use the jury less frequently), all of them recognize the use of precedent in judicial cases, and none of them rely on the comprehensive, legislative codes that are prevalent in **civil-law systems**.

CIVIL-LAW SYSTEMS

The main alternative to the **common-law** legal system was developed in Europe and is based in Roman and Napoleonic law. A civil-law or code-law system is one where all the legal rules are in one or more comprehensive legislative enactments. During Napoleon's reign, a comprehensive book of laws—a code—was developed for all of France. The code covered criminal law, criminal procedure, noncriminal law and procedure, and commercial law. The rules of the code are still used today in

France and in other continental European legal systems. The code is used to resolve particular cases, usually by judges without a jury. Moreover, the judges are not required to follow the decisions of other courts in similar cases. As George Cameron of the University of Michigan has noted, "The law is in the code, not in the cases." He goes on to note, "Where several cases all have interpreted a provision in a particular way, the French courts may feel bound to reach the same result in future cases, under the doctrine of *jurisprudence constante.* The major agency for growth and change, however, is the legislature, not the courts."

Civil-law systems are used throughout Europe as well as in Central and South America. Some nations in Asia and Africa have also adopted codes based on European civil law. Germany, Holland, Spain, France, and Portugal all had colonies outside of Europe, and many of these colonies adopted the legal practices that were imposed on them by colonial rule, much like the original thirteen states of the United States, which adopted English common-law practices.

One source of possible confusion at this point is that we have already referred to U.S. civil law in contrast to criminal law. But the European civil law covers both civil and criminal law.

There are also legal systems that differ significantly from the common-law and civil-law systems. The communist and socialist legal systems that remain (e.g., in Cuba and North Korea) operate on very different assumptions than those of either English common law or European civil law. Islamic and other religion-based systems of law bring different values and assumptions to social and commercial relations.

1.6 READ A SAMPLE CASE

Preliminary Note to Students

Title VII of the Civil Rights Act of 1964 is a federal statute that applies to all employers whose workforce exceeds fifteen people. The text of Title VII says that

(a) it shall be an unlawful employment practice for an employer—

(1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or natural origin.

At common law—where judges decide cases without reference to statutory guidance—employers were generally free to hire and fire on any basis they might choose, and employees were generally free to work for an employer or quit an employer on any basis they might choose (unless the employer and the employee had a contract). This rule has been called "employment at will." State and federal statutes that prohibit discrimination on any basis (such as the prohibitions on discrimination because of race, color, religion, sex, or national origin in Title VII) are essentially legislative exceptions to the common-law employment-at-will rule.

In the 1970s, many female employees began to claim a certain kind of sex discrimination: sexual harassment. Some women were being asked to give sexual favors in exchange for continued employment or promotion (quid pro quo sexual harassment) or found themselves in a working

environment that put their chances for continued employment or promotion at risk. This form of sexual discrimination came to be called “hostile working environment” sexual harassment.

Notice that the statute itself says nothing about sexual harassment but speaks only in broad terms about discrimination “because of” sex (and four other factors). Having set the broad policy, Congress left it to employees, employers, and the courts to fashion more specific rules through the process of civil litigation.

This is a case from our federal court system, which has a trial or hearing in the federal district court, an appeal to the Sixth Circuit Court of Appeals, and a final appeal to the U.S. Supreme Court. Teresa Harris, having lost at both the district court and the Sixth Circuit Court of Appeals, here has petitioned for a writ of certiorari (asking the court to issue an order to bring the case to the Supreme Court), a petition that is granted less than one out of every fifty times. The Supreme Court, in other words, chooses its cases carefully. Here, the court wanted to resolve a difference of opinion among the various circuit courts of appeal as to whether or not a plaintiff in a hostile-working-environment claim could recover damages without showing “severe psychological injury.”

A SAMPLE CASE

Harris v. Forklift Systems, 510 U.S. 17 (U.S. Supreme Court 1992)

O’CONNOR, J., delivered the opinion for a unanimous Court. SCALIA, J., and GINSBURG, J., filed concurring opinions.

JUSTICE O’CONNOR delivered the opinion of the Court.

In this case we consider the definition of a discriminatorily “abusive work environment” (also known as a “hostile work environment”) under Title VII of the Civil Rights Act of 1964, 78 Stat. 253, as amended, 42 U.S.C. § 2000e et seq. (1988 ed., Supp. III).

I

Teresa Harris worked as a manager at Forklift Systems, Inc., an equipment rental company, from April 1985 until October 1987. Charles Hardy was Forklift’s president.

The Magistrate found that, throughout Harris’ time at Forklift, Hardy often insulted her because of her gender and often made her the target of unwanted sexual innuendoes. Hardy told Harris on several occasions, in the presence of other employees, “You’re a woman, what do you know” and “We need a man as the rental manager”; at least once, he told her she was “a dumbass woman.” Again in front of others, he suggested that the two of them “go to the Holiday Inn to negotiate [Harris’s] raise.” Hardy occasionally asked Harris and other female employees to get coins from his front pants pocket. He threw objects on the ground in front of Harris and other women, and asked them to pick the objects up. He made sexual innuendoes about Harris’ and other women’s clothing.

In mid-August 1987, Harris complained to Hardy about his conduct. Hardy said he was surprised that Harris was offended, claimed he was only joking, and apologized. He also promised he would stop, and

based on this assurance Harris stayed on the job. But in early September, Hardy began anew: While Harris was arranging a deal with one of Forklift's customers, he asked her, again in front of other employees, "What did you do, promise the guy…some [sex] Saturday night?" On October 1, Harris collected her paycheck and quit.

Harris then sued Forklift, claiming that Hardy's conduct had created an abusive work environment for her because of her gender. The United States District Court for the Middle District of Tennessee, adopting the report and recommendation of the Magistrate, found this to be "a close case," but held that Hardy's conduct did not create an abusive environment. The court found that some of Hardy's comments "offended [Harris], and would offend the reasonable woman," but that they were not "so severe as to be expected to seriously affect [Harris's] psychological well-being. A reasonable woman manager under like circumstances would have been offended by Hardy, but his conduct would not have risen to the level of interfering with that person's work performance.

"Neither do I believe that [Harris] was subjectively so offended that she suffered injury….Although Hardy may at times have genuinely offended [Harris], I do not believe that he created a working environment so poisoned as to be intimidating or abusive to [Harris]."

In focusing on the employee's psychological well-being, the District Court was following Circuit precedent. See *Rabiduev. Osceola Refining Co.*, 805 F.2d 611, 620 (CA6 1986), cert. denied, 481 U.S. 1041, 95 L. Ed. 2d 823, 107 S. Ct. 1983 (1987). The United States Court of Appeals for the Sixth Circuit affirmed in a brief unpublished decision…reported at 976 F.2d 733 (1992).

We granted certiorari, 507 U.S. 959 (1993), to resolve a conflict among the Circuits on whether conduct, to be actionable as "abusive work environment" harassment (no quid pro quo harassment issue is present here), must "seriously affect [an employee's] psychological well-being" or lead the plaintiff to "suffer injury." Compare *Rabidue* (requiring serious effect on psychological well-being); *Vance v. Southern Bell Telephone & Telegraph Co.*, 863 F.2d 1503, 1510 (CA11 1989) (same); and *Downes v. FAA*, 775 F.2d 288, 292 (CA Fed. 1985) (same), with *Ellison v. Brady*, 924 F.2d 872, 877–878 (CA9 1991) (rejecting such a requirement).

II

Title VII of the Civil Rights Act of 1964 makes it "an unlawful employment practice for an employer…to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." 42 U.S.C. § 2000e-2(a)(1). As we made clear in *Meritor Savings Bank, FSB v. Vinson*, 477 U.S. 57 (1986), this language "is not limited to 'economic' or 'tangible' discrimination. The phrase 'terms, conditions, or privileges of employment' evinces a congressional intent 'to strike at the entire spectrum of disparate treatment of men and women' in employment," which includes requiring people to work in a discriminatorily hostile or abusive environment. Id., at 64, quoting *Los Angeles Dept. of Water and Power v. Manhart*, 435 U.S. 702, 707, n.13, 55 L. Ed. 2d 657, 98 S. Ct. 1370 (1978). When the workplace is permeated with "discriminatory intimidation, ridicule, and insult," 477 U.S. at 65, that is "sufficiently severe or pervasive to alter the conditions of the victim's employment and create an abusive working environment," Title VII is violated.

This standard, which we reaffirm today, takes a middle path between making actionable any conduct that is merely offensive and requiring the conduct to cause a tangible psychological injury. As we pointed out in *Meritor*, "mere utterance of an…epithet which engenders offensive feelings in an employee," does not sufficiently affect the conditions of employment to implicate Title VII. Conduct that is not severe or pervasive enough to create an objectively hostile or abusive work environment—an environment that a

reasonable person would find hostile or abusive—is beyond Title VII's purview. Likewise, if the victim does not subjectively perceive the environment to be abusive, the conduct has not actually altered the conditions of the victim's employment, and there is no Title VII violation.

But Title VII comes into play before the harassing conduct leads to a nervous breakdown. A discriminatorily abusive work environment, even one that does not seriously affect employees' psychological well-being, can and often will detract from employees' job performance, discourage employees from remaining on the job, or keep them from advancing in their careers. Moreover, even without regard to these tangible effects, the very fact that the discriminatory conduct was so severe or pervasive that it created a work environment abusive to employees because of their race, gender, religion, or national origin offends Title VII's broad rule of workplace equality. The appalling conduct alleged in *Meritor*, and the reference in that case to environments "'so heavily polluted with discrimination as to destroy completely the emotional and psychological stability of minority group workers,'" Id., at 66, quoting *Rogers v. EEOC*, 454 F.2d 234, 238 (CA5 1971), cert. denied, 406 U.S. 957,32 L. Ed. 2d 343, 92 S. Ct. 2058 (1972), merely present some especially egregious examples of harassment. They do not mark the boundary of what is actionable.

We therefore believe the District Court erred in relying on whether the conduct "seriously affected plaintiff's psychological well-being" or led her to "suffer injury." Such an inquiry may needlessly focus the fact finder's attention on concrete psychological harm, an element Title VII does not require. Certainly Title VII bars conduct that would seriously affect a reasonable person's psychological well-being, but the statute is not limited to such conduct. So long as the environment would reasonably be perceived, and is perceived, as hostile or abusive, *Meritor*, supra, at 67, there is no need for it also to be psychologically injurious.

This is not, and by its nature cannot be, a mathematically precise test. We need not answer today all the potential questions it raises, nor specifically address the Equal Employment Opportunity Commission's new regulations on this subject, see 58 Fed. Reg. 51266 (1993) (proposed 29 CFR §§ 1609.1, 1609.2); see also 29 CFR § 1604.11 (1993). But we can say that whether an environment is "hostile" or "abusive" can be determined only by looking at all the circumstances. These may include the frequency of the discriminatory conduct; its severity; whether it is physically threatening or humiliating, or a mere offensive utterance; and whether it unreasonably interferes with an employee's work performance. The effect on the employee's psychological well-being is, of course, relevant to determining whether the plaintiff actually found the environment abusive. But while psychological harm, like any other relevant factor, may be taken into account, no single factor is required.

III

Forklift, while conceding that a requirement that the conduct seriously affect psychological well-being is unfounded, argues that the District Court nonetheless correctly applied the *Meritor* standard. We disagree. Though the District Court did conclude that the work environment was not "intimidating or abusive to [Harris]," it did so only after finding that the conduct was not "so severe as to be expected to seriously affect plaintiff's psychological well-being," and that Harris was not "subjectively so offended that she suffered injury," ibid. The District Court's application of these incorrect standards may well have influenced its ultimate conclusion, especially given that the court found this to be a "close case."

We therefore reverse the judgment of the Court of Appeals, and remand the case for further proceedings consistent with this opinion.

So ordered.

Note to Students

This was only the second time that the Supreme Court had decided a sexual harassment case. Many feminist legal studies scholars feared that the court would raise the bar and make hostile-working-environment claims under Title VII more difficult to win. That did not happen. When the question to be decided is combined with the court's decision, we get the holding of the case. Here, the question that the court poses, plus its answer, yields a holding that "An employee need not prove severe psychological injury in order to win a Title VII sexual harassment claim." This holding will be true until such time as the court revisits a similar question and answers it differently. This does happen, but happens rarely.

Sample case questions

1. Is this a criminal case or a civil-law case? How can you tell?
2. Is the court concerned with making a procedural rule here, or is the court making a statement about the substantive law?
3. Is this a case where the court is interpreting the Constitution, a federal statute, a state statute, or the common law?
4. In *Harris v. Forklift*, what if the trial judge does not personally agree that women should have any rights to equal treatment in the workplace? Why shouldn't that judge dismiss the case even before trial? Or should the judge dismiss the case after giving the female plaintiff her day in court?
5. What was the employer's argument in this case? Do you agree or disagree with it? What if those who legislated Title VII gave no thought to the question of seriousness of injury at all?

End of Chapter Exercises

In the following situations, which source of law takes priority, and why?

- The state statute conflicts with the common law of that state.
- A federal statute conflicts with the U.S. Constitution.
- A common-law decision in one state conflicts with the U.S. Constitution.
- A federal statute conflicts with a state constitution.

1. Vandana Shiva draws a picture of a stream in a forest. She says that in our society the stream is seen as unproductive if it is simply there, fulfilling the need for water of women's families and communities, until engineers come along and tinker with it, perhaps damming it and using it for generating hydropower. The same is true of a forest, unless it is replaced with a monoculture plantation of a commercial species. A forest may very well be productive—protecting groundwater; creating oxygen; providing fruit, fuel, and craft materials for nearby inhabitants; and creating a habitat for animals that are also a valuable resource. She criticizes the view that if there is no monetary amount that can contribute to gross domestic product, neither the forest nor the river can be seen as a productive resource. Which school of legal thought does her criticism reflect?
2. Anatole France said, "The law, in its majesty, forbids rich and poor alike from sleeping under bridges." Which school of legal thought is represented by this quote?
3. Adolf Eichmann was a loyal member of the National Socialist Party in the Third Reich and worked hard under Hitler's government during World War II to round up Jewish people for incarceration—and eventual extermination—at labor camps like Auschwitz and Buchenwald. After an Israeli "extraction team" took him from Argentina to Israel, he was put on trial for "crimes against humanity." His defense was that he was "just following orders." Explain why Eichmann was not an adherent of the natural-law school of legal thought.
4. Jenna gets a ticket for careless driving after the police come to investigate a car accident she had with you on Hanover Boulevard. Your car is badly damaged through no fault of your own. Is Jenna likely to face criminal charges, civil charges, or both?
5. Jenna's ticket says that she has thirty days in which to respond to the charges against her. The thirty days conforms to a state law that sets this time limit. Is the thirty-day limit procedural law or substantive law?
6. Lindsey Paradise is not selected for her sorority of choice at the University of Kansas. She has spent all her time rushing that particular sorority, which chooses some of her friends but not her. She is disappointed and angry and wants to sue the sorority. What are her prospects of recovery in the legal system? Explain.

CHAPTER 2 - COURTS AND THE LEGAL PROCESS

Learning Objectives

After studying this chapter, you should be able to:

1. Describe the two different court systems in the United States, and explain why some cases can be filed in either court system.
2. Explain the importance of subject matter jurisdiction and personal jurisdiction and know the difference between the two.
3. Describe the various stages of a civil action: from pleadings, to discovery, to trial, and to appeals.
4. Describe two alternatives to litigation: mediation and arbitration.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=38#h5p-9

2.1 GENERAL PERSPECTIVES ON COURTS AND THE LEGAL PROCESS

In the United States, law and government are interdependent. The Constitution establishes the basic framework of government and imposes certain limitations on the powers of government. In turn, the various branches of government are intimately involved in making, enforcing, and interpreting the law. Today, much of the law comes from Congress and the state legislatures. But it is in the courts that legislation is interpreted and prior case law is interpreted and applied.

As we go through this chapter, consider the case of Harry and Kay Robinson summarized below.

ROBINSON V. AUDI

Harry and Kay Robinson purchased a new Audi automobile from Seaway Volkswagen, Inc. (Seaway), in Massena, New York, in 1976. The following year the Robinson family, who resided in New York, left that state for a new home in Arizona. As they passed through Oklahoma, another car struck their Audi in the rear, causing a fire that severely burned Kay Robinson and her two children. Later on, the Robinsons brought a products-liability action in the District Court for Creek County, Oklahoma,

claiming that their injuries resulted from the defective design and placement of the Audi's gas tank and fuel system. They sued numerous defendants, including the automobile's manufacturer, Audi NSU Auto Union Aktiengesellschaft (Audi); its importer, Volkswagen of America, Inc. (Volkswagen); its regional distributor, World-Wide Volkswagen Corp. (World-Wide); and its retail dealer, Seaway.

A case like this raises several questions that this Chapter can help you answer. In which court should the Robinsons file their action? Can the Oklahoma court hear the case and make a judgment that will be enforceable against all of the defendants? Which law will the court use to come to a decision? Will it use New York law, Oklahoma law, federal law, or German law?

Should the Robinsons bring their action in state court or in federal court? Over which of the defendants will the court have personal jurisdiction?

2.2 THE RELATIONSHIP BETWEEN STATE AND FEDERAL COURT SYSTEMS IN THE UNITED STATES

Although it is sometimes said that there are two separate court systems, the reality is more complex. There are more than fifty court systems in the United States. Each state has its own court system, there is a local court system in the District of Columbia, and of course there is the federal court system. While these are all separate court systems, there are points of contact between them.

Courts must honor the laws of other states, and must also honor federal law. To understand what this means, let's review how state laws and federal laws might come into contact. First, under the **Supremacy Clause** of the United States Constitution, state courts must honor federal law where state laws are in conflict with federal law. Second, claims arising under federal statutes can be tried in the state courts as long as the Constitution or Congress has not explicitly required that only federal courts can hear that kind of claim. Third, under the **full faith and credit** clause, each state court is obligated to respect the final judgments of courts in other states. Thus, a contract dispute resolved by an Arkansas court cannot be relitigated in North Dakota when the plaintiff wants to collect on the Arkansas judgment in North Dakota. Fourth, state courts often must consider the laws of other states in deciding cases involving issues where two states have an interest, such as when drivers from two different states collide in a third state. Under these circumstances, state judges will consult their own state's case decisions involving conflicts of laws and sometimes decide that they must apply another state's laws to decide the case.

Just as state courts are concerned with federal law, so too are federal courts often concerned with state law and with what happens in state courts. Federal courts will consider state-law-based claims when a case involves claims using both state and federal law. Claims based on federal laws will permit the federal court to take jurisdiction over the whole case, including any state issues raised. In those cases, the federal court is said to exercise **pendent jurisdiction** over the state claims. Also, the Supreme Court will occasionally take appeals from a state supreme court where state law raises an important issue of federal law to be decided. For example, a convict on death row may claim that the state's chosen method of execution using the injection of drugs is unusually painful and involves "cruel and unusual punishment," raising an **Eighth Amendment** issue.

Jurisdiction

Jurisdiction is an essential concept in understanding courts and the legal system. Jurisdiction is a combination of two Latin words: *juris* (law) and *diction* (to speak). Which court has the power "to speak the law" is the basic question of jurisdiction. Jurisdiction therefore refers to the legal authority or power that a court governing body has over a particular geographical area, subject matter, or individuals. In order to decide a claim or controversy, a Court must have jurisdiction over that claim, the parties in the suit, and geographic area in which the claim arose. Jurisdiction determines which Court has the right to hear and decide legal cases and make rulings that bind the parties on various matters. Jurisdiction ensures that legal proceedings are conducted within a defined framework and that decisions are binding and enforceable.

Subject Matter Jurisdiction – Filing in Federal Court

The decision of whether a case can be heard in the federal courts is a question of **subject matter jurisdiction**. Federal court jurisdiction is based on the types of cases outlined in Article III of the Constitution. Generally, federal courts have jurisdiction over cases in the following situations, meaning that these cases can be filed in federal courts.

Federal Question Jurisdiction: Federal courts have jurisdiction over cases that involve a federal law, treaty, or the interpretation of the U.S. Constitution. If the legal dispute centers around a question of federal law, it can be brought in federal court. For example, cases involving violations of federal statutes like civil rights laws, antitrust laws, or intellectual property laws often fall under federal question jurisdiction, and therefore such cases can originate in the federal courts.

Diversity of Citizenship Jurisdiction: Federal courts can hear cases between parties from different states if the amount in controversy exceeds a certain threshold (currently $75,000). In these cases, the federal courts are applying state law to decide a case. This is intended to provide a neutral forum when parties from different states are involved in a dispute, and it helps prevent bias that might arise in state courts. For example, a citizen of New Jersey may sue a citizen of New York over a contract dispute in federal court, but if both were citizens of New Jersey, the plaintiff would be limited to the state courts. The Constitution establishes diversity jurisdiction to avoid any hostility of the local courts toward people from other states. In 2020 more than 40% of all lawsuits filed in federal court were based on diversity of citizenship. In a diversity of citizenship case, the plaintiff may choose to file in federal court. Or, the plaintiff may file in their home state court, and the defendant in turn may ask for removal to federal court on the basis of diversity. This may be because litigants sometimes believe that there would be a "home-court advantage" for an in-state plaintiff who brings a lawsuit against a nonresident in his local state court.

Along with these two main ways to establish subject matter jurisdiction in the federal courts, there are some other cases that originate in federal court – admiralty cases, cases between states, and bankruptcy cases among them.

THE FEDERAL COURT SYSTEM

The federal judicial system is uniform throughout the United States and consists of three levels: the **district courts**, the **courts of appeal** and the United States Supreme Court.

District Courts

At the first level are the federal **district courts**, which are the trial courts in the federal system. Every state has one or more federal districts; the less populous states have one, and the more populous states (California, Texas, and New York) have four. New Jersey has one federal District Court.

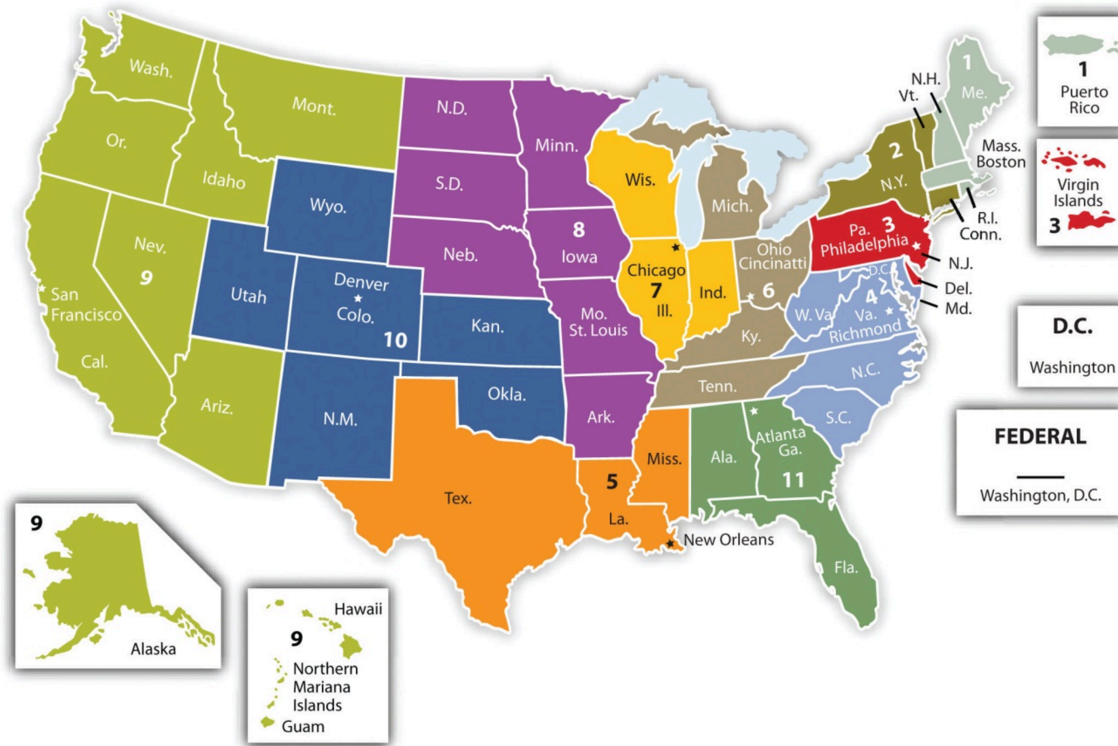
Courts of Appeal

Cases from the **district courts** can then be appealed to the circuit **courts of appeal**, of which there are thirteen. Each circuit oversees the work of the district courts in several states. For example, the U.S. Court of Appeals for the Second Circuit hears appeals from district courts in New York, Connecticut, and Vermont. New Jersey is part of the Third Circuit, which also hears appeals from the district courts in Pennsylvania, Delaware, and the U.S. Virgin Islands. Appeals are usually heard by three-judge panels, but sometimes there will be a rehearing at the court of appeals level, in which case all judges sit to hear the case "**en banc**."

United States Supreme Court

Overseeing all federal courts is the U.S. Supreme Court, in Washington, DC. It consists of nine justices—the chief justice and eight associate justices. (This number is not constitutionally required; Congress can establish any number. It has been set at nine since after the Civil War.) The Supreme Court has selective control over most of its docket. By law, the cases it hears represent only a tiny fraction of the cases that are submitted. In the 2022 term, the Supreme Court had numerous petitions (over 7,000, not including thousands of petitions from prisoners) but decided only 58 cases. All the justices hear and consider each case together, unless a justice has a conflict of interest and must withdraw from hearing the case.

Figure 2.1 The Federal Judicial Circuits



Federal judges—including Supreme Court justices—are nominated by the president and must be confirmed by the Senate. Unlike state judges, who are usually elected and preside for a fixed term of years, federal judges sit for life unless they voluntarily retire or are impeached.

EXCLUSIVE JURISDICTION IN FEDERAL COURTS

There are some cases that can only be heard in the federal courts. In other words, these types of cases cannot be filed in the state court systems. These cases are listed in Article III of the U.S. Constitution and include:

- cases in which two or more states are a party
- cases involving ambassadors and other high-ranking public figures
- federal crimes
- bankruptcy
- patent, copyright, and trademark cases
- cases involving Securities and banking regulation

In addition, other cases can be specified by federal statute where Congress declares that federal courts will have **exclusive jurisdiction**.

Subject Matter Jurisdiction – Filing in State Court

When a dispute does not fall within the specific jurisdiction of federal courts, the resulting case will be filed in state court. State courts have jurisdiction over a wide range of legal matters not filed in the

federal courts. Basically, when a case cannot be filed in federal court because the federal courts do not have jurisdiction, the only choice for jurisdiction would be to file in state court. The vast majority of civil lawsuits in the United States are filed in state courts.

The State Court Systems

A typical state court system in the United States looks a lot like the federal court system, with three levels of courts that handle a wide range of legal matters arising under state laws. While the structure and terminology can vary from state to state, the following is a general overview of the components that might be found in a state court system.

State Trial Courts

Each state will have a court that functions as its general trial court, which is going to be the court in which most cases will originate. In New Jersey, this court is the **Superior Court**.

State Intermediate Appellate Courts

Most, but not all, states have an intermediate appeals court that hears appeals from the state trial court. Whether or not a state has an intermediate appeals court will be established in its state constitution. These courts primarily handle appeals, ensuring that legal errors or misinterpretations are corrected. Court appeals in New Jersey go through the **Appellate Division of the Superior Court.**

State Supreme Court

This is the highest court in a state's judicial system. It has discretionary review authority over cases and provides final interpretation of state laws and constitution within the state. It often focuses on important legal questions and issues of public policy. In New Jersey, the highest court is called the **New Jersey Supreme Court**

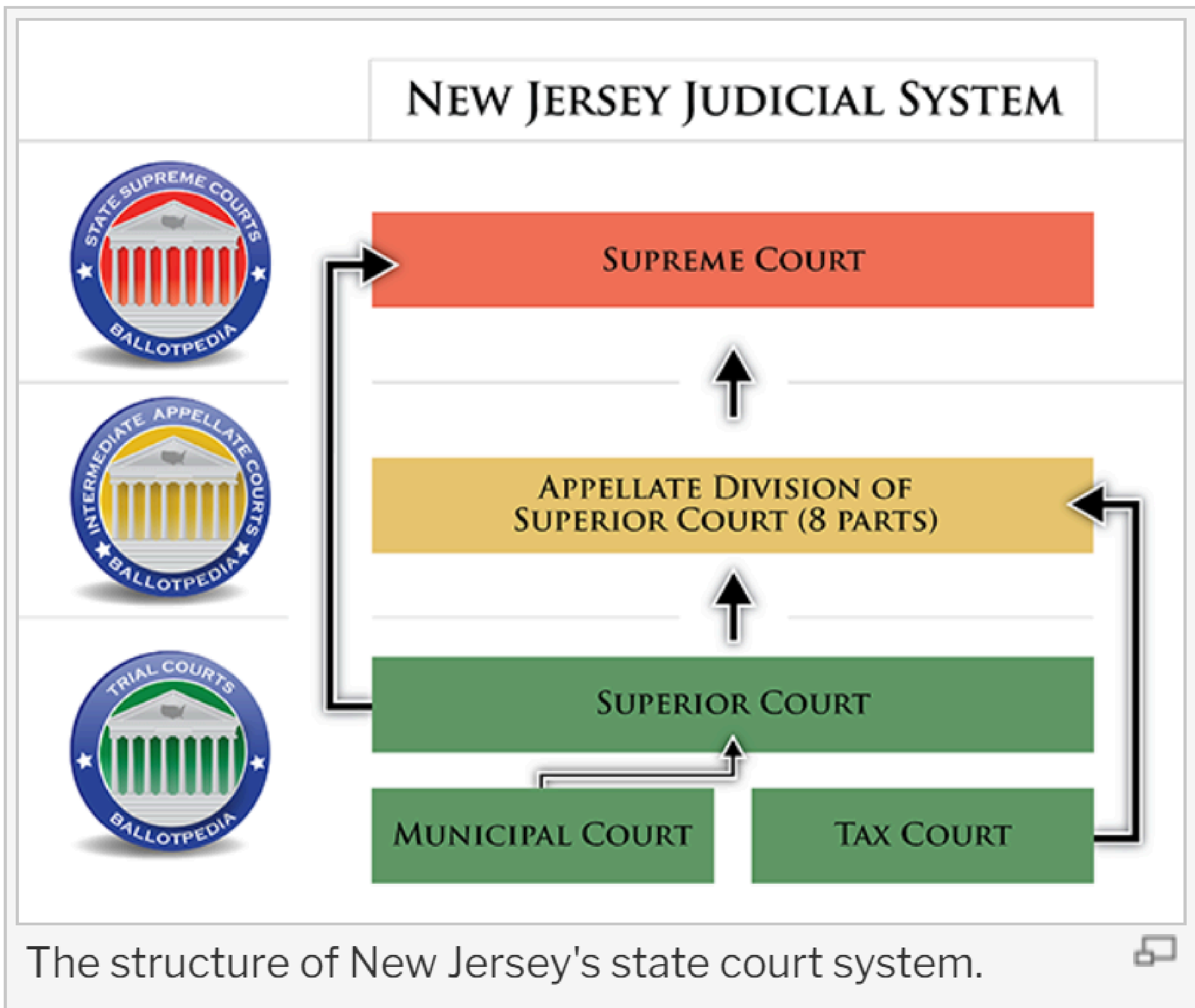
ACTIVITY 2A

Appointed v. Elected Judges

There is no uniform way of selecting judges in state courts. The majority of states hold elections for the judiciary, with some states using partisan platforms for their judicial elections, and others using a non-partisan election process where judges run not with a political party, but rather on qualifications and experience. Some states have limited terms for elected judges, while in other states an election might lead to a lifetime seat on the judicial bench in a retention election. Other states, like New Jersey, use an appointment process for members of the judiciary, where judges are appointed by the state Governor either for a fixed term or for a lifetime appointment.

Research at least one internet source about judicial selection and length of judicial service and its impact on judicial independence, accountability, impartiality, public perception, and the overall effectiveness of the judiciary. Would it better serve society if judges were elected by the people, or appointed by a Governor or other political body? Should judges serve for a term, or for a lifetime seat? And if for a lifetime seat, are there any circumstances under which judges should be removed?

Figure 2.2 The New Jersey State Court System



The structure of New Jersey's state court system.

This image comes from the website Ballotpedia.org. It is suitable for reuse under GFDL licensing.

SUBJECT MATTER JURISDICTION – LIMITED VERSUS GENERAL JURISDICTION COURTS

Most cases that are filed in a Court system are filed in a court of **general jurisdiction**. A court of general jurisdiction has the authority to hear and decide a wide variety of cases, both civil and criminal, without being limited to specific subject matters or certain types of legal disputes. These courts are designed to handle a broad spectrum of legal issues and provide a forum for parties to resolve a wide range of disputes under the law. In the federal system, a Court of General Jurisdiction is the **District Court**. In New Jersey, an example of a court of general jurisdiction is the **Superior Court**, where trials are held. State courts of general jurisdiction hear cases involving incidents such as automobile accidents and injuries, or breaches of contract. They also try cases involving serious crimes. Decisions in courts of general jurisdiction are often made by juries.

Court systems also have courts of **limited jurisdiction**. These are courts that hear only certain types of cases – either cases that are specialized to a specific area of the law only, or cases that are considered smaller cases than would typically be heard by a court of general jurisdiction. For example, a state court that only hears landlord-tenant types of cases would be a court of limited jurisdiction to this specific area of law. In New Jersey, there is a tax court which is a specialized court hears cases involving disputes related to state taxation, including property taxes, income taxes, and other tax matters. There are also several specialized courts in the federal judicial system. These include the U.S. Tax Court, the Court of Customs and Patent Appeals, and the Court of Claims.

Limited jurisdiction courts can also include county or municipal courts that hear minor criminal cases (petty assaults, traffic offenses, and breach of peace, among others) and civil cases involving monetary amounts up to a fixed ceiling (no more than $10,000 in most states and far less in many states). Limited jurisdiction courts handle many cases, with estimates up to 80% of all cases filed in state court systems. One familiar limited jurisdiction state court is the small claims court, with jurisdiction to hear civil cases involving claims for amounts ranging between $1,000 and $5,000 in about half the states and for considerably less in the other states ($500 to $1,000). The advantage of the small claims court is that its procedures are informal, and lawyers are not necessary to present the case.

Decisions in limited jurisdiction courts are made by judges, and are usually considered final. If a party is dissatisfied with the outcome, typically that party will be able to get a new trial in a court of general jurisdiction. Because there has been one trial already, this is known as a trial de novo. It is not an appeal, since the case essentially starts over.

2.3 SUBJECT MATTER JURISDICTION – ORIGINAL VERSUS APPELLATE JURISDICTION

Two aspects of civil lawsuits are common to all state courts: trials and appeals. A court exercising a trial function has **original jurisdiction**—that is, jurisdiction to determine the facts of the case and apply the law to them. A court that hears appeals from the trial court is said to have **appellate jurisdiction**—it must accept the facts as determined by the trial court and limit its review to the lower court's theory of the applicable law.

Original jurisdiction refers to the authority of a court to hear and decide a case when it is first filed. Original jurisdiction courts are also called courts of "first resort." This is the court that is the initial **forum** for legal proceedings, where the case is presented, evidence is introduced, witnesses are heard, and a decision is reached on the merits of the case. Usually this is the trial court.

In contrast, appellate courts have appellate jurisdiction, which means they have the authority to review decisions made by lower courts, including courts of original jurisdiction. Appellate Courts do not reexamine the facts of the case but focus on legal issues, procedural errors, and the application of the law. For example, the appellant (the losing party who appeals) might complain that the judge wrongly instructed the jury on the meaning of the law, or improperly allowed testimony of a particular witness, or misconstrued the law in question. The appellee (who won in the lower court) will ask that the appellant be denied—usually this means that the appellee wants the lower-court judgment affirmed. The appellate court, which usually includes at least three judges, has quite a few choices: it can affirm, modify, reverse, or reverse and remand the lower court (return the case to the lower court for retrial).

Typically, a case will begin in a court of original jurisdiction, with the losing party having a right to appeal to a court of appellate jurisdiction. In many states in and in the federal system this would be the intermediate appellate court, which are usually composed of a panel of three judges. After the one appeal of right, further appeals by either party to the same or higher appeals court are discretionary. Should the highest court chose to hear the case, a single panel of between five and nine judges, typically located in the state capital, will review the case and decision of the lower court. For most litigants in state court, the ruling of the state supreme court is final. In a relatively small class of cases—those in which federal constitutional claims are made—appeal to the U.S. Supreme Court to issue a **writ of certiorari** remains a possibility.

CONCURRENT JURISDICTION

When a plaintiff takes a case to state court, it will be because state courts typically hear that kind of case (i.e., there is **subject matter jurisdiction**). If the plaintiff's main cause of action comes from a certain state's constitution, statutes, or court decisions, the state courts have subject matter jurisdiction over the case. If the plaintiff's main cause of action is based on federal law (e.g., Title VII of the Civil Rights Act of 1964), the federal courts have subject matter jurisdiction over the case. But federal courts will also have subject matter jurisdiction over certain cases that have only a state-based cause of action; those cases are ones in which the plaintiff(s) and the defendant(s) are from different states and the amount in controversy is more than $75,000. State courts can have subject matter jurisdiction over certain cases that have only a federal-based cause of action. The Supreme Court has now made clear that state courts have **concurrent jurisdiction** of any federal cause of action unless Congress has given **exclusive jurisdiction** to federal courts.

In short, a case with a federal question can be often be heard in either state or federal court, and a case that has parties with a diversity of citizenship can be heard in state courts or in federal courts where the tests of complete diversity and amount in controversy are met.

Whether a case will be heard in a state court or moved to a federal court will depend on the parties. If a plaintiff files a case in state trial court where concurrent jurisdiction applies, a defendant may (or may not) ask that the case be removed to federal **district court**.

Robinson v. Audi

Now consider Mr. and Mrs. Robinson and their products-liability claim against Seaway Volkswagen and the other three defendants. There is no federal products-liability law that could be used as a cause of action. They are most likely suing the defendants using products-liability law based on common-law **negligence** or common-law **strict liability law**, as found in state court cases. They were not yet Arizona residents at the time of the accident, and their accident does not establish them as Oklahoma residents, either. They bought the vehicle in New York from a New York–based retailer. None of the other defendants is from Oklahoma.

They file in an Oklahoma state court, but how will their attorney or the court know if the state court has **subject matter jurisdiction**? Unless the case is *required* to be in a federal court (i.e., unless the federal courts have **exclusive jurisdiction** over this kind of case), *any* state court system will have subject matter jurisdiction, including Oklahoma's state court system. But if their claim is for a significant amount of money, they cannot file in small claims court, probate court, or any court in

Oklahoma that does not have statutory jurisdiction over their claim. They will need to file in a court of general jurisdiction. In short, even filing in the right court system (state versus federal), the plaintiff must be careful to find the court that has subject matter jurisdiction.

If they wish to go to federal court, can they? There is no federal question presented here (the claim is based on state common law), and the United States is not a party, so the only basis for federal court jurisdiction would be **diversity jurisdiction**. If enough time has elapsed since the accident and they have established themselves as Arizona residents, they could sue in federal court in Oklahoma (or elsewhere), but only if none of the defendants—the retailer, the regional Volkswagen company, Volkswagen of North America, or Audi (in Germany) are incorporated in or have a principal place of business in Arizona. The federal judge would decide the case using federal civil procedure but would have to make the appropriate choice of state law. In this case, the choice of conflicting laws would most likely be Oklahoma, where the accident happened, or New York, where the defective product was sold.

CHOICE OF LAW AND CHOICE OF FORUM CLAUSES

Sometimes parties decide in advance of a dispute what law will apply to their claims and what court they will file in. Such decisions are made in a written contract, and courts will honor contractual choices of parties in a lawsuit. Suppose the parties to a contract wind up in court arguing over the application of the contract's terms. If the parties are from two different states, the judge may have difficulty determining which law to apply. But if the contract says that a particular state's law will be applied if there is a dispute, then ordinarily the judge will apply that state's law as a rule of decision in the case. For example, Kumar Patel (a Missouri resident) opens a brokerage account with Goldman, Sachs and Co., and the contractual agreement calls for "any disputes arising under this agreement" to be determined "according to the laws of the state of New York." When Kumar claims in a Missouri court that his broker is "churning" his account, and, on the other hand, Goldman, Sachs claims that Kumar has failed to meet his margin call and owes $38,568.25 (plus interest and attorney's fees), the judge in Missouri will apply New York law based on the contract between Kumar and Goldman, Sachs.

Ordinarily, a choice-of-law clause will be accompanied by a choice-of-forum clause. In a choice-of-forum clause, the parties in the contract specify which court they will go to in the event of a dispute arising under the terms of contract. For example, Harold (a resident of Virginia) rents a car from Alamo at the Denver International Airport. He does not look at the fine print on the contract. He also waives all collision and other insurance that Alamo offers at the time of his rental. While driving back from Telluride Bluegrass Festival, he has an accident in Idaho Springs, Colorado. His rented Nissan Altima is badly damaged. On returning to Virginia, he would like to settle up with Alamo, but his insurance company and Alamo cannot come to terms. He realizes, however, that he has agreed to hear the dispute with Alamo in a specific court in San Antonio, Texas. In the absence of fraud or bad faith, any court in the United States is likely to uphold the choice-of-form clause and require Harold (or his insurance company) to litigate in San Antonio, Texas.

Figure 2.3 Sample Conflict-of-Law Principles

Substantive Law Issue	Law to be Applied
Liability for injury caused by tortious conduct	State in which the injury was inflicted
Real property	State where the property is located
Personal Property: inheritance	Domicile of deceased (not location of property)
Contract: validity	State in which contract was made
Contract: breach	State in which contract was to be performed*
***Or, in many states, the state with the most significant contacts with the contractual activities**	
Note: Choice-of-law clauses in a contract will ordinarily be honored by judges in state and federal courts.	

2.4 PERSONAL JURISDICTION

Personal jurisdiction, also known as "**in personam jurisdiction**," refers to a court's authority to make decisions and issue rulings that are legally binding on a specific individual or entity involved in a legal case. It pertains to the court's power over the parties themselves, as opposed to **subject matter jurisdiction** (which we explored above) which focuses on the court's authority over the type of case being heard.

In order for a court to exercise personal jurisdiction over a party, certain conditions or connections must be established. These conditions generally involve the defendant's contacts with the jurisdiction in which the court is located. Note that this analysis does not focus on the Plaintiff. The Court must still have jurisdiction over the Plaintiff, but as the filing party, the Plaintiff consents to the jurisdiction of the court that they choose to file in.

As to the Defendant, there are two ways to obtain jurisdiction and both are related to the defendant's activities within the jurisdiction. General personal jurisdiction is typically established when a defendant has significant and continuous contacts with the jurisdiction, such as maintaining a residence or conducting substantial business activities there. In other words, the physical presence of the Defendant within the area the court serves provides jurisdiction over the Defendant for purposes of litigation. This means that personal jurisdiction of a state court over persons is clear for those defendants found within the state.

At times, a lawsuit is filed against a Defendant that is not ordinarily present in the area served by the Court, such as an out-of-state Defendant. In this situation, jurisdiction can still be obtained by establishing that the Defendant has sufficient **minimum contacts** with the forum.

The minimum contacts test was established by the U.S. Supreme Court in the landmark case *International Shoe Co. v. Washington* (1945). The test considers whether a defendant's connections or activities within a particular jurisdiction are substantial enough to warrant that jurisdiction's courts asserting personal jurisdiction over the defendant. The defendant has minimum contacts if he has purposefully availed himself of the benefits and protections of the jurisdiction in question such that he could reasonably foresee that they could be subject to lawsuits in that jurisdiction.

Almost every state in the United States has a statute regarding personal jurisdiction, instructing judges when it is permissible to assert personal jurisdiction over an out-of-state resident. These are called long-arm statutes. But no state can reach out beyond the limits of what is constitutionally permissible

under the Fourteenth Amendment, which binds the states with its proviso to guarantee the due process rights of the citizens of every state in the union.

In sum, the exercise of personal jurisdiction over the defendant must be consistent with due process and any statutes in that state that prescribe the jurisdictional reach of that state.

CASE 2.1

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (U.S. Supreme Court 1985)

Summary

Burger King Corp. is a Florida corporation with principal offices in Miami. It principally conducts restaurant business through franchisees. The franchisees are licensed to use Burger King's trademarks and service marks in standardized restaurant facilities. Rudzewicz is a Michigan resident who, with a partner (MacShara) operated a Burger King franchise in Drayton Plains, Michigan. Negotiations for setting up the franchise occurred in 1978 largely between Rudzewicz, his partner, and a regional office of Burger King in Birmingham, Michigan, although some deals and concessions were made by Burger King in Florida. A preliminary agreement was signed in February of 1979. Rudzewicz and MacShara assumed operation of an existing facility in Drayton Plains and MacShara attended prescribed management courses in Miami during the four months following Feb. 1979.

Rudzewicz and MacShara bought $165,000 worth of restaurant equipment from Burger King's Davmor Industries division in Miami. But before the final agreements were signed, the parties began to disagree over site-development fees, building design, computation of monthly rent, and whether Rudzewicz and MacShara could assign their liabilities to a corporation they had formed. Negotiations took place between Rudzewicz, MacShara, and the Birmingham regional office; but Rudzewicz and MacShara learned that the regional office had limited decision-making power and turned directly to Miami headquarters for their concerns. The final agreement was signed by June 1979 and provided that the franchise relationship was governed by Florida law, and called for payment of all required fees and forwarding of all relevant notices to Miami headquarters.

The Drayton Plains restaurant did fairly well at first, but a recession in late 1979 caused the franchisees to fall far behind in their monthly payments to Miami. Notice of default was sent from Miami to Rudzewicz, who nevertheless continued to operate the restaurant as a Burger King franchise. Burger King sued in federal district court for the southern district of Florida. Rudzewicz contested the court's personal jurisdiction over him, since he had never been to Florida.

The federal court looked to Florida's **long arm statute** and held that it did have personal jurisdiction over the non-resident franchisees, and awarded Burger King a quarter of a million dollars in contract damages and enjoined the franchisees from further operation of the Drayton Plains facility. Franchisees appealed to the 11th Circuit Court of Appeals and won a reversal based on lack of personal jurisdiction. Burger King petitioned the Supreme Ct. for a writ of certiorari.

Justice Brennan delivered the opinion of the court.

The Due Process Clause protects an individual's liberty interest in not being subject to the binding

judgments of a forum with which he has established no meaningful "contacts, ties, or relations." *International Shoe Co. v. Washington.* By requiring that individuals have "fair warning that a particular activity may subject [them] to the jurisdiction of a foreign sovereign," the Due Process Clause "gives a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit."…

Where a forum seeks to assert specific jurisdiction over an out-of-state defendant who has not consented to suit there, this "fair warning" requirement is satisfied if the defendant has "purposefully directed" his activities at residents of the forum, and the litigation results from alleged injuries that "arise out of or relate to" those activities, Thus "[t]he forum State does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum State" and those products subsequently injure forum consumers. Similarly, a publisher who distributes magazines in a distant State may fairly be held accountable in that forum for damages resulting there from an allegedly defamatory story.…

…[T]he constitutional touchstone remains whether the defendant purposefully established "minimum contacts" in the forum State.…In defining when it is that a potential defendant should "reasonably anticipate" out-of-state litigation, the Court frequently has drawn from the reasoning of *Hanson v. Denckla*, 357 U.S. 235, 253 (1958):

The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws.

This "purposeful availment" requirement ensures that a defendant will not be hauled into a jurisdiction solely as a result of "random," "fortuitous," or "attenuated" contacts, or of the "unilateral activity of another party or a third person," [Citations] Jurisdiction is proper, however, where the contacts proximately result from actions by the defendant himself that create a "substantial connection" with the forum State. [Citations] Thus where the defendant "deliberately" has engaged in significant activities within a State, or has created "continuing obligations" between himself and residents of the forum, he manifestly has availed himself of the privilege of conducting business there, and because his activities are shielded by "the benefits and protections" of the forum's laws it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well.

Jurisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are "purposefully directed" toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.

Once it has been decided that a defendant purposefully established minimum contacts within the forum State, these contacts may be considered in light of other factors to determine whether the assertion of

personal jurisdiction would comport with "fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S., at 320. Thus courts in "appropriate case[s]" may evaluate "the burden on the defendant," "the forum State's interest in adjudicating the dispute," "the plaintiff's interest in obtaining convenient and effective relief," "the interstate judicial system's interest in obtaining the most efficient resolution of controversies," and the "shared interest of the several States in furthering fundamental substantive social policies." These considerations sometimes serve to establish the reasonableness of jurisdiction upon a lesser showing of minimum contacts than would otherwise be required. [Citations] Applying these principles to the case at hand, we believe there is substantial record evidence supporting the District Court's conclusion that the assertion of personal jurisdiction over Rudzewicz in Florida for the alleged breach of his franchise agreement did not offend due process.…

In this case, no physical ties to Florida can be attributed to Rudzewicz other than MacShara's brief training course in Miami. Rudzewicz did not maintain offices in Florida and, for all that appears from the record, has never even visited there. Yet this franchise dispute grew directly out of "a contract which had a substantial connection with that State." Eschewing the option of operating an independent local enterprise, Rudzewicz deliberately "reach[ed] out beyond" Michigan and negotiated with a Florida corporation for the purchase of a long-term franchise and the manifold benefits that would derive from affiliation with a nationwide organization. Upon approval, he entered into a carefully structured 20-year relationship that envisioned continuing and wide-reaching contacts with Burger King in Florida. In light of Rudzewicz' voluntary acceptance of the long-term and exacting regulation of his business from Burger King's Miami headquarters, the "quality and nature" of his relationship to the company in Florida can in no sense be viewed as "random," "fortuitous," or "attenuated." Rudzewicz' refusal to make the contractually required payments in Miami, and his continued use of Burger King's trademarks and confidential business information after his termination, caused foreseeable injuries to the corporation in Florida. For these reasons it was, at the very least, presumptively reasonable for Rudzewicz to be called to account there for such injuries.

…Because Rudzewicz established a substantial and continuing relationship with Burger King's Miami headquarters, received fair notice from the contract documents and the course of dealing that he might be subject to suit in Florida, and has failed to demonstrate how jurisdiction in that forum would otherwise be fundamentally unfair, we conclude that the District Court's exercise of jurisdiction pursuant to Fla. Stat. 48.193(1)(g) (Supp. 1984) did not offend due process. The judgment of the Court of Appeals is accordingly reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Case questions

1. Why did Burger King sue in Florida rather than in Michigan?
2. If Florida has a long-arm statute that tells Florida courts that it may exercise personal jurisdiction over someone like Rudzewicz, why is the court talking about the due process clause?
3. Why is this case in federal court rather than in a Florida state court?

4. If this case had been filed in state court in Florida, would Rudzewicz be required to come to Florida? Explain.

IN REM JURISDICTION

In rem jurisdiction, also known as "jurisdiction over the thing," refers to a court's authority to make decisions and rulings concerning a specific property or asset, rather than over a particular individual. This type of jurisdiction is often invoked when the case involves rights or claims associated with a piece of property, such as real estate, personal property, or other assets. In cases involving in rem jurisdiction, the court's authority is based on its control over the property itself, rather than the parties involved. This means that the court can make determinations about the property's ownership, title, rights, or other legal issues related to the property. In rem jurisdiction is commonly used in cases involving property disputes, foreclosure proceedings, probate matters, and admiralty and maritime law.

2.5 VENUE

Before concluding the discussion about jurisdiction, we should explore the requirement of **venue**. Venue refers to the specific geographic location or district where a legal case is heard or tried. It determines the appropriate court within a particular jurisdiction that has the authority to handle a case. While jurisdiction refers to the court's authority to hear a case based on factors such as subject matter and parties involved, venue determines the physical location of the court where the case should be heard. The concept of venue is crucial for ensuring that legal proceedings take place in a fair and convenient location, often to facilitate access to justice for the parties involved and to promote efficiency in the legal process. For example, in a civil lawsuit, venue may be determined based on factors such as where the events giving rise to the dispute occurred, where the parties reside, or where the contract was executed. In New Jersey, the venue of a case filed in the state court system would be the specific county in which the case is filed (e.g. Hunterdon County). If there are concerns about improper venue, parties may seek a change of venue to move the case to a different court location within the same jurisdiction that is a more appropriate geographic location where the case should be heard.

ACTIVITY 2B

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=38#h5p-22

2.6 HOW A CASE PROCEEDS IN COURT

In this section, we consider how lawsuits are begun and how they make their way through the Courts. Courts do not reach out for cases. Instead, cases are brought to them, usually when an attorney files a case with the right court on behalf of a person that believes they have suffered a legal harm. Once correctly filed, the case will proceed through the various processes designed with due process concerns in mind. In the United States, we have an adversarial court process, which means that the parties oppose each other throughout the litigation, with the goal of "winning" their case. The lawyer, if one is employed by the litigant, serves as an advocate for the client's claim. Their duty would be to shape the evidence and the argument—the line of reasoning about the evidence—to advance his client's cause and persuade the court of its rightness. The lawyer for the opposing party will be doing the same thing, of course, for her client. The judge (or, if one is sitting, the jury) must sort out the facts and reach a decision from this cross-fire of evidence and argument. The litigant that initiated the case has the burden of proof, which in a civil trial is generally a "preponderance of the evidence" which means that the plaintiff's evidence must outweigh whatever evidence the defendant can muster that casts doubts on the plaintiff's claim. Let's review the process in more depth below.

INITIAL PLEADINGS AND PROCESS

Complaint and Summons

Beginning a lawsuit is simple and is spelled out in the rules of procedure by which each court system operates. A civil plaintiff begins a lawsuit by filing a **complaint**—a document clearly explaining the grounds for suit—with the clerk of the court. A complaint will have several key components as it serves as an initial pleading and sets the stage for the remainder of the litigation. The complaint will have a caption which indicates the parties to the lawsuit, the court the case is filed in, and the type of case, as well as identifying information called a docket number so the case can be tracked. The complaint must establish that the court has jurisdiction to decide the controversy, and the complaint must state the nature of the plaintiff's claim and the relief that is being asked for (usually an award of money, but sometimes an injunction, or a declaration of legal rights). In addition, the complaint is signed, attesting to its truthfulness. Once the complaint is filed with the court, the defendant must be served with the complaint and **summons**. The summons is a court document stating the name of the plaintiff and their attorney and directing the defendant to respond to the complaint within a fixed time period.

Jurisdiction and Venue

As the complaint must establish that the Court has the power to decide the case, the complaint must

be filed in a correct location. The Court must have **subject matter jurisdiction** over the claim in the complaint, and the complaint must be filed in the proper geographic location – called **venue**.

Service of Process

As stated above, the defendant in the case must be "served"—that is, must receive notice that he has been sued. This delivery of notice is referred to as **service of process**. Service can be done by physically presenting the defendant with a copy of the **summons** and **complaint**. But sometimes the defendant is difficult to find (or deliberately avoids the marshal or other process server). The rules spell out a variety of ways by which individuals and corporations can be served. These include using U.S. Postal Service certified mail or serving someone already designated to receive service of process. A corporation or partnership, for example, is often required by state law to designate a "registered agent" for purposes of getting public notices or receiving a summons and complaint.

Timing of Filing

The timing of the filing is important. Almost every possible legal complaint is governed by a federal or state statute of limitations, which requires a lawsuit to be filed within a certain period of time. For example, in many states a lawsuit for injuries resulting from an automobile accident must be filed within two years of the accident or the plaintiff forfeits his right to proceed. As noted earlier, making a correct initial filing, and including the required components of a complaint in a court that has **subject matter jurisdiction** is critical to avoiding statute of limitations problems.

Answer and Affirmative Defenses

Once a complaint is appropriately served, the Defendant in a lawsuit files an **answer**. The answer is the initial pleading of the defendant that is a written response to the plaintiff's claims. The answer typically either 'admits' or 'denies' the allegations made by the plaintiff. Admitted allegations are accepted as true, while denied allegations require the plaintiff to prove their case. Therefore, most allegations are denied. The answer may also include "**affirmative defenses**," which are legal reasons that, if proven, would excuse the defendant from liability. Affirmative defenses can also introduce new facts or principles to justify the defendant's actions. As an example, the issue of the statute of limitations, referenced above, could be an affirmative defense if by defendant's calculations the plaintiff did not file their complaint in time. The answer may also include counterclaims against the plaintiff or cross-claims against other defendants. The answer is filed within a specific time frame governed by the rules of the court in which the complaint was filed.

Motions and Discovery

The early phases of a civil action are characterized by many different kinds of motions and the exchange of mutual fact-finding between the parties that is known as **discovery**. After the pleadings, the parties may make various **motions**, which are requests to the judge to rule on legal issues in the case. Motions in the early stages of a lawsuit usually aim to dismiss the lawsuit, to have it moved to another **venue**, or to compel the other party to act in certain ways during the discovery process.

Motions

In litigation, a "motion" is a formal request made by one party to a lawsuit (the moving party) asking

the court to take a specific action or make a particular decision. If a party wins a motion, or loses one for that matter, it can streamline the legal issues in the case substantially.

Motions to Dismiss at Pleadings Stage

A complaint and subsequent pleadings are usually quite general and give little detail. But in some instances, a case can be decided based on the pleadings alone. For example, if the defendant fails to answer the complaint, the Plaintiff can move for the court to enter a default judgment, awarding the plaintiff what they seek.

A defendant that believes that the complaint is defective can move to dismiss the complaint on the grounds that the plaintiff failed to "state a claim on which relief can be granted," or on the basis that there is no **subject matter jurisdiction** for the court chosen by the plaintiff, or on the basis that there is no **personal jurisdiction** over the defendant. The defendant is saying, in effect, that even if all the plaintiff's allegations are true, they do not amount to a legal claim that can be heard by the court.

Motion for Summary Judgment

A "**motion for summary judgment**" is a legal request made by a party to a lawsuit, asking the court to decide the case or specific claims in their favor without going to trial. This motion is typically filed after the parties have conducted discovery (summarized below) such that key facts in the case are known to both parties. If there is no triable question of fact or law, there is no reason to have a trial with a jury, and a judge could simply decide the case.

Discovery

If the claim made by the plaintiff involves a factual dispute, the case will usually involve some degree of **discovery**, where each party tries to get as much information out of the other party as the discovery rules allow. In a civil action, the parties are entitled to learn the facts of the case before trial. The basic idea is to help the parties determine what the evidence might be, who the potential witnesses are, and what specific issues are relevant. Full discovery helps determine which cases should genuinely go to trial to be heard by a jury, and which cases can be amicably settled. It helps each side understand the strengths and weaknesses of their opponent's claims and defenses. There are several methods by which discovery can take place, the most common of which are listed here:

Interrogatories: Written questions that one party sends to the other which the recipient is required to answer under oath. Interrogatories seek factual information, legal contentions, or details about the parties' claims and defenses.

Depositions: Oral testimony given under oath outside of court, typically recorded by a court reporter. Parties or witnesses answer questions posed by attorneys. Depositions help gather firsthand accounts and allow each party to assess credibility.

Requests for Production: Formal requests for specific documents, electronically stored information, or tangible items relevant to the case. These requests seek evidence such as contracts, emails, reports, and records.

Requests for Admission: Written requests asking the opposing party to admit or deny specific statements or facts. Admissions streamline the issues by eliminating the need to prove certain facts at

trial. An allegation that was denied in the pleading stage of the lawsuit might now be admitted after full discovery.

Physical and Mental Examinations: When a person's physical or mental condition is relevant to the case, such as in a personal injury case, a court may order an examination by a qualified medical professional.

The lawyers, not the court, run the discovery process. For example, one party simply makes a written demand, stating the time at which the deposition will take place or the type of documents it wishes to inspect and make copies of. A party unreasonably resisting discovery methods (whether depositions, written interrogatories, or requests for documents) can be challenged using a motion to compel discovery as judges can be brought into the process to push reluctant parties to make more disclosure or to protect a party from irrelevant or unreasonable discovery requests. For example, the party receiving the discovery request can apply to the court for a protective order if it can show that the demand is for privileged material (e.g., a party's lawyers' records are not open for inspection) or that the demand was made to harass the opponent. In complex cases between companies, the discovery of documents can run into tens of millions of pages and can take years. Depositions can consume days or even weeks of an executive's time.

The Pretrial and Trial Phase

Once the discovery period is complete, the case moves on to trial if it has not been settled. Most cases are settled before this stage; perhaps 85 percent of all civil cases end before trial, and more than 90 percent of criminal prosecutions end with a guilty plea.

Pretrial Conference

Depending on the nature and complexity of the case, the court may hold a **pretrial conference** to clarify the issues and establish a timetable for the upcoming trial, as well as discuss any legal issues or pretrial motions raised in the case. The pretrial conference may also be used as a settlement conference to see if the parties can work out their differences and avoid trial altogether. If the judge believes that settlement is a possibility, the judge will explore the strengths and weaknesses of each party's case with the attorneys. The parties may decide that it is more prudent or efficient to settle than to risk going to trial.

Trial

If the case does not settle, motions have been fully litigated, and discovery is complete, the case will be scheduled for trial.

Jury Selection

At trial, the first order of business is to select a jury. The judge and sometimes the lawyers are permitted to question the jurors to be sure that they are unbiased. This questioning is known as the ***voir dire*** (pronounced vwahr-DEER). This is an important process, and a great deal of thought goes into selecting the jury, especially in high-profile cases. A jury panel can be as few as six persons, or as many as twelve, with alternates selected and sitting in court in case one of the jurors is unable to

continue. In a long trial, having alternates is essential; even in shorter trials, most courts will have at least two alternate jurors.

In both criminal and civil trials, each side has opportunities to challenge potential jurors **for cause**. For example, in the Robinsons' case against Audi, the attorneys representing Audi will want to know if any prospective jurors have ever owned an Audi, what their experience has been, and if they had a similar problem (or worse) with their Audi that was not resolved to their satisfaction. If so, the defense attorney could well believe that such a juror has a potential for a bias against her client. In that case, she could use a **for cause challenge**, explaining to the judge the basis for her challenge. The judge, at her discretion, could either accept the for-cause reason or reject it.

Even if an attorney cannot articulate a for-cause reason acceptable to the judge, she may use one of several **peremptory challenges** that most states (and the federal system) allow. A trial attorney with many years of experience may have a sixth sense about a potential juror and, in consultation with the client, may decide to use a peremptory challenge to avoid having that juror on the panel.

Opening Statements

After the jury is sworn and seated, the plaintiff's lawyer makes an **opening statement**, laying out the nature of the plaintiff's claim, the facts of the case as the plaintiff sees them, and the evidence that the lawyer will present. The defendant's lawyer may also make an opening statement or may reserve his right to do so at the end of the plaintiff's case.

Examination of Witnesses

Once **opening statements** are completed, the plaintiff's lawyer then calls witnesses and presents the physical evidence that is relevant to her proof, called the plaintiff's case in chief. The initial questioning of witnesses by the party that calls them to the stand is a **direct examination**. Testimony at trial is usually far from a smooth narration. The rules of evidence (that govern the kinds of testimony and documents that may be introduced at trial) and the question-and-answer format tend to make the presentation of evidence choppy and difficult to follow.

Anyone who has watched an actual televised trial or a television melodrama featuring a trial scene will appreciate the nature of the trial itself: witnesses are asked questions about a number of issues that may or may not be related, the opposing lawyer will frequently object to the question or the form in which it is asked, and the jury may be sent from the room while the lawyers argue at the bench before the judge.

After **direct examination** of each witness is over, the opposing lawyer may conduct **cross-examination**. The formal rules of direct testimony are then relaxed, and the cross-examiner may probe the witness more informally, asking questions that may not seem immediately relevant. The opposing attorney may become harsh trying to cast doubt on a witness's credibility, trying to trip her up and show that the answers she gave are false or not to be trusted. This use of cross-examination, along with the requirement that the witness must respond to questions that are at all relevant to the questions raised by the case, distinguishes common-law courts from those of authoritarian regimes around the world.

Following cross-examination, the plaintiff's lawyer may then question the witness again: this is called

redirect examination and is used to demonstrate that the witness's original answers were accurate and to show that any implications otherwise, suggested by the cross-examiner, were unwarranted. The cross-examiner may then engage the witness in **recross-examination**, and so on. The process usually stops after cross-examination or redirect.

During the trial, the judge's chief responsibility is to see that the trial is fair to both sides. One big piece of that responsibility is to rule on the admissibility of evidence. A judge may rule that a particular question is out of order—that is, not relevant or appropriate—or that a given document is irrelevant. Where the attorney is convinced that a particular witness, a particular question, or a particular document (or part thereof) is critical to her case, she may preserve an objection to the court's ruling by saying "exception," in which case the court stenographer will note the exception, and the attorney may raise these issues on appeal should there be one.

At the end of the plaintiff's case, the defendant presents his case in chief, following the same procedure just outlined. The plaintiff is then entitled to present rebuttal witnesses, if necessary, to deny or argue with the evidence the defendant has introduced. The defendant in turn may present "surrebuttal" witnesses.

Motion for Directed Verdict

When all testimony has been introduced, either party may ask the judge for a motion for **directed verdict**—a **verdict** decided by the judge without advice from the jury. This motion may be granted if the plaintiff has failed to introduce evidence that is legally sufficient to meet her burden of proof or if the defendant has failed to do the same on issues on which she has the burden of proof. (For example, the plaintiff alleges that the defendant owes him money and introduces a signed promissory note. The defendant cannot show that the note is invalid. The defendant must lose the case unless he can show that the debt has been paid or otherwise discharged.)

The defendant can move for a directed verdict at the close of the plaintiff's case, but the judge will usually wait to hear the entire case until deciding whether to do so. Directed verdicts are not usually granted, since it is the jury's job to determine the facts in dispute.

Closing Argument

If the judge refuses to grant a **directed verdict**, each lawyer will then present a **closing argument** to the jury (or, if there is no jury, to the judge alone). The closing argument is used to tie up the loose ends, as the attorney tries to bring together various seemingly unrelated facts into a story that will make sense to the jury, and make the argument as to why finding in their client's favor is the correct **verdict**.

Jury Instruction

After **closing arguments**, the judge will instruct the jury. The purpose of jury instruction is to explain to the jurors the meaning of the law as it relates to the issues they are considering and to tell the jurors what facts they must determine if they are to give a **verdict** for one party or the other. Each lawyer will have prepared a set of written instructions that she hopes the judge will give to the jury. These will be tailored to advance her client's case. Many a verdict has been overturned on appeal because a trial judge has wrongly instructed the jury. The judge will carefully determine which instructions

to give and often will use a set of pattern instructions provided by the state bar association or the supreme court of the state. These pattern jury instructions are often safer because they are patterned after language that appellate courts have used previously, and appellate courts are less likely to find reversible error in the instructions. In civil cases, the plaintiff has the burden of proof, typically of proving their claim by a preponderance of the evidence. The jury will be instructed on what this means and how to apply this burden of proof.

Deliberations and Verdict

After all instructions are given, the jury will retire to a private room and discuss the case and the answers requested by the judge for as long as it takes to reach a unanimous **verdict**. In New Jersey, civil cases are not required to be unanimous. Instead, only 5/6 of the jurors need to agree on a verdict. If the jury cannot reach a decision, this is called a hung jury, and the case will have to be retried. When a jury does reach a verdict, it delivers it in court with both parties and their lawyers present. The jury is then discharged, and control over the case returns to the judge. (If there is no jury, the judge will usually announce in a written opinion his findings of fact and how the law applies to those facts. Juries just announce their verdicts and do not state their reasons for reaching them.)

Posttrial Motions

Once the trial is complete, it is still possible to ask the judge to make a ruling that is contrary to the jury **verdict**. The losing party at trial is allowed to ask the judge for a new trial or for a judgment notwithstanding the verdict (often called a JNOV, from the Latin *non obstante veredicto*).

Motion for a New Trial: A motion for a new trial is a request made by a party after a trial has concluded, asking the court to set aside the jury's verdict and order a new trial. This motion is typically based on perceived errors or irregularities that occurred during the trial that may have influenced the outcome. The party seeking a new trial asserts that some legal error, procedural mistake, or unfairness occurred during the trial process that warrants another opportunity to present their case.

Judgment Notwithstanding the Verdict (JNOV): A JNOV is a motion that challenges the jury's verdict after trial. It is typically filed by the losing party, arguing that the jury's verdict was not supported by sufficient evidence or was legally erroneous. In other words, the party contends that even if all the evidence is viewed in the light most favorable to the winning party, no reasonable jury could have reached the verdict that was reached.

Post-trial, a party may renew a prior motion for directed verdict. A judge who decides that a directed verdict is appropriate will usually wait to see what the jury's verdict is. If it is favorable to the party the judge thinks should win, she can rely on that verdict. If the verdict is for the other party, the judge can grant the motion for JNOV. This is a safer way to proceed because if the judge is reversed on appeal, a new trial is not necessary. The jury's verdict always can be restored, whereas without a jury verdict (as happens when a directed verdict is granted before the case goes to the jury), the entire case must be presented to a new jury.

CASE 2.2

Ferlito v. Johnson & Johnson Products, Inc., 771 F. Supp. 196 (U.S. District Ct., Eastern District of Michigan 1991)

GADOLA, J.

Plaintiffs Susan and Frank Ferlito, husband and wife, attended a Halloween party in 1984 dressed as Mary (Mrs. Ferlito) and her little lamb (Mr. Ferlito). Mrs. Ferlito had constructed a lamb costume for her husband by gluing cotton batting manufactured by defendant Johnson & Johnson Products ("JJP") to a suit of long underwear. She had also used defendant's product to fashion a headpiece, complete with ears. The costume covered Mr. Ferlito from his head to his ankles, except for his face and hands, which were blackened with Halloween paint. At the party Mr. Ferlito attempted to light his cigarette by using a butane lighter. The flame passed close to his left arm, and the cotton batting on his left sleeve ignited. Plaintiffs sued defendant for injuries they suffered from burns which covered approximately one-third of Mr. Ferlito's body.

Following a jury verdict entered for plaintiffs November 2, 1989, the Honorable Ralph M. Freeman entered a judgment for plaintiff Frank Ferlito in the amount of $555,000 and for plaintiff Susan Ferlito in the amount of $ 70,000. Judgment was entered November 7, 1989. Subsequently, on November 16, 1989, defendant JJP filed a timely motion for judgment notwithstanding the verdict pursuant to Fed.R.Civ.P. 50(b) or, in the alternative, for new trial. Plaintiffs filed their response to defendant's motion December 18, 1989; and defendant filed a reply January 4, 1990. Before reaching a decision on this motion, Judge Freeman died. The case was reassigned to this court April 12, 1990.

MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT

Defendant JJP filed two motions for a directed verdict, the first on October 27, 1989, at the close of plaintiffs' proofs, and the second on October 30, 1989, at the close of defendant's proofs. Judge Freeman denied both motions without prejudice. Judgment for plaintiffs was entered November 7, 1989; and defendant's instant motion, filed November 16, 1989, was filed in a timely manner.

The standard for determining whether to grant a j.n.o.v. is identical to the standard for evaluating a motion for directed verdict:

In determining whether the evidence is sufficient, the trial court may neither weigh the evidence, pass on the credibility of witnesses nor substitute its judgment for that of the jury. Rather, the evidence must be viewed in the light most favorable to the party against whom the motion is made, drawing from that evidence all reasonable inferences in his favor. If after reviewing the evidence…the trial court is of the opinion that reasonable minds could not come to the result reached by the jury, then the motion for j.n.o.v. should be granted.

To recover in a "failure to warn" product liability action, a plaintiff must prove each of the following four elements of negligence: (1) that the defendant owed a duty to the plaintiff, (2) that the defendant violated that duty, (3) that the defendant's breach of that duty was a proximate cause of the damages suffered by the plaintiff, and (4) that the plaintiff suffered damages.

To establish a prima facie case that a manufacturer's breach of its duty to warn was a proximate cause of an injury sustained, a plaintiff must present evidence that the product would have been used differently had the proffered warnings been given.[1][Citations omitted] In the absence of evidence that a warning would

have prevented the harm complained of by altering the plaintiff's conduct, the failure to warn cannot be deemed a proximate cause of the plaintiff's injury as a matter of law. [In accordance with procedure in a diversity of citizenship case, such as this one, the court cites Michigan case law as the basis for its legal interpretation.]

…

A manufacturer has a duty "to warn the purchasers or users of its product about dangers associated with intended use." Conversely, a manufacturer has no duty to warn of a danger arising from an unforeseeable misuse of its product. [Citation] Thus, whether a manufacturer has a duty to warn depends on whether the use of the product and the injury sustained by it are foreseeable. *Gootee v. Colt Industries Inc.*, 712 F.2d 1057, 1065 (6th Cir. 1983); *Owens v. Allis-Chalmers Corp.*, 414 Mich. 413, 425, 326 N.W.2d 372 (1982). Whether a plaintiff's use of a product is foreseeable is a legal question to be resolved by the court. Trotter, supra. Whether the resulting injury is foreseeable is a question of fact for the jury.[2] *Thomas v. International Harvester Co.*, 57 Mich. App. 79, 225 N.W.2d 175 (1974).

In the instant action no reasonable jury could find that JJP's failure to warn of the flammability of cotton batting was a proximate cause of plaintiffs' injuries because plaintiffs failed to offer any evidence to establish that a flammability warning on JJP's cotton batting would have dissuaded them from using the product in the manner that they did.

Plaintiffs repeatedly stated in their response brief that plaintiff Susan Ferlito testified that "she would never again use cotton batting to make a costume…" However, a review of the trial transcript reveals that plaintiff Susan Ferlito never testified that she would never again use cotton batting to make a costume. More importantly, the transcript contains no statement by plaintiff Susan Ferlito that a flammability warning on defendant JJP's product would have dissuaded her from using the cotton batting to construct the costume in the first place. At oral argument counsel for plaintiffs conceded that there was no testimony during the trial that either plaintiff Susan Ferlito or her husband, plaintiff Frank J. Ferlito, would have acted any different if there had been a flammability warning on the product's package. The absence of such testimony is fatal to plaintiffs' case; for without it, plaintiffs have failed to prove proximate cause, one of the essential elements of their negligence claim.

In addition, both plaintiffs testified that they knew that cotton batting burns when it is exposed to flame. Susan Ferlito testified that she knew at the time she purchased the cotton batting that it would burn if exposed to an open flame. Frank Ferlito testified that he knew at the time he appeared at the Halloween party that cotton batting would burn if exposed to an open flame. His additional testimony that he would not have intentionally put a flame to the cotton batting shows that he recognized the risk of injury of which he claims JJP should have warned. Because both plaintiffs were already aware of the danger, a warning by JJP would have been superfluous. Therefore, a reasonable jury could not have found that JJP's failure to provide a warning was a proximate cause of plaintiffs' injuries.

The evidence in this case clearly demonstrated that neither the use to which plaintiffs put JJP's product nor the injuries arising from that use were foreseeable. Susan Ferlito testified that the idea for the costume was hers alone. As described on the product's package, its intended uses are for cleansing, applying medications, and infant care. Plaintiffs' showing that the product may be used on occasion in classrooms for decorative purposes failed to demonstrate the foreseeability of an adult male encapsulating himself from head to toe in cotton batting and then lighting up a cigarette.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that defendant JJP's motion for judgment notwithstanding the verdict is GRANTED.

IT IS FURTHER ORDERED that the judgment entered November 2, 1989, is SET ASIDE.

IT IS FURTHER ORDERED that the clerk will enter a judgment in favor of the defendant JJP.

Case questions

1. The opinion focuses on proximate cause. As we will see when we study tort law, a negligence case cannot be won unless the plaintiff shows that the defendant has breached a duty and that the defendant's breach has actually and proximately caused the damage complained of. What, exactly, is the alleged breach of duty by the defendant here?
2. Explain why Judge Gadola reasoning that JJP had no duty to warn in this case. After this case, would they then have a duty to warn, knowing that someone might use their product in this way?

Judgment, Appeal, and Execution

Judgment or Order

At the end of a trial, the judge will enter an order that makes findings of fact (often with the help of a jury) and conclusions of law. The judge will also make a judgment as to what relief or remedy should be given. Often it is an award of money damages to one of the parties. The losing party may ask for a new trial at this point or within a short period of time following. Once the trial judge denies any such request, the judgment—in the form of the court's order—is final.

Appeal

If the loser's motion for a new trial or a JNOV is denied, the losing party may appeal but must ordinarily post a bond sufficient to ensure that there are funds to pay the amount awarded to the winning party. In an appeal, the appellant aims to show that there was some prejudicial error committed by the trial judge. There will be errors, of course, but the errors must be significant (i.e., not harmless). The basic idea is for an appellate court to ensure that a reasonably fair trial was provided to both sides. Enforcement of the court's judgment—an award of money, an injunction—is usually stayed (postponed) until the appellate court has ruled. As noted earlier, the party making the appeal is called the appellant, and the party defending the judgment is the appellee (or in some courts, the petitioner and the respondent).

During the trial, the losing party may have objected to certain procedural decisions by the judge. In compiling a record on appeal, the appellant needs to show the appellate court some examples of

mistakes made by the judge—for example, having erroneously admitted evidence, having failed to admit proper evidence that should have been admitted, or having wrongly instructed the jury. The appellate court must determine if those mistakes were serious enough to amount to prejudicial error.

Appellate and trial procedures are different. The appellate court does not hear witnesses or accept evidence. It reviews the *record* of the case—the transcript of the witnesses' testimony and the documents received into evidence at trial—to try to find a legal error on a specific request of one or both of the parties. The parties' lawyers prepare briefs (written statements containing the facts in the case), the procedural steps taken, and the argument or discussion of the meaning of the law and how it applies to the facts. After reading the briefs on appeal, the appellate court may dispose of the appeal without argument, issuing a written opinion that may be very short or many pages. Often, though, the appellate court will hear oral argument. (This can be months, or even more than a year after the briefs are filed.) Each lawyer is given a short period of time, usually no more than thirty minutes, to present his client's case. The lawyer rarely gets a chance for an extended statement because he is usually interrupted by questions from the judges. Through this exchange between judges and lawyers, specific legal positions can be tested and their limits explored.

Depending on what it decides, the appellate court will *affirm* the lower court's judgment, *modify* it, *reverse* it, or *remand* it to the lower court for retrial or other action directed by the higher court. The appellate court itself does not take specific action in the case; it sits only to rule on contested issues of law. The lower court must issue the final judgment in the case. As we have already seen, there is the possibility of appealing from an intermediate appellate court to the state supreme court in twenty-nine states and to the U.S. Supreme Court from a ruling from a federal circuit court of appeal. In cases raising constitutional issues, there is also the possibility of appeal to the Supreme Court from the state courts.

Like trial judges, appellate judges must follow previous decisions, or precedent. But not every previous case is a precedent for every court. Lower courts must respect appellate court decisions, and courts in one state are not bound by decisions of courts in other states. State courts are not bound by decisions of federal courts, except on points of federal law that come from federal courts within the state or from a federal circuit in which the state court sits. A state supreme court is not bound by case law in any other state. But a supreme court in one state with a type of case it has not previously dealt with may find persuasive reasoning in decisions of other state supreme courts.

Federal **district courts** are bound by the decisions of the court of appeals in their circuit, but decisions by one circuit court are not precedents for courts in other circuits. Federal courts are also bound by decisions of the state supreme courts within their geographic territory in diversity jurisdiction cases. All courts are bound by decisions of the U.S. Supreme Court, except the Supreme Court itself, which seldom reverses itself but on occasion has overturned its own precedents.

Not everything a court says in an opinion is a precedent. Strictly speaking, only the exact holding is binding on the lower courts. A holding is the theory of the law that applies to the particular circumstances presented in a case. The courts may sometimes declare what they believe to be the law with regard to points that are not central to the case being decided. These declarations are called dicta (the singular, *dictum*), and the lower courts do not have to give them the same weight as holdings.

Execution

When a party has no more possible appeals, it usually pays up voluntarily. If not voluntarily, then the losing party's assets can be seized or its wages or other income garnished to satisfy the judgment. This is called executing the judgment. If the final judgment is an injunction, failure to follow its dictates can lead to a contempt citation, with a fine or jail time imposed.

ACTIVITY 2C

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=38#h5p-21

2.7 WHEN CAN SOMEONE BRING A LAWSUIT?

Almost anyone can bring a lawsuit, but a court may not hear it for a number of reasons. There may be no case or controversy, there may be no law to support the plaintiff's claim, or the case may be filed in the wrong court. Another reason may be that the plaintiff does not have **standing**.

STANDING TO SUE

Article III of the U.S. Constitution provides limits to federal judicial power. For some cases, the Supreme Court has decided that it has no power to adjudicate because there is no "case or controversy." For example, perhaps the case has settled or the "real parties in interest" are not before the court. In such a case, a court might dismiss the case on the grounds that the plaintiff does not have "**standing**" to sue.

For example, suppose you see a sixteen-wheel moving van drive across your neighbor's flower bed, destroying her beloved roses. You have enjoyed seeing her roses every summer, for years. She is forlorn and tells you that she is not going to raise roses there anymore. She also tells you that she has decided not to sue, because she has made the decision to never deal with lawyers. Incensed, you decide to sue on her behalf. But you will not have standing to sue because your person or property was not directly injured by the moving van. Standing means that only the person whose interests are directly affected has the legal right to sue.

CLASS ACTIONS

Most lawsuits concern a dispute between two people or between a person and a company or other organization. But it can happen that someone injures more than one person at the same time. A driver

who runs a red light may hit another car carrying one person or many people. If several people are injured in the same accident, they each have the right to sue the driver for the damage that he caused them. Could they sue as a group? Usually not, because the damages would probably not be the same for each person, and different facts would have to be proved at the trial. Plus, the driver of the car that was struck might have been partially to blame, so the defendant's liability toward him might be different from his liability toward the passengers.

If, however, the potential plaintiffs were all injured in the same way and their injuries were identical, a single lawsuit might be a far more efficient way of determining liability and deciding financial responsibility than many individual lawsuits.

How could such a suit be brought? All the injured parties could hire the same lawyer, and she could present a common case. But with a group numbering more than a handful of people, it could become overwhelmingly complicated. So how could, say, a million stockholders who believed they were cheated by a corporation ever get together to sue?

Because of these types of situations, there is a legal procedure that permits one person or a small group of people to serve as representatives for all others. This is the **class action**. In general anyone can file a class action in an appropriate case, subject to approval of the court. Once the class is "certified," or judged to be a legally adequate group with common injuries, the lawyers for the named plaintiffs become, in effect, lawyers for the entire class.

Usually a person who doesn't want to be in the class can decide to leave. If she does, she will not be included in an eventual judgment or settlement. But a potential plaintiff who is included in the class cannot, after a final judgment is awarded, seek to relitigate the issue if she is dissatisfied with the outcome, even though she did not participate at all in the legal proceeding.

2.8 RELATIONSHIPS WITH LAWYERS

LEGAL FEES

Lawyers charge for their services in one of three different ways: **flat rate**, **hourly rate**, and **contingent fee**. A flat rate is used usually when the work is relatively routine and the lawyer knows in advance approximately how long it will take her to do the job. Drawing a will or doing a real estate closing are examples of legal work that is often paid a flat rate. The rate itself may be based on a percentage of the worth of the matter—say, 1 percent of a home's selling price.

Lawyers generally charge by the hour for courtroom time and for ongoing representation in commercial matters. Virtually every sizable law firm bills its clients by hourly rates, which in large cities can range from $300 for an associate's time to $500 and more for a senior partner's time.

A contingent fee is one that is paid only if the lawyer wins—that is, it is contingent, or depends upon, the success of the case. This type of fee arrangement is used most often in personal injury cases (e.g., automobile accidents, products liability, and professional malpractice). Although used quite often, the contingent fee is controversial. Trial lawyers justify it by pointing to the high cost of preparing for such lawsuits. A typical automobile accident case can cost at least ten thousand dollars to prepare, and a complicated products-liability case can cost tens of thousands of dollars. Few people have that

kind of money or would be willing to spend it on the chance that they might win a lawsuit. Corporate and professional defendants complain that the contingent fee gives lawyers a license to go big game hunting, or to file suits against those with deep pockets in the hopes of forcing them to settle.

Trial lawyers respond that the contingent fee arrangement forces them to screen cases and weed out cases that are weak, because it is not worth their time to spend the hundreds of hours necessary on such cases if their chances of winning are slim or nonexistent.

COSTS

In England and in many other countries, the losing party must pay the legal expenses of the winning party, including attorneys' fees. That is not the general rule in this country. Here, each party must pay most of its own costs, including (and especially) the fees of lawyers. (Certain relatively minor costs, such as filing fees for various documents required in court, are chargeable to the losing side, if the judge decides it.) This type of fee structure is known as the American rule (in contrast to the British rule).

There are two types of exceptions to the American rule. By statute, Congress and the state legislatures have provided that the winning party in particular classes of cases may recover its full legal costs from the loser—for example, the federal antitrust laws so provide and so does the federal Equal Access to Justice Act. The other exception applies to litigants who either initiate lawsuits in bad faith, with no expectation of winning, or who defend them in bad faith, in order to cause the plaintiff great expense. Under these circumstances, a court has the discretion to award attorneys' fees to the winner. But this rule is not infinitely flexible, and courts do not have complete freedom to award attorneys' fees in any amount, but only "reasonable" attorney's fees.

Footnotes

[1] By "prima facie case," the court means a case in which the plaintiff has presented all the basic elements of the cause of action alleged in the complaint. If one or more elements of proof are missing, then the plaintiff has fallen short of establishing a prima facie case, and the case should be dismissed (usually on the basis of a **directed verdict**).

[2] Note the division of labor here: questions of law are for the judge, while questions of "fact" are for the jury. Here, "foreseeability" is a fact question, while the judge retains authority over questions of law. The division between questions of fact and questions of law is not an easy one, however.

End of Chapter Exercises

1. James, a New Jersey resident, is sued by Jonah, an Iowa resident. After a trial in which James appears and vigorously defends himself, the Iowa state court awards Jonah $136,750 dollars in damages for his tort claim. In trying to collect from James in New Jersey, Jonah must have the New Jersey court certify the Iowa judgment. Why, ordinarily, must the New Jersey court do so?

2. The Constitution specifies that federal courts have exclusive jurisdiction over admiralty claims. Mr. and Mrs. Shute have a claim against Carnival Cruise lines for the negligence of the cruise line. Mrs. Shute sustained injuries as a result of the company's negligence. Mr. and Mrs. Shute live in the state of Washington. Can they bring their claim instate court? Must they bring their claim in federal court?
3. Congress passed Title VII of the Civil Rights Act of 1964. In Title VII, employers are required not to discriminate against employees on the basis of race, color, sex, religion, or national origin. In passing Title VII, Congress did not require plaintiffs to file only in federal courts. That is, Congress made no statement in Title VII that federal courts had "exclusive jurisdiction" over Title VII claims. Mrs. Harris wishes to sue Forklift Systems, Inc. of Nashville, Tennessee, for sexual harassment under Title VII. She has gone through the Equal Employment Opportunity Commission process and has a right-to-sue letter, which is required before a Title VII action can be brought to court. Can she file a complaint that will be heard by a state court?
4. Mrs. Harris failsto go to the Equal Employment Opportunity Commission to get her right-to-sue letter against Forklift Systems, Inc. She therefore does not have a viable Title VII cause of action against Forklift. She does, however, have her rights under Tennessee's equal employment statute and various court decisions from Tennessee courts regarding sexual harassment. Forklift is incorporated in Tennessee and has its principal place of business in Nashville. Mrs. Harris is also a citizen of Tennessee. Explain why, if she brings her employment discrimination and sexual harassment lawsuit in a federal court, her lawsuit will be dismissed for lack of subject matter jurisdiction.
5. Suppose Mr. and Mrs. Robinson find in the original paperwork with Seaway Volkswagen that there is a contractual agreement with a provision that says"all disputes arising between buyer and Seaway Volkswagen will be litigated, if at all, in the county courts of Westchester County, New York." Will the Oklahoma court take personal jurisdiction over Seaway Volkswagen, or will it require the Robinsons to litigate their claim in New York?
6. Mrs. Robinson (in the Volkswagen Audi case) never establishes residency in Arizona, returns to New York, and files her case in federal district court in New York, alleging diversity jurisdiction. Assume that the defendants do not want to have the case heard in federal court. What motion will they make?
7. Under contributory negligence, the negligence of any plaintiff that causes or contributes to the injuries a plaintiff complains of will be grounds for dismissal. Suppose that in discovery, Mr. Ferlito in *Ferlito v. Johnson & Johnson* admits that he brought the cigarette lighter dangerously close to his costume, saying, "Yes, you could definitely say I was being careless; I had a few drinks under my belt." Also, Mrs. Ferlito admits that she never reads product instructions from manufacturers. If the case is brought in a state where contributory negligence is the law, on what basis can Johnson & Johnson have the case dismissed before trial?
8. Mrs. Robinson has a key witness on auto safety that the judge believes is not qualified as an expert. The judge examines the witness while the jury is in the jury room and disqualifies him from testifying. The jury does not get to hear this witness. Her attorney objects. She loses her case. What argument would you expect Mrs. Robinson's attorney to make in an appeal?
9. Why don't appellate courts need a witness box for witnesses to give testimony under oath?

REFERENCES

Robinson v. Audi Nsu Auto Union Aktiengesellschaft, 739 F.2d 1481 (10th Cir. 1984)

CHAPTER 3 - ALTERNATIVE DISPUTE RESOLUTION

Learning Objectives

After studying this chapter, you should be able to:

1. Describe the process of negotiation as it is commonly employed in business.
2. Discuss the process of mediation as an alternative dispute resolution (ADR) strategy.
3. Discuss the option of arbitration as an alternative dispute resolution (ADR) strategy.
4. Describe the benefits and drawbacks of ADR as compared to litigation.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=35#h5p-10

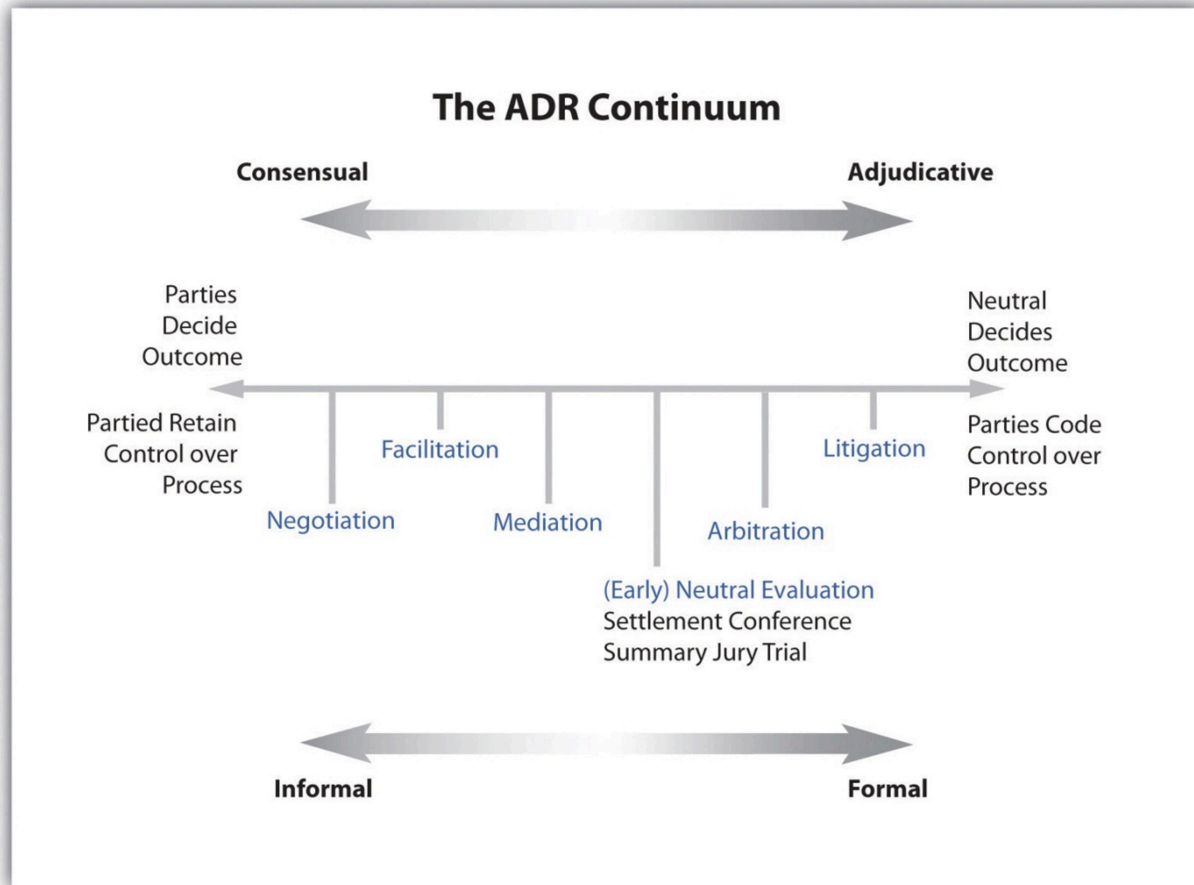
3.1 GENERAL PERSPECTIVES ON ALTERNATIVE DISPUTE RESOLUTION

Imagine that you believe you've been wronged by a supplier, by your employer, or by a business where you are a customer. You've correctly determined that you have an actionable legal claim. But, now what do you do to try to resolve that claim? We learned in a prior chapter that one option might be to initiate a lawsuit against the alleged wrongdoer. But you know that litigation is expensive and time consuming, not to mention frustrating. If you want to try to continue to have a relationship with a supplier, employer, or other business, filing a lawsuit against them is unlikely to promote a strong current and future business relationship. If the matter is of a private nature you may not want to engage in a public process to determine the outcome. So, while you want the matter to be addressed and resolved, you may not want to engage in public, time-consuming, expensive and adversarial litigation to resolve it.

A common method of dispute resolution that avoids many of the challenges associated with litigation is alternative dispute resolution. **Alternative dispute resolution (ADR)** is a term that encompasses many different methods of dispute resolution *other than* litigation. ADR involves resolving disputes outside of the judicial process, though the judiciary can require parties to participate in specific types of ADR, such as **arbitration**, for some types of conflicts. Moreover, some ADR methods vest the power to resolve the dispute in a neutral party, while other strategies vest that power in the parties

themselves. See Figure 3.1 "A Continuum of Different ADR Methods" to understand ADR methods based on where the power to solve the dispute is vested.

Figure 3.1 A Continuum of Different ADR Methods



Source: Adapted from New York State Unified Court System

Common methods of ADR include **negotiation**, **mediation**, and **arbitration**. Less frequently used methods of ADR include **minitrials**, hybrid forms of **mediation-arbitration** (with elements of both), and collaborative goal-oriented processes. ADR is often used to resolve disputes between businesses, employers and employees, and businesses and consumers. ADR can also be used in many other types of conflicts. For instance, ADR strategies can be used in domestic law cases, such as divorce, or in international legal issues, such as issues relating to transboundary pollution. This Chapter focuses on the use of common ADR methods in business, including the benefits and drawbacks to each. We will also examine potential consequences to parties that have unequal bargaining power. Additionally, we will examine the use of ADR methods in situations where ADR may not be the most appropriate method of dispute resolution, such as civil rights violations.

ADR methods are used outside of the courtroom, but that does not mean that they are outside of the interests of our legal system. Participation in ADR has important legal consequences. For instance, parties that have agreed by contract to be subject to binding arbitration give up their constitutional right to bring their complaint to court. The **Federal Arbitration Act (FAA)** is a federal statute under

which parties are required to participate in arbitration when they have agreed by contract to do so, even in state court matters. Indeed, the FAA is a national policy favoring arbitration. In New Jersey, there are certain types of cases filed with courts that are required to go first to mandatory arbitration. This **court-ordered arbitration** would be non-binding because it was ordered by a court, yet this court rule showcases the policy of the state to try to use ADR to resolve disputes between parties.

It is likely that you will or already have agreed to a contract that contains a mandatory arbitration clause. Arbitration clauses are common in business contracts, consumer contracts, and even employee handbooks. If a dispute arises under that contract or agreement, you will be required to arbitrate your claim rather than going straight to court. Under a binding arbitration clause, you will have waived your constitutional rights to go to court. Because of this, it's important to understand the ADR process, situations in which litigation is a better choice than ADR, and special issues that arise when parties have unequal bargaining power.

3.2 NEGOTIATION

Let's start this section with an example. A tent manufacturer has a supplier of tent fabric that supplies an appropriate water-resistant fabric to construct the tents. After many years of a good working relationship, there is an issue with the fabric supplier. Specifically, the fabric delivered was not water-resistant, despite the necessity of water-resistant fabric to produce the tents. The tent manufacturer notifies the supplier of the problem and the supplier denies that there is any issue with the fabric sent to fulfill the order. The tent manufacturer refuses to pay for the fabric. The supplier insists on payment before any future delivery of additional fabric. Without water-resistant fabric, the manufacturer cannot continue to produce tents.

This is an example of a **business-to-business (B2B)** dispute. Despite the problem, the manufacturer will likely want to continue working with the supplier and preserve a good, long-standing relationship. Accordingly, the parties will probably want to resolve this dispute quickly and without hard feelings. If this is the goal of the parties, it is unlikely that either one will immediately hire an attorney to file a formal complaint. That does not change the fact that there is a dispute that needs to be resolved.

One of the first strategies that the manufacturer and supplier are likely to employ is negotiation. **Negotiation** is a method of **alternative dispute resolution (ADR)** that retains power to resolve the dispute to the parties involved. No outside third party is vested with authoritative decision-making power concerning the resolution of the dispute. Negotiation requires the parties to define the conflicts and agree to an outcome to resolve those conflicts. Often, this can take the form of a compromise. Note that a compromise does not mean that anyone "loses." Indeed, if both parties are satisfied with the result of the negotiation and the business relationship can continue moving forward, then both parties will be very likely to consider this as a "winning" situation.

Benefits to negotiation as a method of ADR include its potential for a speedy resolution, the inexpensive nature of participation, and the fact that parties participate voluntarily. Drawbacks include the fact that there are no set rules, and either party may bargain badly or even unethically, if they choose to do so. In a negotiation, there is no neutral party charged with ensuring that rules are followed, that the negotiation strategy is fair, or that the overall outcome is sound. Moreover,

any party can walk away from the negotiation whenever it wishes, even going on to pursue another method of dispute resolution as appropriate. Negotiation is not guaranteed to resolve the dispute.

Generally speaking, attorneys are not involved in many business negotiations. Attorneys are not prohibited from being negotiators, or providing legal advice to a party that is negotiating, but they are not required to have a successful negotiation. Some parties might find it helpful not to have attorneys get involved when they feel capable of handling the negotiation themselves. Whether attorneys get involved, therefore, will depend on the circumstances of the negotiation.

Though the example above is a B2B dispute, the parties may or may not have equal bargaining power. If the manufacturer and the supplier are both dependent on each other for roughly equal portions of the respective businesses, then they are most likely relatively equal with respect to bargaining power. But if the manufacturer is a very small business but the supplier is a very large fabric company, then the B2B negotiation is potentially unbalanced, since one party has a much more powerful bargaining position than the other. For example, if the business needs that particular type of fabric, which is only available from one supplier, but the supplier doesn't need the relationship with the tent business, this would result in unequal bargaining power.

When the negotiation occurs as a result of a dispute, then the party with the weakest bargaining position may be in a vulnerable spot. While anyone can engage in negotiation, this is a skill developed by people who are charged with settling existing disputes or with creating new agreements. The goal of negotiation is to achieve a "win-win" outcome, unlike litigation where one party must win and the other lose. The book *Getting to Yes* by Harvard Program on Negotiation members emphasizes principled negotiation and provides steps and strategies for achieving this goal. Common concepts in negotiation include BATNA (best alternative to a negotiated agreement), WATNA (worst alternative to a negotiated agreement), bargaining zone (the area within which parties can find an acceptable agreement), and reservation point (a party's "bottom line" beyond which it will not agree to terms). This is just one strategy for negotiation.

Going back to the example, imagine that after negotiating with the fabric supplier, the tent manufacturer learns that the fabric supplier believed that it sent the correct fabric as a new tent employee inadvertently ordered the wrong fabric. Business records then confirm this was the source of the error. This sort of misunderstanding should be cleared up through negotiation. Any number of outcomes are now available to the parties once they've identified the source of the problem. It is likely that the dispute can be resolved in a professional manner, and the working relationship between the two businesses can be preserved.

3.3 MEDIATION

Mediation is a method of **ADR** in which parties work to form a mutually acceptable agreement. Like **negotiation**, parties in mediation do not vest authority to decide the dispute in a neutral third party. Instead, this authority to settle the dispute remains with the parties themselves, who are free to terminate mediation if they believe it is not working. Mediation is appropriate only for parties who are willing to participate in the process. Like negotiation, mediation seeks a "win-win" outcome for the parties involved. Additionally, mediation is confidential, which can be an attractive attribute for people who wish to avoid the public nature of litigation. The mediation process is usually much

faster than litigation, and the associated costs can be substantially less expensive than litigation. If the dispute is unable to be resolved through mediation, the parties are free to pursue another form of ADR, such as arbitration, or they choose to litigate their claims in court.

A neutral third-party **mediator** is crucial to the mediation process. Mediators act as a go-between for the parties, seeking to facilitate the agreement. Requirements to be a mediator vary by state. There are no uniform licensing requirements, but some states require specific training or qualifications for a person to be certified as a mediator. Mediators do not provide advice on the subject matter of the dispute. In fact, the mediators may not possess any subject-matter expertise concerning the nature of the dispute. However, many mediators are trained in conflict resolution, and this allows them to employ methods to discover common goals or objectives, set aside issues that are not relevant, and facilitate an agreement into which the parties will voluntarily enter. Mediators try to find common ground by identifying common goals or objectives and by asking parties to set aside the sometimes emotionally laden obstacles that are not relevant to the sought-after agreement itself.

Parties choose their mediator. This choice is often made based on the mediator's reputation as a skilled conflict resolution expert, professional background, training, experience, cost, and availability. After a mediator is chosen, the parties prepare for mediation. For instance, prior to the mediation process, the mediator typically asks the parties to sign a mediation agreement. This agreement may embody the parties' commitments to proceed in good faith, understanding of the voluntary nature of the process, commitments to confidentiality, and recognition of the mediator's role of neutrality rather than one of legal counsel. At the outset, the mediator typically explains the process that the mediation will observe. The parties then proceed according to that plan, which may include opening statements, face-to-face communication, or indirect communication through the mediator. The mediator may suggest options for resolution and, depending on his or her skill, may be able to suggest alternatives not previously considered by the parties.

Mediation is often an option for parties who cannot negotiate with each other but who could reach a mutually beneficial or mutually acceptable resolution with the assistance of a neutral party to help sort out the issues to find a resolution that achieves the parties' objectives. Sometimes parties in mediation retain attorneys, but this is not required. If parties do retain counsel, the costs for participating in the mediation will obviously increase.

In business, mediation is often the method of ADR used in disputes between employers and employees about topics such as workplace conditions, wrongful discharge, or advancement grievances. Mediation is used in disputes between businesses, such as in contract disputes. Mediation is also used for disputes arising between businesses and consumers, such as in medical malpractice cases or health care disputes.

For example, in the tent fabric dispute, a mediator can assist the parties in communicating their concerns and interests effectively, exploring potential solutions, and reaching a mutually satisfactory agreement. The mediator can first meet with each party separately to gain an understanding of their positions, interests, and concerns. The mediator can then facilitate a joint meeting where the parties can discuss the issue, clarify misunderstandings, and brainstorm potential solutions. The mediator can also help the parties evaluate the strengths and weaknesses of their positions and explore alternative options that may address the needs of both parties. If the core issue in the dispute

is whether the fabric was really water-resistant, the mediator could help the parties decide on how to determine the quality of the fabric, say through some sort of testing. If the issue is financial, a mediator could help the parties to discuss and ultimately agree to spreading the cost of a replacement fabric over future orders, or otherwise revise their payment terms or delivery schedule to address the issue.

Like other forms of dispute resolution, mediation has benefits and drawbacks. Benefits are many. They include the relative expediency of reaching a resolution, the reduced costs as compared to litigation, the ability for parties that are unable to communicate with each other to resolve their dispute using a non-adversarial process, the imposition of rules on the process by the mediator to keep parties "within bounds" of the process, confidentiality, and the voluntary nature of participation. Of course, the potential for a "win-win" outcome is a benefit. Attorneys may or may not be involved, and this can be viewed as either a benefit or a drawback, depending on the circumstances.

Drawbacks to mediation also exist. For example, if parties are not willing to participate in the mediation process, the mediation will not work. This is because mediation requires voluntary participation between willing parties to reach a mutually agreeable resolution. Additionally, even after considerable effort by the parties in dispute, the mediation may fail. This means that the resolution of the problem may have to be postponed until another form of ADR is used, or until the parties litigate their case in court. Since mediators are individuals, they have different levels of expertise in conflict resolution, and they possess different backgrounds and worldviews that might influence the manner in which they conduct mediation. Parties may be satisfied with one mediator but not satisfied in subsequent mediations with a different mediator. Even if an agreement is reached, the mediation itself is usually not binding. Parties can later become dissatisfied with the agreement reached during mediation and choose to pursue the dispute through other ADR methods or through litigation. For this reason, parties often enter into a legally binding contract that embodies the terms of the resolution of the mediation immediately on conclusion of the successful mediation. Therefore, the terms of the mediation can become binding if they are reduced to such a contract, and some parties may find this to be disadvantageous to their interests. Of course, any party that signs such an agreement would do so voluntarily. However, in some cases, if legal counsel is not involved, parties may not fully understand the implications of the agreement that they are signing.

3.4 ARBITRATION

Arbitration is a method of **ADR** in which parties vest authority in a third-party neutral decision maker who will hear their case and issue a decision, which is called an arbitration **award**.

An **arbitrator** presides over arbitration proceedings, much as a judge would preside over a trial. For instance, they determine which evidence can be introduced, hear the parties' cases, and issue decisions. Arbitrators may even be former members of the judiciary. Often, arbitrators are experts in the law and subject matter at issue in the dispute.

Their decisions do not form binding precedent, so no single arbitration decision would be binding on the next arbitration even if the issue in the dispute was similar. Arbitrators may be certified by the state in which they arbitrate, and they may arbitrate only certain types of claims. For instance, the Better Business Bureau trains its own arbitrators to hear common complaints between businesses and consumers (B2C).

Sometimes participation in an arbitration proceeding is mandatory. Mandatory arbitration results when disputes arise out of a legally binding contract in which the parties agreed to submit to mandatory arbitration. Arbitration is also mandatory when state law requires parties to enter into mandatory arbitration.

Although perhaps not obvious, federal law lies at the heart of mandatory arbitration clauses in contracts. Specifically, Congress enacted the **Federal Arbitration Act (FAA)** through its Commerce Clause powers. This act requires parties to engage in arbitration when those parties have entered into legally binding contracts with a mandatory arbitration clause, providing the subject of those contracts involves commerce. In *Southland Park v. Keating*, the U.S. Supreme Court interpreted this federal statute to apply to matters of both federal and state court jurisdiction. Indeed, the Court held that the FAA created a national policy in favor of arbitration. It also held that the FAA preempts state power to create a judicial forum for disputes arising under contracts with mandatory arbitration clauses. In a later decision, the Court held that the FAA encompasses transactions within the broadest permissible exercise of congressional power under the Commerce Clause. This means that the FAA requires mandatory arbitration clauses to be enforceable for virtually any transaction involving interstate commerce, very broadly construed.

Some states require mandatory arbitration for certain types of disputes. For instance, in Oregon, the state courts require mandatory arbitration for civil suits where the prayer for damages is less than $50,000, excluding attorney fees and costs. Many parties accept the arbitration award without appeal. However, when state law requires mandatory arbitration of certain types of disputes, parties are permitted to appeal because the arbitration is nonbinding. In nonbinding arbitration, the parties may choose to resolve their dispute through litigation if the arbitration award is rejected by a party. However, some states have statutory requirements that, in practice, create a chilling effect on appealing an arbitration award. For example, in the state of Washington, if the appealing party from a nonbinding mandatory arbitration does not do better at trial than the original award issued by the arbitrator, then that party will incur liability not only for its own expenses but also for those of the opposing side. In nonbinding arbitration, this is a powerful incentive for parties to accept the arbitration award without appealing to the judicial system.

In New Jersey, by rule of court, nonbinding arbitration is mandatory for civil cases involving automobile negligence, personal injury, contracts and commercial matters. In addition, some insurance matters must be submitted to nonbinding arbitration as well. Like the situation in Oregon above, if either party chooses to reject the arbitration award, the case can then proceed to trial.

Voluntary arbitration also exists, and it is frequently used in business disputes. Sometimes parties simply agree that they do not want to litigate a dispute because they believe that the benefits of arbitration outweigh the costs of litigation, so they choose voluntary arbitration in hopes of a speedy and relatively inexpensive and private outcome. Other times, parties are not certain how strong their case is. In such cases, arbitration can seem much more attractive than litigation.

ACTIVITY 3A

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=35#h5p-23

Arbitration **awards** can be binding or nonbinding. Some states, like Washington State, have codified the rule that arbitration decisions are binding when parties voluntary submit to the arbitration procedure. In binding arbitration, the arbitration award is final; therefore, appealing an arbitration award to the judicial system is not available. In many states, an arbitration awards is converted to a judgment by the court, thereby creating the legal mechanism through which the judgment holder can pursue collection activities. This process, called confirmation, is contemplated by the FAA and often included in arbitration agreements. But even if the FAA does not apply, most states have enacted versions of either the Uniform Arbitration Act or the Revised Uniform Arbitration Act. These state laws allow confirmation of arbitration awards into judgments as well.

In the tent example, the tent manufacturer and the fabric supplier could agree to submit their dispute to voluntary arbitration. Since they are deciding to go to arbitration in lieu of litigation, they will most likely elect for the decision of the arbitrator to be binding. They would mostly likely select an arbitrator that has expertise in the fabric industry and will agree on the procedures and rules that will govern the arbitration process. During the arbitration, the arbitrator would review the evidence presented by both parties, including any independent testing of the fabric, and make a decision on whether the supplier provided water-resistant fabric or not. The arbitrator would then decide whether the supplier is entitled to payment for the fabric and, if so, the amount owed. If the parties agreed to make the arbitration binding, there would be no appeal of the arbitrator's decision. However, if the parties elected non-binding arbitration, either of the parties that was unhappy with the award could appeal to the appropriate court.

Like any other form of dispute resolution, arbitration has certain benefits and drawbacks. Arbitration is an adversarial process like a trial, and it will produce a "winner" and a "loser." Arbitration is more formal than negotiation and mediation and, in many ways, it resembles a trial. Parties present their cases to the arbitrator by introducing evidence. After both sides have presented their cases, the arbitrator issues an arbitration award.

Rules related to arbitration differ by state. The rules of procedure that apply to litigation in a trial do not typically apply to arbitration. Specifically, the rules are often less formal or less restrictive on the presentation of evidence and the arbitration procedure. Arbitrators decide which evidence to allow,

and they are not required to follow precedents or to provide their reasoning in the final award. In short, arbitrations adhere to rules, but those rules are not the same as rules of procedure for litigation. Regardless of which rules are followed, arbitrations proceed under a set of external rules known to all parties involved in any given arbitration.

Arbitration can be more expensive than negotiation or mediation, but it is often less expensive than litigation. In *Circuit City Stores Inc. v. Adams*, the U.S. Supreme Court noted that avoiding the cost of litigation was a real benefit of arbitration. The costly discovery phase of a trial is nonexistent or sharply reduced in arbitration. However, arbitration is not necessarily inexpensive. Parties must bear the costs of the arbitrator, and they typically retain counsel to represent them. Additionally, in mandatory arbitration clause cases, the arbitration may be required to take place in a distant city from one of the parties. This means that the party will have to pay travel costs and associated expenses during the arbitration proceeding. The *Circuit City* Court also noted that mandatory arbitration clauses avoid difficult choice-of-law problems that litigants often face, particularly in employment law cases.

Arbitration is faster than litigation, but it is not as private as negotiation or mediation. Unlike **mediators**, arbitrators are often subject-matter experts in the legal area of dispute. However, as is true for mediators, much depends on the arbitrator's skill and judgment.

A common issue that arises is whether mandatory arbitration is fair in certain circumstances. It's easy to imagine that arbitration is fair when both parties are equally situated. For example, **business-to-business (B2B)** arbitrations are often perceived as fair, especially if businesses are roughly the same size or have roughly equal bargaining power. This is because they will be able to devote approximately the same amount of resources to a dispute resolution, and they both understand the subject under dispute, whatever the commercial issue may be. Moreover, in B2B disputes, the subjects of disputes are commercial issues, which may not implicate deeper social and ethical questions. For example, contract disputes between businesses might involve whether goods are conforming goods or nonconforming goods under the Uniform Commercial Code (UCC). No powerful social or ethical questions arise in such disputes. Indeed, resolving such disputes might be seen as "business as usual" to many commercial enterprises.

However, issues of fairness often arise in **business to employee (B2E)** and **business to consumer (B2C)** situations, particularly where parties with unequal bargaining power have entered into a contract that contains a mandatory arbitration clause. In such cases, the weaker party has no real negotiating power to modify or to delete the mandatory arbitration clause, so that party is required to agree to such a clause if it wants to engage in certain types of transactions. For example, almost all credit card contracts contain mandatory arbitration clauses. This means that if a consumer wishes to have a credit card account, he will agree to waive his constitutional rights to a trial by signing the credit card contract. As we know, the FAA will require parties to adhere to the mandatory arbitration agreed to in such a contract, in the event that a dispute arises under that contract. In such cases, questions regarding whether consent was actually given may legitimately be raised. However, the U.S. Supreme Court has held that in B2E contexts, unequal bargaining power alone is not a sufficient reason to hold that arbitration agreements are unenforceable, and it is not sufficient to preclude arbitration.

Additionally, concerns about fairness do not end at contract formation. If a dispute arises and mandatory arbitration is commenced, the unequal power between parties will continue to be an important issue. In the case between a credit card company and an average consumer debtor, the credit card company would clearly be in a more powerful position vis-à-vis the debtor by virtue of the company's financial strength and all that comes with it, such as experienced attorneys on staff, dispute-resolution experience, and contractual terms that favor it, rather than the consumer debtor. In such cases, if the consumer debtor is the aggrieved party, he may very well decide to drop the matter, especially if the arbitration clause requires arbitration proceedings to occur in a distant city. The credit card company will have vast financial resources as compared to the consumer debtor. Moreover, in this example the credit card company's legal counsel will know how to navigate the arbitration process and will have experience in dispute resolution, processes that often confound people who are not trained in law. Additionally, the list of arbitrators may include people who are dependent on repeat business from the credit card company for their own livelihoods, thereby creating—or at least suggesting—an inherent conflict of interest. Many mandatory arbitration clauses create binding awards on one party while reserving the right to bring a claim in court to the other party. That is, a mandatory arbitration clause may allow the credit card company to appeal an arbitrator's award but to render an award binding on the consumer debtor. Obviously, this would allow the credit card company to appeal an unfavorable ruling, while requiring the consumer debtor to abide by an arbitrator's unfavorable ruling. To a consumer debtor, the arbitration experience can seem like a game played on the credit card company's home court—daunting, feckless, and intimidating.

Additionally, some types of disputes that have been subjected to mandatory arbitration raise serious questions about the appropriateness of **ADR**, due to the nature of the underlying dispute. For example, in some recent **B2E** disputes, claims relating to sexual assault have been subjected to mandatory arbitration when the employee signed an employment contract with a mandatory arbitration clause. Tracy Barker, for example, was reportedly sexually assaulted by a State Department employee in Iraq while she was employed as a civilian contractor by KBR Inc., a former Halliburton subsidiary. When she tried to bring her claim in court, the judge dismissed the claim, citing the mandatory arbitration clause in her employment contract. After arbitration, she won a three-million-dollar arbitration award. As KBR Inc. noted, this "decision validates what KBR has maintained all along; that the arbitration process is truly neutral and works in the best interest of the parties involved." Despite this statement, KBR Inc. has filed a motion to modify the award.

In a similar case, employee Jamie Leigh Jones worked for KBR Inc. in Iraq when she was drugged and gang raped. She was initially prohibited from suing KBR Inc. in court because her employment contract contained a mandatory arbitration clause. However, when considering this case, the Fifth Circuit Court of Appeals ruled that sexual assault cases may, in fact, be brought in court rather than being subjected to mandatory arbitration, despite the contract language requiring mandatory arbitration. Jones's claims were beyond the scope of the arbitration clause, because sexual assault is not within the scope of employment.

Cases like these have brought public attention to the question of fairness in the use of arbitration clauses, and some states have made recent changes to laws in this area.

In part as a reaction to these types of cases, the Ending Forced Arbitration of Sexual Assault and

Sexual Harassment Act of 2021 was signed into law in 2022 by President Joe Biden. This Act amends the FAA and give employees with arbitration agreements with their employers the option of bringing claims of sexual assault or sexual harassment either in arbitration or in court.

In B2C cases, different issues of fairness exist. As noted previously, when the parties possess unequal power, these issues can be magnified. Public Citizen, a nonprofit organization that represents consumer interests in Congress, released a report concerning arbitration in B2C disputes. Specifically, the report argued that arbitration is unfair to consumers in B2C disputes and that consumers fare better in litigation than in arbitration. According to the report, incentives exist to favor businesses over consumers in the arbitration process. It pointed to the lack of appeal rights, lack of requirement to follow precedents or established law, limits on consumers' remedies, prohibitions against class-action suits, limitations on access to jury trials, limitations on abilities to collect evidence, and greater expense as additional factors speaking to the unfairness of arbitration over litigation in B2C disputes.

Importantly, and despite the FAA's broad interpretation, not all binding arbitration clauses have been upheld by courts in B2C cases. In 2007, the Ninth Circuit Court of Appeals ruled that AT&T's binding arbitration clause for wireless customers is unenforceable under California state law. The court further noted that the relevant state law is not preempted by the FAA, because the FAA does not prevent the courts from applying state law. In this case, that law involved unconscionability of contract terms. As noted previously, the FAA requires parties to submit to mandatory arbitration when they agree to do so in a legally binding contract, and it preempts state powers to provide a judicial forum in those matters. However, the Ninth Circuit's holding in this case underscores the fact that state contract law is not circumvented by the federal statute.

Arbitration is a widely used form of ADR, but important questions have been raised about its appropriateness in certain types of disputes. Before signing a mandatory arbitration agreement, it's important to realize that under current law, your opportunity to bring your claim in court will be severely restricted or entirely precluded. Moreover, if you sign such an agreement with a party who holds inherently greater power than you, such as your employer, then you may find yourself at an extreme disadvantage in an arbitration proceeding.

ACTIVITY 3B

What's Your Verdict?

After considering the reasons why businesses use arbitration clauses, the benefits and drawbacks, should there be limitations on when arbitration clauses can be used? Should there be times when such clauses are prohibited by law? Should the employee or consumer that is to be bound by the arbitration clause have a legal right to reject an arbitration clause in a contract? And if so, and the business is subjected to protracted litigation as a consequence, should the business have any remedies against the employee or consumer? What types of rights should a business have in such a situation?

3.5 OTHER METHODS OF ALTERNATIVE DISPUTE RESOLUTION

Remember that **ADR** is a broad term used to denote methods of resolving disputes outside of litigation. This can really be any method, whether or not it bears a specific label or adheres to a particular procedure. For instance, **negotiation** might be a quick meeting in the hallway between parties, or it might involve a formal round of negotiations where all parties are represented by legal counsel.

However, when parties are attempting to resolve a dispute, it makes sense for them to agree to a specific procedure beforehand, so that each party understands how to proceed. **Negotiation**, **mediation**, and **arbitration** are the most common forms of **ADR**. However, these methods might not be appropriate for every dispute. Other forms of ADR exist, ranging from in-house programs to very formal external processes. This section briefly discusses commonly used alternatives to resolving disputes besides negotiation, mediation, arbitration, or litigation.

Some ADR processes or programs are available only to certain groups of people, such as members of a particular organization. For instance, some organizations, like Boeing, have an internal ethics hotline. This hotline is available for employees to report perceived ethics violations that they have observed. Ethics advisors answer employees' questions and follow up on reports that need further investigation. One major benefit of this method is that reporting parties generally (but not always) remain anonymous. Another benefit is that the company has time to redress problems that could give rise to disputes of much greater magnitude if left unaddressed.

An open-door policy is an in-house program that allows company employees to go directly to any level of management to file a complaint or grievance, without threat of retaliation for their reporting. In theory, this policy creates an open atmosphere of trust, and it breaks down class barriers between groups of employees. However, many employees may not feel comfortable in making a complaint about a manager's decision. Moreover, supervisors may not be comfortable with their employees bypassing them to file complaints. Open-door policies sound very good in theory, but they may not work as well in practice.

Another type of in-house program is an ombudsmen's office. These stations generally hear complaints from stakeholders, such as employees or customers.Ombudsmen try to troubleshoot these complaints by investigating and attempting to resolve the issues before they escalate into more formal complaints.

More formal methods of ADR include **mediation-arbitration** (med-arb), which is essentially a mediation followed by an arbitration. If the mediation does not produce a satisfactory outcome, then the parties submit to arbitration. The neutral party mediating the dispute also serves as the **arbitrator** if the dispute-resolution process goes that far. Med-arb has the same benefits and drawbacks as mediation and arbitration separately, with some important differences. For instance, parties in a med-arb know that their dispute will be resolved. This is unlike mediation alone, where parties may walk away if they do not think that the mediation is serving their interests. Moreover, the parties in med-arb have an opportunity to reach a win-win outcome as in mediation. However, if they do not reach a satisfactory outcome, then one party will "win" and one party will "lose" during the arbitration phase. The knowledge that an arbitration will definitely follow a failed mediation can be a strong incentive to ensure that the mediation phase of a med-arb works.

Private judging, contemplated by many state statutes, is a process in which active or retired judges may be hired for private trials. Private judging is essentially private litigation. The hired judge can preside over a private trial that is not truncated by limits on discovery or abbreviated rules of procedure, as would be the case in arbitration. Additionally, the judge who oversees the process is highly experienced in such matters as evidence and decision rendering. Moreover, the parties who can afford to pay for this service have a substantial benefit in not having to wait to have their cases heard in the public court. The private trial is also private rather than public, which may be important to parties who require confidentiality. In states where statutes permit hiring a judge for such matters, the parties' ability to appeal is often preserved. Drawbacks include the sometimes-questionable nature of enforceability of judgments rendered, though some state statutes allow enforceability of those judgments as if they were issued in public court. Moreover, this system may benefit those who can afford to pay for this service, while others must wait for their case to appear on the docket in public court. This raises questions of fairness.

A **minitrial** is a procedure that allows the parties to present their case to decision makers on both sides of the dispute, following discovery. This is a private affair. After the cases are presented, the parties enter into mediation or negotiation to resolve their dispute.

A summary jury trial is a mock trial presented to a jury whose verdict is nonbinding. The presentation is brief and succinct, and it follows a discovery period. The jury does not know that its verdict will be advisory only. This process allows parties to measure the strengths and weaknesses of their cases prior to engaging in litigation, which presumably saves both time and money. After the minitrial, parties are in a better position to negotiate or mediate an outcome that fairly represents their positions.

3.6 PUBLIC POLICY, LEGISLATION, AND ALTERNATIVE DISPUTE RESOLUTION

Alternative dispute resolution can be a very useful alternative to litigation. There are many advantages to parties, such as expediency, cost savings, and greater privacy than litigation. In **business-to-business (B2B)** disputes, **alternative dispute resolution (ADR)** often makes sense.

The **Federal Arbitration Act (FAA)** is a federal statute that the U.S. Supreme Court interpreted as a national policy favoring arbitration in *Southland Corp. v. Keating*. According to the *Southland Corp* Court, state power to create judicial forums to resolve claims when contracting parties enter into a mandatory arbitration agreement has been preempted by the FAA. However, not all disputes are well suited for ADR. This is an area in which Congress could make substantial changes in **public policy** through the creation of new law to ensure fairness between unequal parties and to ensure the protection of civil rights. Congress could do this by making ADR optional, rather than mandatory, for some types of disputes. It could also exclude certain types of disputes from being bound to arbitration through mandatory arbitration clauses.

For example, the proposed Arbitration Fairness Act of 2009 (AFA) would invalidate mandatory arbitration clauses in employment and consumer disputes, as well as in disputes arising from civil rights violations. The AFA is a proposed bill to amend the FAA. Under the Commerce Clause, Congress has the power to limit the use of mandatory arbitration, just as it has the power to enforce mandatory arbitration clauses under the Commerce Clause through the existing FAA. By passing

a new law that excludes certain types of disputes from being subjected to mandatory arbitration, Congress could set new policy regarding fairness in dispute resolution. Likewise, if it fails to act, Congress is also acceding to the U.S. Supreme Court's broad interpretation of the FAA as a national policy favoring arbitration. Either way, policy regarding mandatory arbitration exists, and Congress has a central role in defining that policy. Recent Congresses have considered many Bills that would create more options and choice surrounding arbitration under the FAA, but thus far they have failed to receive enough votes to make it to the President's desk for a signature.

In 1925, when the FAA was originally passed, records indicate that Congress intended that mandatory arbitration clauses be enforced in contracts between merchants, rather than between businesses and consumers or between employers and employees. In the latter relationships, the parties have vastly unequal power. Moreover, despite the existence of mandatory arbitration clauses in contracts, the FAA was not contemplated as a means to preempt state power to provide judicial forums for certain types of disputes. However, the U.S. Supreme Court has greatly expanded the FAA's applicability since then.

If Congress passed the AFA, this would be an example of one branch of government "checking" another branch's power as contemplated by the U.S. Constitution. Specifically, the legislative branch would be checking the judicial branch's power by passing a law to counteract the U.S. Supreme Court's broad interpretation of the FAA in *Southland Corp. v. Keating.*

This is how our government is supposed to work. One branch checks another branch's power. This "checking" of power maintains relative balance among the branches. Because people have different points of entry into the lawmaking process, this system ultimately balances the many special interests of the American people. For example, some businesses and employers that do not wish the AFA to pass may wonder what recourse they have. After all, the U.S. Supreme Court's interpretation of the FAA currently favors their interests. Since the AFA has not yet passed, they could lobby lawmakers against its passage. Note too that if the AFA becomes law, these interest groups are not simply shut out of the government's lawmaking process. They continue to have access to lawmaking. One point of entry is through the legislative branch. For instance, they could return to Congress and ask it to pass a new law to counteract the AFA, or to repeal the AFA altogether. They also have a point of entry to the lawmaking process through the judicial branch. Specifically, once a case or controversy arose under the AFA in which they had standing, they could ask the courts to interpret the statute narrowly, or they could ask the courts to strike down the statute altogether.

On the other side of the issue, consumers and employees who do not like the FAA's current broad interpretation can work within our government system to change the law. For instance, they can ask Congress to pass a new law, such as the AFA. They could ask Congress to repeal the FAA. They could also wait for another case to arise under the FAA to try to get the relevant holding in the *Southland Corp.* case overturned. This is perhaps more difficult than the first two options, because any U.S. Supreme Court case produces many progeny at the circuit court level. Each decision at the circuit court level also produces binding precedent within that jurisdiction. It is very difficult to get a case before the U.S. Supreme Court. Even if that happened, there would be no guarantee that the Court would overturn a prior opinion. In fact, the opposite is usually true. Precedent is most often followed rather than overturned.

In the United States, the policy process is open for participation, though changes often take much work and time. People with special interests tend to coalesce and press for changes in the law to reflect those positions. This appears to be what is happening in the world of ADR now. After many years of mandatory arbitration requirements that have yielded perhaps unfair processes or results, groups that believe they should not be forced into ADR by mandatory arbitration clauses are building momentum for their position in Congress. If the AFA passes, that will not be the end of the story, however. New interest groups may form to support the previous law, or a new law altogether.

ACTIVITY 3C

Debate: Unbinding Arbitration

Randall Fris was employed by Exxon Shipping Company as an able-bodied seaman on an oil tanker called the Exxon Long Beach. Fris worked under a union agreement that required arbitration of employment disputes. Exxon had a policy against working under the influence of drugs or alcohol on its tankers, and the agreement with the union provided for the use of a breathalyzer test 'for cause' with a Blood Alcohol Content (BAC) of .04 or above considered intoxicated for purposes of working on an Exxon tanker. The agreement stated that the penalty for such intoxication "… may result in discharge from the vessel and subject the employee to further discipline up to and including termination." Around midnight one night, Fris reported for duty on the tanker appearing to several officers to be intoxicated. A breathalyzer was administered and resulting in a BAC of .15. The next day, Exxon Shipping discharged Fris, and the union filed a grievance. The grievance was submitted to a panel of arbitrators and after a hearing, the panel found that Fris should be reinstated to his position, stating that the policy did not require dismissal, and considering the totality of the circumstances, including the length of employment and Fris' good record, termination was not the appropriate remedy.

Question: As a rule, arbitration is mandatory and binding and cannot be appealed. What does this mean for a case like the Exxon Shipping case?

Question: Would you be in favor of a law that prevented arbitrations from being binding in certain situation? What situations?

Question: Should Exxon Shipping be able to appeal this decision even though the arbitration clause in the union agreement is for binding arbitration?

Debate the Case: Find and review a source of information on the benefits and drawbacks of binding arbitration. If arbitration was non-binding would this change the utility of this type of alternative dispute resolution? Would arbitration still be a valuable alternative to litigation?

End of Chapter Exercises

1. What are the benefits of negotiation as a dispute-resolution method? What are the drawbacks?

2. How can parties that have unequal bargaining power negotiate meaningfully, without one party taking advantage of the other? Have you ever negotiated with someone who had more bargaining power than you? What were your strategies during the negotiation? Did you obtain your goal by the conclusion of the negotiation?
3. Identify a situation in which you would choose mediation as your preferred method of dispute resolution. Why is mediation the best method in this situation? What are the potential benefits and drawbacks of mediation in this situation?
4. Should mediators be required to be licensed, like attorneys or physicians, before practicing? Why or why not?
5. Bank of America announced that it would no longer require mandatory arbitration in disputes arising between it and consumer credit card account holders. Review the story here: http://www.reuters.com/article/idUSTRE57D03E20090814. What are the benefits and drawbacks to Bank of America's credit card account customers with respect to this change?
6. In what contexts have you entered into an arbitration agreement (e.g., home purchase, credit card agreement, cell phone agreement)? Write a short essay discussing the implications of entering into that agreement.
7. Locate two "ethics hotline" programs from an online search. Compare these programs. What are the benefits and drawbacks to each?

REFERENCES

9 U.S.C. §1 et seq.

Circuit City Stores, Inc., v. Adams, 532 U.S. 105 (2001).

Citizens Bank v. Alafabco, Inc., 539 U.S. 52 (2003).

Exxon Shipping Co. v. Exxon Seamen's Union, 11 F.3d 1189 (3d Cir. 1993)

Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

Jones v. Halliburton Co., 583 F.3d 228 (5th Cir. 2009).

Juan A. Lozano, "Woman Awarded $3M in Assault Claim against KBR," *AP News*, November 19, 2009

Lozano v. AT & T Wireless, 504 F.3d 718 (9th Cir. 2007).

Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 Fla. St. U.L. Rev. 99 (2006).

New Jersey Court Rule 4:21A

ORS 36.405.

Roger Fisher, William Ury, and Bruce Patton, *Getting to Yes* (New York: Penguin Books, 1991), 100.

Southland Corp. v. Keating, 465 U.S. 1 (1984).

Uniform Arbitration Act, RCW 7.04.

Washington State Court Rules of Procedure, Superior Court Mandatory Arbitration Rules 7.3.

CHAPTER 4 - INTRODUCTION TO TORT LAW

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the purpose of tort law.
2. Identify the three classifications of torts.
3. Discuss various types of intentional torts.
4. Explain negligence and defenses to claims of negligence.
5. Describe strict liability torts and the reasons for them in the U.S. legal system.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=45#h5p-11

In civil litigation, contract and tort claims are by far the most numerous. The law attempts to adjust for **harms** done by awarding **damages** to a successful plaintiff who demonstrates that the defendant was the cause of the plaintiff's losses. This Chapter will explore the law of torts. Torts can be **intentional torts**, **negligent torts**, or **strict liability torts**. Employers must be aware that in many circumstances, the actions of their employees may create **liability** in tort. This Chapter explains the different kinds of torts, as well as available defenses to tort claims.

4.1 PURPOSE OF TORT LAWS

The term tort is the French equivalent of the English word wrong. The word tort is derived from the Latin word *tortum*, which means twisted or crooked or wrong. Long ago, tort was a word used in everyday speech; today it is left to the legal system. A judge will instruct a jury that a tort is usually defined as a wrong for which the law will provide a remedy, most often in the form of monetary **damages**. The law does not remedy all "wrongs." Hurting someone's feelings may be more devastating than saying something untrue about him behind his back; yet the law will not provide a remedy for saying something cruel to someone directly, while it may provide a remedy for "defaming" someone, orally or in writing, to others.

Although the word is no longer in general use, tort suits are the stuff of everyday headlines. More

and more people injured by exposure to a variety of risks now seek redress (some sort of remedy through the courts). Headlines boast of multimillion-dollar jury awards against doctors who bungled operations, against newspapers that libeled subjects of stories, and against oil companies that devastate entire ecosystems. All are examples of tort suits.

The law of torts developed almost entirely in the common-law courts; that is, statutes passed by legislatures were not the source of law that plaintiffs usually relied on. Usually, plaintiffs would rely on the common law (judicial decisions). Through thousands of cases, the courts have fashioned a series of rules that govern the tortious conduct of individuals. Tort law holds individuals legally accountable for the consequences of their actions and those who suffer losses at the hands of others can be compensated.

Many acts (like murder) are both criminal and tortious. But torts and crimes are different. A crime is an act against the people as a whole. Society punishes the murderer; it does not usually compensate the family of the victim. Tort law, on the other hand, views the death as a private wrong for which damages are owed from the **tortfeasor**. In a civil case, the tort victim or his family, not the state, brings the action. The judgment against a defendant in a civil tort suit is usually expressed in monetary terms, not in terms of prison times or fines, and is the legal system's way of trying to make up for the victim's loss.

4.2 TYPES OF TORTS

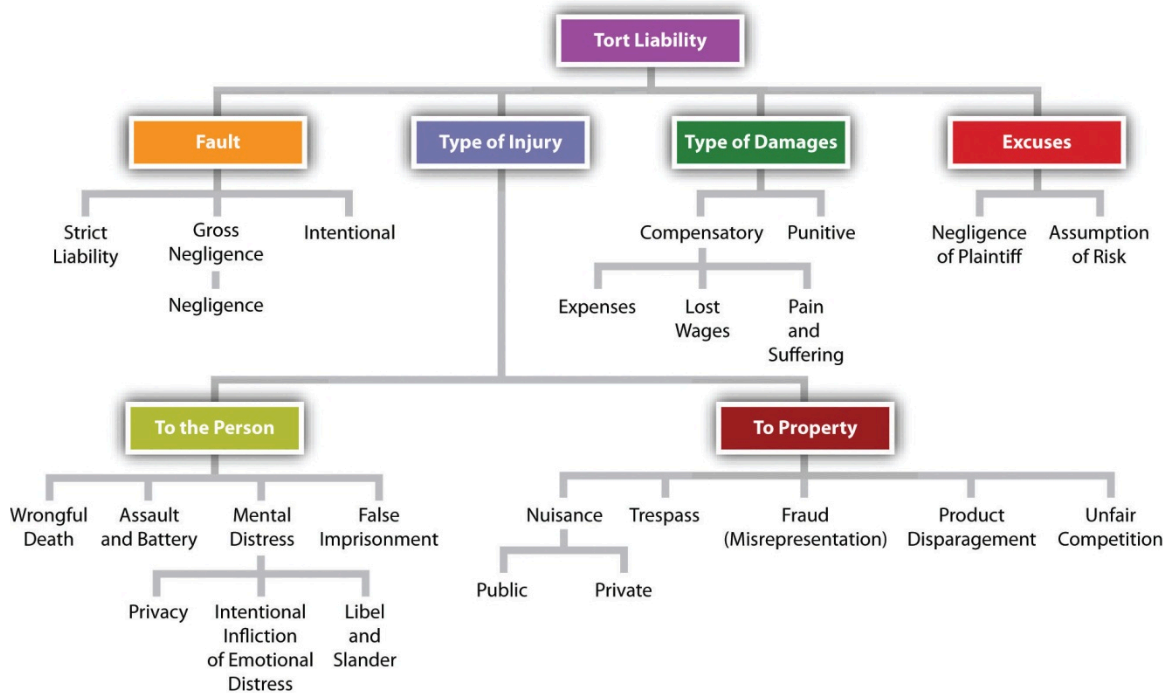
There are three kinds of torts: **intentional torts**, **negligent torts**, and **strict liability torts**. Intentional torts arise from intentional acts, whereas unintentional torts often result from carelessness. Both intentional torts and negligent torts imply some **fault** on the part of the defendant. In strict liability torts, by contrast, there may be no fault at all, but tort law will sometimes require a defendant to make up for the victim's losses even where the defendant was not careless and did not intend to do **harm**.

DIMENSIONS OF TORT LIABILITY

There is a clear moral basis for recovery through the legal system where the defendant has been careless (negligent) or has intentionally caused **harm**. Using the concepts that we are free and autonomous beings with basic rights, we can see that when others interfere with either our freedom or our autonomy, we will usually react negatively. As the old saying goes, "Your right to swing your arm ends at the tip of my nose." The law takes this even one step further: under **intentional tort** law, if you frighten someone by swinging your arms toward the tip of her nose, you may have committed the tort of **assault**, even if there is no actual touching (**battery**).

Under a capitalistic market system, rational economic rules also call for no negative externalities. That is, actions of individuals, either alone or in concert with others, should not negatively impact third parties. The law will try to compensate third parties who are harmed by your actions, even though it knows that a money judgment cannot actually mend a badly injured victim.

Figure 4.1 Dimensions of Tort Liability



Fault

Tort principles can be viewed along different dimensions. One is the **fault** dimension which requires a wrongful act by a defendant for the plaintiff to recover damages. The intent behind that act, however, need not be a specific intent. In other words, an innocent or relatively innocent action may still provide the basis for **liability**. Nevertheless, tort law—except for **strict liability**—relies on standards of fault, or blameworthiness.

The most obvious standard is willful conduct. If the defendant intentionally injures another, there is little argument about fault and tort liability. Thus, all crimes resulting in injury to a person or property (murder, **assault**, arson, etc.) are also torts, and the plaintiff may bring a civil lawsuit to recover **damages** for injuries to his person, family, or property.

Most tort suits do not rely on *intentional* fault. Most tort suits arise from **negligent** conduct that in the circumstances is careless or poses unreasonable risks of causing damage. Most automobile accident and medical malpractice suits are examples of negligence suits.

The fault dimension is a continuum. At one end of the continuum is the deliberate desire to do injury. The middle ground is occupied by careless conduct or negligence, and then at the other end of the continuum – no fault – is conduct that most would consider entirely blameless. In other words, the defendant may have observed all possible precautions and yet still be held liable. This is called strict liability. Here are examples illustrating the three different types of torts discussed in this section.

Sandy is at a shooting range practicing her marksmanship. Sandy gets into an argument with James. While yelling at James, Sandy points the gun toward him, and the gun discharges unexpectedly and a bullet strikes and injures James.

Sandy is at a shooting range practicing her marksmanship and showing James how to use her gun.

James has not handled a gun before, and Sandy gives James the gun without making sure that the gun isn't loaded with live bullets. It turns out the gun is loaded, it discharges unexpectedly and a bullet strikes and injures James.

Sandy is at a shooting range practicing her marksmanship. The gun she uses is made by a manufacturer with a reputation for producing high-quality firearms. However, due to an unforeseen manufacturing defect in one batch of guns, a small number of them occasionally discharge unexpectedly. Sandy has unknowingly purchased one of those guns. Sandy is using reasonable safety precautions while using the gun, but without any warning the gun discharges unexpectedly injuring James.

Nature of Injury

Tort liability varies by the type of injury caused. The most obvious type of injury is physical harm to the person **(assault**, **battery**, **infliction of emotional distress**, negligent exposure to toxic pollutants, wrongful death). Mental suffering can be redressed if it is a result of physical injury (e.g., shock and depression following an automobile accident). A few states now permit recovery for mental distress without a physical injury (a mother's shock at seeing her son injured by a car while both were crossing the street). Other protected interests include a person's reputation (injured by defamatory statements or writings), a person's privacy (injured by those who divulge secrets of his personal life), and a person's economic interests (misrepresentation to secure an economic advantage, certain forms of unfair competition).

Other torts don't result in harm to a person, but instead result in harm to their property (**trespass**, **nuisance**, **interference with contract**).

Damages

Since the purpose of tort law is to compensate the victim for **harm** actually done, **damages** are usually measured by the extent of the injury. Expressed in money terms, these include replacement of property destroyed, compensation for lost wages, reimbursement for medical expenses, and dollars that are supposed to approximate the pain that is suffered. Damages for these injuries are called compensatory damages.

In certain instances, the courts will permit an award of **punitive damages**. As the word *punitive* implies, the purpose is to punish the defendant's actions. Because a punitive award (sometimes called **exemplary damages**) is at odds with the general purpose of tort law, it is allowable only in aggravated situations. The law in most states permits recovery of punitive damages only when the defendant has deliberately committed a wrong with malicious intent or has otherwise done something outrageous.

Punitive damages are rarely allowed in negligence cases for that reason. But if someone sets out intentionally and maliciously to hurt another person, punitive damages may well be appropriate. Punitive damages are intended not only to punish the wrongdoer, by exacting an additional and sometimes heavy payment (the exact amount is left to the discretion of jury and judge), but also to deter others from similar conduct. The punitive damage award has been subject to heavy criticism in recent years in cases in which it has been awarded against manufacturers. One fear is that huge

damage awards on behalf of a multitude of victims could swiftly bankrupt the defendant. Unlike compensatory damages, punitive damages are taxable.

Excuses

The law does not condemn every act that ultimately results in injury. Excuses are recognized under certain circumstances when the defendant's actions, although they might have caused **harm**, are considered justified or excusable due to specific reasons.

One common rule of exculpation is **assumption of risk**. A baseball fan who sits along the third base line close to the infield assumes the risk that a line drive foul ball may fly toward him and strike him. He will not be permitted to complain in court that the batter should have been more careful or that management should have either warned him or put up a protective barrier.

Another excuse is negligence of the plaintiff. If two drivers are careless and hit each other on the highway, some states will refuse to permit either to recover from the other. Still another excuse is consent: two boxers in the ring consent to being struck with fists (but not to being bitten on the ear).

4.3 INTENTIONAL TORTS

Keeping these dimensions of torts in mind, let's turn to a discussion of intentional torts. There are several intentional torts, and some common ones are illustrated in this section.

ASSAULT AND BATTERY

One of the most obvious intentional torts is **assault** and **battery** as tort law seeks to restrain individuals from using physical force on others. **Assault** is (1) the threat of immediate **harm** or offense of contact or (2) any act that would arouse reasonable apprehension of imminent harm. **Battery** is unauthorized and harmful or offensive physical contact with another person that causes injury. At common law, these were two separate torts. Some states now merge these torts and treat them together as a single tort.

Often an assault results in battery, but not always. Consider these three examples:

Alex is walking down the street when they suddenly become angry with Taylor. Alex clenches their fist and shouts at Taylor, "I'm going to punch you!" This is an assault as this could create a reasonable apprehension in Taylor's mind that imminent harmful physical contact is about to occur.

Alex is walking down the street when they suddenly become angry with Taylor. Alex runs up to Taylor from behind and punches Taylor in the back. This is a battery. This physical contact is an intentional act which (without consent or justification) caused **harm**.

Alex is walking down the street when they suddenly become angry with Taylor. Alex clenches their fist and shouts at Taylor, "I'm going to punch you!" Alex runs up and punches Taylor. Both assault and battery are present in this situation. The initial threat created the apprehension of imminent harm, and their subsequent physical act of the punch fulfilled that threat.

Transferred intent allows for the intent behind an action to be transferred from the intended victim

to the actual victim. For example, If Alex becomes angry at Taylor and runs up to Taylor intending to land a punch, but Alex mistakenly punches Hermione, this is still an intentional tort. The intent to touch in an offensive way (battery) would transfer from Alex to Hermione, thus Hermione could sue Alex for battery for any damages she had suffered.

FALSE IMPRISONMENT

The tort of **false imprisonment** originally implied a locking up, as in a prison, but today it can occur if a person is restrained in a room or a car or even if his or her movements are restricted while walking down the street. People have a right to be free to go as they please, and anyone who, without cause, deprives another of that personal freedom has committed a tort. The intent requirement in the context of false imprisonment refers to the defendant's state of mind when engaging in the actions that led to the confinement. Specifically, the plaintiff needs to show that the defendant intended to confine or restrain them against their will. However, it's important to understand that the intent requirement does not necessarily mean that the defendant must have intended to cause **harm** to the plaintiff or to commit false imprisonment. The key aspect is the defendant's intent to confine the plaintiff, and the loss of liberty to the Plaintiff is enough to show harm.

Damages are allowed for time lost, discomfort and resulting ill health, mental suffering, humiliation, and loss of reputation or business.

CASE 4.1

Lester v. Albers Super Markets, Inc., 94 Ohio App. 313, 114 N.E.2d 529 (Ohio 1952)

Facts: The plaintiff, carrying a bag of rolls purchased at another store, entered the defendant's grocery store to buy some canned fruit. Seeing her bus outside, she stepped out of line and put the can on the counter. The store manager intercepted her and repeatedly demanded that she submit the bag to be searched. Finally, she acquiesced; he looked inside and said she could go. She testified that several people witnessed the scene, which lasted about fifteen minutes, and that she was humiliated. The jury awarded her $800. She also testified that no one laid a hand on her or made a move to restrain her from leaving by any one of numerous exits.

* * *

MATTHEWS, JUDGE.

As we view the record, it raises the fundamental question of what is imprisonment. Before any need for a determination of illegality arises there must be proof of imprisonment. In 35 Corpus Juris Secundum (C.J.S.), False Imprisonment, § II, pages 512–13, it is said: "Submission to the mere verbal direction of another, unaccompanied by force or by threats of any character, cannot constitute a false imprisonment, and there is no false imprisonment where an employer interviewing an employee declines to terminate the interview if no force or threat of force is used and false imprisonment may not be predicated on a person's unfounded belief that he was restrained."

Many cases are cited in support of the text.

* * *

In *Fenn v. Kroger Grocery & Baking Co.*, Mo. Sup., 209 S.W. 885, 887, the court said:

A case was not made out for false arrest. The plaintiff said she was intercepted as she started to leave the store; that Mr. Krause stood where she could not pass him in going out. She does not say that he made any attempt to intercept her. She says he escorted her back to the desk, that he asked her to let him see the change.

…She does not say that she went unwillingly…Evidence is wholly lacking to show that she was detained by force or threats. It was probably a disagreeable experience, a humiliating one to her, but she came out victorious and was allowed to go when she desired with the assurance of Mr. Krause that it was all right. The demurrer to the evidence on both counts was properly sustained.

The result of the cases is epitomized in 22 Am.Jur. 368, as follows:

A customer or patron who apparently has not paid for what he has received may be detained for a reasonable time to investigate the circumstances, but upon payment of the demand, he has the unqualified right to leave the premises without restraint, so far as the proprietor is concerned, and it is false imprisonment for a private individual to detain one for an unreasonable time, or under unreasonable circumstances, for the purpose of investigating a dispute over the payment of a bill alleged to be owed by the person detained for cash services.

* * *

For these reasons, the judgment is reversed and final judgment entered for the defendant-appellant.

Case questions

1. The court begins by saying what false imprisonment is not. What is the legal definition of false imprisonment?
2. What kinds of detention are permissible for a store to use in accosting those that may have been shoplifting?
3. Jody broke up with Jeremy and refused to talk to him. Jeremy saw Jody get into her car near the business school and parked right behind her so she could not move. He then stood next to the driver's window for fifteen minutes, begging Jody to talk to him. She kept saying, "No, let me leave!" Has Jeremy committed the tort of false imprisonment?

INTENTIONAL INFLICTION OF EMOTIONAL DISTRESS

The tort of **intentional infliction of emotional distress (IIED)** is a legal claim that allows individuals to seek compensation for severe emotional distress or mental anguish caused by the intentional and outrageous conduct of another party. Like other intentional torts, the defendant's actions must be

intentional. The conduct of the defendant must involve extreme and outrageous behavior that goes beyond the bounds of decency. The plaintiff must suffer severe emotional distress as a result of the defendant's actions. Proving an IIED claims can be challenging as the threshold for establishing extreme and outrageous conduct is a high one. Examples of conduct that might lead to a successful IIED claim include intentional acts such as deliberate humiliation, intentional infliction of fear, or intentional spreading of false and harmful rumors. Many states require that this distress must result in physical symptoms such as nausea, headaches, ulcers, or, as in the case of the pregnant wife, a miscarriage. Other states have not required physical symptoms, finding that shame, embarrassment, fear, and anger constitute severe mental distress.

In an early California case, bill collectors came to the debtor's home repeatedly and threatened the debtor's pregnant wife. Among other things, they claimed that the wife would have to deliver her child in prison. The wife miscarried and had emotional and physical complications. The court found that the behavior of the collection company's two agents was sufficiently outrageous to prove the tort of intentional infliction of emotional distress

TRESPASS AND NUISANCE

Trespass is intentionally going on land that belongs to someone else or putting something on someone else's property and refusing to remove it. This part of tort law shows how strongly the law values the rights of property owners. The right to enjoy your property without interference from others is also found in common law of **nuisance**. To illustrate the difference between trespass and nuisance, consider this scenario. Roberto owns a piece of land, and Ysabel, without Roberto's permission, regularly enters his property to access a shortcut to a nearby park. In this scenario, Ysabel's repeated unauthorized entry onto Roberto's property constitutes a trespass. Trespass occurs when someone intentionally enters another person's property without permission. Even if Ysabel is just using the shortcut and doesn't cause any damage, the act of entering the property without authorization constitutes a trespass. Over time, Ysabel's continuous use of the shortcut and the resulting annoyance and inconvenience to Roberto and his neighbors can be considered a nuisance. Nuisance involves the unreasonable interference with another person's use and enjoyment of their property. Trespass focuses on the physical presence on the property without permission, while nuisance focuses on the unreasonable interference with the enjoyment of the property.

There are limits to property owners' rights, however. In the case of *Katko v. Briney*, a property owner set up a spring gun in an abandoned farmhouse on his property. The gun was rigged in such a way that if an intruder entered the farmhouse unlawfully, the gun would discharge and potentially cause **harm**. When an intruder entered the farmhouse, it triggered the spring gun to discharge, severely injuring him. He sued the property owner claiming that the use of the spring gun constituted an unreasonable use of force. The Court found that the use of a spring gun in a potentially lethal way was unreasonable as an intruder to an abandoned house posed no threat to human life.

The rigging of a spring gun is an intentional act, but in the case of negligence on the part of the landowner, states have differing rules about trespass and negligence. In some states, a trespasser is only protected against the gross negligence of the landowner. In other states, trespassers may be owed the **duty of due care** on the part of the landowner. For example, consider if a very small child wanders off his own property and falls into a gravel pit on a nearby property; if the pit should (in the exercise

of due care) have been filled in or some barrier erected around it, then there was negligence. But if the state law holds that the duty to trespassers is only to avoid gross negligence, the child's family would lose, unless the state law makes an exception for very young trespassers. In general, guests, licensees, and invitees are owed a duty of due care; a trespasser may not be owed such a duty, but states have different rules on this.

INTENTIONAL INTERFERENCE WITH CONTRACTUAL RELATIONS

The tort of **intentional interference with contractual relations** involves a situation where a third party intentionally takes actions to disrupt or interfere with an existing contractual relationship between two parties, causing **harm** to one of the parties involved. This tort can generally be established by proving four elements:

- There was a contract between the plaintiff and a third party.
- The defendant knew of the contract.
- The defendant improperly induced the third party to **breach** the contract or made performance of the contract impossible.
- There was injury to the plaintiff.

In a famous case of interference with contract relations, Texaco was sued by Pennzoil for interfering with an agreement that Pennzoil had with Getty Oil. After complicated negotiations between Pennzoil and Getty, a takeover share price was struck, a memorandum of understanding was signed, and a press release announced an agreement in principle between Pennzoil and Getty. Texaco's lawyers, however, believed that Getty Oil was "still in play," and before the lawyers for Pennzoil and Getty could complete the paperwork for their agreement, Texaco announced it was offering Getty shareholders an additional $12.50 per share over what Pennzoil had offered.

Texaco later increased its offer to $228 per share, and the Getty board of directors soon began dealing with Texaco instead of Pennzoil. Pennzoil decided to sue in Texas state court for tortious interference with a contract. After a long trial, the jury returned an enormous verdict against Texaco: $7.53 billion in actual damages and $3 billion in punitive damages. The verdict was so large that it would have bankrupted Texaco. After appeals were filed, Texaco agreed to pay $3 billion to Pennzoil to dismiss its claim of tortious interference with a contract.

ACTIVITY 4A

Case Debate:

Should punitive damages be available in intentional interference with contractual relations cases?

A breach of contract occurs when one party to a contract fails to fulfill its obligations as outlined in a valid and enforceable contract. As you will learn later in the course, punitive damages are generally not available

in contract lawsuits. Yet, as noted in the Texaco case above, punitive damages, and a lot of them, were awarded in the tort case centered on interference with a contract.

Question: What makes a breach of contract case different than an intentional interference with contract case?

Question: In what way is a breach of contract case similar to a case that is centered on intentional interference with contract?

Case Debate: Look up a credible internet resource discussing punitive damages in tort actions. Should an interference with contract case be eligible for punitive damages against a third-party tortfeasor, when the party that actually decided to breach the contract would only be liable for compensatory damages?

MISUSE OF THE LEGAL SYSTEM

Malicious prosecution, **abuse of process**, and **wrongful use of civil proceedings** are all torts that involve misuse or abuse of the legal system. Here's a brief explanation of each:

Malicious Prosecution

Malicious prosecution is a tort causing someone to be prosecuted for a criminal act, knowing that there was no probable cause to believe that the plaintiff committed the crime. To be clear, the Plaintiff in the tort case would have been the Defendant accused of, but did not commit, a criminal act. Key to this tort is there must be a lack of reasonable grounds to initiate a criminal legal action, and malice in so initiating that action. The criminal proceeding must terminate in the plaintiff's favor in order for his suit to be sustained. As with all torts, there must be a legal injury.

Wrongful Use of Civil Proceedings

Wrongful use of civil proceedings is similar to malicious prosecution but applies to civil cases. It involves the initiation of a civil lawsuit without proper grounds or with an improper motive, resulting in **harm** to the defendant. Civil litigation is usually costly and burdensome, and one who forces another to defend himself against baseless accusations should not be permitted to saddle the one he sues with the costs of defense. Like malicious prosecution, this tort provides a remedy for those who have been wrongfully sued in civil court. However, because, as a matter of public policy, litigation is favored as the means by which legal rights can be vindicated—indeed, the Supreme Court has even ruled that individuals have a constitutional right to litigate—the plaintiff must meet a heavy burden in proving his case.

Abuse of Process

Abuse of process is another legal tort related to the misuse of legal proceedings. It involves using a legal process itself to achieve some ulterior motive, such as intimidation or gaining an unfair advantage. In malicious prosecution and in wrongful use of civil proceedings, someone falsely accuses another person and starts a lawsuit without any real reason. In abuse of process differs because it focuses more narrowly on a legal process. So, there could be a real case for the Courts, but a litigant might be using a legal procedure within that case in a tricky or unfair way.

ACTIVITY 4B

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=45#h5p-24

DEFAMATION

Defamation involves making a false statement that causes injury to a person's good name or reputation. The Restatement (Second) of Torts defines a defamatory communication as one that "so tends to harm the reputation of another as to lower him in the estimation of the community or to deter third persons from associating or dealing with him."

In general, if the **harm** is done through the spoken word—one person to another, by telephone, by radio, or on television—it is called **slander**. If the defamatory statement is published in written form, it is called **libel**.

A statement is not defamatory unless it is false. Truth is an absolute defense to a charge of libel or slander. Moreover, the statement must be "published"—that is, communicated to a third person. You cannot be **libeled** by one who sends you a letter full of false accusations and scurrilous statements about you unless a third person opens it first (your roommate, perhaps). Any living person is capable of being defamed, but the dead are not. Corporations, partnerships, and other forms of associations can also be defamed if the statements tend to injure their ability to do business or to garner contributions.

The statement must have reference to a particular person, but he or she need not be identified by name. A statement that "the company president is a crook" is defamatory, as is a statement that "the major network weathermen are imposters." The company president and the network weathermen could show that the words were aimed at them. But statements about large groups will not support an action for defamation (e.g., "all doctors are butchers" is not defamatory of any particular doctor). Publishing false information about another business's product constitutes the tort of slander of quality, or trade libel. In some states, this is known as the tort of product disparagement. It may be difficult to establish **damages**, however. A plaintiff must prove that actual damages proximately resulted from the slander of quality and must also show the extent of the economic harm.

That a person did not intend to defame is not an excuse; a typographical error that converts a true statement into a false one in a newspaper, magazine, or corporate brochure can be sufficient to

make a case of libel. Even the exercise of due care is usually no excuse if the statement is in fact communicated. Repeating a libel is itself a libel; a libel cannot be justified by showing that you were quoting someone else.

On the other hand, even if a plaintiff is able to prove that a defamatory statement was made, and a harm to reputation resulted, he is not necessarily entitled to an award of damages. That is because the law contains a number of privileges that excuse the defamation.

Absolute Privilege

Statements made during the course of judicial proceedings are **absolutely privileged**, meaning that they cannot serve as the basis for a **defamation** suit. Accurate accounts of judicial or other proceedings are absolutely privileged; a newspaper, for example, may pass on the slanderous comments of a judge in court. "Judicial" is broadly construed to include most proceedings of administrative bodies of the government. The Constitution exempts members of Congress from suits for **libel** or slander for any statements made in connection with legislative business. The courts have constructed a similar privilege for many executive branch officials.

Qualified Privilege

Absolute privileges pertain to those in the public sector. A narrower privilege exists for private citizens. In general, a statement that would otherwise be actionable is held to be justified if made in a reasonable manner and for a reasonable purpose. Thus, you may warn a friend to beware of dealing with a third person, and if you had reason to believe that what you said was true, you are privileged to issue the warning, even though false. Likewise, an employee may warn an employer about the conduct or character of a fellow or prospective employee, and a parent may complain to a school board about the competence or conduct of a child's teacher. There is a line to be drawn, however, and a defendant with nothing but an idle interest in the matter (an "officious intermeddler") must take the risk that his information is wrong.

In 1964, the Supreme Court handed down its historic decision in *New York Times v. Sullivan*, holding that under the First Amendment a libel judgment brought by a public official against a newspaper cannot stand unless the plaintiff has shown "actual malice," which in turn was defined as "knowledge that [the statement] was false or with a reckless disregard of whether it was false or not." In subsequent cases, the court extended the constitutional doctrine further, applying it not merely to government officials but to public figures, people who voluntarily place themselves in the public eye or who involuntarily find themselves the objects of public scrutiny. Whether a private person is or is not a public figure is a difficult question that has so far eluded rigorous definition and has been answered only from case to case. A CEO of a private corporation ordinarily would be considered a private figure unless he puts himself in the public eye—for example, by starring in the company's television commercials.

INVASION OF PRIVACY

Invasion of privacy involves violating an individual's right to keep certain aspects of their personal life private – it is a right "to be let alone." This tort encompasses a range of situations where someone's privacy is intruded upon without their consent, leading to emotional distress, embarrassment, or

other negative consequences. Courts and commentators have discerned at least four different types of interests: (1) the right to control the appropriation of your name and picture for commercial purposes, (2) the right to be free of intrusion on your "personal space" or seclusion, (3) freedom from public disclosure of embarrassing and intimate facts of your personal life, and (4) the right not to be presented in a "false light."

Appropriation of Name or Likeness

This happens when someone uses an individual's name, likeness, or identity for commercial purposes without their permission, such as using someone's photo in an advertisement without their consent. This is the earliest privacy interest recognized by the courts. The aggrieved person can sue and recover **damages** for use of their likeness including unauthorized profits and also to have the court enjoin (judicially block) any further unauthorized use of the plaintiff's name, likeness, or image.

Personal Space

This occurs when someone intentionally intrudes upon an individual's private space or personal affairs without a legitimate reason. Developed and extended over time, today, for example, taking photos of someone else with your cell phone in a locker room could constitute invasion of the right to privacy. Reading someone else's mail or e-mail could also constitute an invasion of the right to privacy. Photographing someone on a city street is not tortious, but subsequent use of the photograph could be. Whether the invasion is in a public or private space, the amount of **damages** will depend on how the image or information is disclosed to others.

Public Disclosure of Embarrassing Facts

This involves revealing private and sensitive information about an individual to the public without their consent, causing **harm** or embarrassment. While circulation of false statements that do injury to a person are actionable under the laws of **defamation**, public disclosure protects the **invasion of privacy** into true statements when they are private and of no legitimate concern to the public. This might include publishing personal medical records, private conversations, or other intimate information, but may not extend as broadly to those that live life in the public eye.

False Light

False light occurs when false information is presented about an individual that portrays them inaccurately and in a false light, leading to **harm** or emotional distress. Though false, this might not be the same as **defamation** as the information presented may not be libelous or harm an individual's reputation. Indeed, the publication might even glorify the plaintiff, making them seem more heroic than they actually are. Subject to the First Amendment requirement that the plaintiff must show intent or extreme recklessness, statements that put a person in a false light, like a fictionalized biography, are actionable.

ACTIVITY 4C

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=45#h5p-25

4.4 NEGLIGENCE

ELEMENTS OF NEGLIGENCE

Negligence occurs when someone doesn't take the proper level of care that a reasonably prudent person would in a similar situation, and this failure leads to **harm**. In layman's terms, this describes an accident. The law imposes a **duty of care** on all of us in our everyday lives and accidents caused by negligence are actionable. Negligence is not an intentional tort because in negligence there is no intent to harm another person or thing, but the resulting harm occurs because of a lack of reasonable care. The tort of negligence has four elements: (1) a duty of due care that the defendant had, (2) the breach of the duty of due care, (3) connection between cause and injury, and (4) actual damage or loss. Even if a plaintiff can prove each of these aspects, the defendant may be able to show that the law excuses the conduct that is the basis for the tort claim. We examine each of these factors below.

Standard of Care

Not every unintentional act that causes injury is negligent. If you brake to a stop when you see a child dart out in front of your car, and if the noise from your tires gives someone in a nearby house a heart attack, you have not acted negligently toward the person in the house. The purpose of the negligence standard is to protect others against the risk of injury that foreseeably would ensue from unreasonably dangerous conduct.

The law has tried to encapsulate this idea in the form of the famous standard of "the reasonable person." This fictitious person "of ordinary prudence" is the model that juries are instructed to compare defendants with in assessing whether those defendants have acted negligently. If a defendant has acted "unreasonably under the circumstances" and his conduct posed an unreasonable risk of injury, then he is liable for injury caused by his conduct. Perhaps in most instances, it is not difficult to divine what the reasonable man would do. The reasonable man stops for traffic lights and always drives at reasonable speeds, does not throw baseballs through windows, performs surgical operations according to the average standards of the medical profession, ensures that the floors of his grocery store are kept free of fluids that would cause a patron to slip and fall, takes proper precautions to avoid spillage of oil from his supertanker, and so on. The "reasonable man" standard imposes hindsight on the decisions and actions of people in society; however, the circumstances of life are such that courts may sometimes impose a standard of due care that many people might not find reasonable.

Duty of Care

Duty of care refers to the legal obligation or responsibility that an individual owes to others to act

in a way that does not put them at an unreasonable risk of **harm**. In a negligence claim, the plaintiff must show that the defendant had a duty of care toward them. This means that the defendant should have acted in a way that a reasonably prudent person would have in similar circumstances.

The law does not impose on us a duty to care for every person. In general, the law imposes no obligation to act in a situation to which we are strangers. We may pass by the drowning child without risking a lawsuit. But if we do act, then the law requires us to act carefully. The law of negligence requires us to behave with due regard for the foreseeable consequences of our actions in order to avoid unreasonable risks of injury. Affirmatively determining a duty of care can be difficult. Physicians, for example, are bound by principles of medical ethics to respect the confidences of their patients, which would place a heightened duty of care on them in their medical capacity, but not necessarily as individuals. In some situations, it may be difficult to tell in what capacity a person with medical expertise is acting.

CASE 4.2

Whitlock v. University of Denver, 744 P.2d 54 (Supreme Court of Colorado 1987)

Factual Summary: On June 19, 1978, at approximately 10:00 p.m., plaintiff Oscar Whitlock suffered a paralyzing injury while attempting to complete a one-and-three-quarters front flip on a trampoline. As Whitlock attempted to perform the one-and-three-quarters front flip, he landed on the back of his head, causing his neck to break. The injury rendered him a quadriplegic. The trampoline was owned by the Beta Theta Pi fraternity (the Beta house) and was situated on the front yard of the fraternity premises, located on the University campus. At the time of his injury, Whitlock was twenty years old, attended the University of Denver, and was a member of the Beta house, where he held the office of acting house manager. The property on which the Beta house was located was leased to the local chapter house association of the Beta Theta Pi fraternity by the defendant University of Denver.

Whitlock had extensive experience jumping on trampolines and at trial recounted prior to his accident he had successfully executed the one-and-three-quarters front flip between seventy-five and one hundred times on the Beta house trampoline.

Whitlock brought suit against the manufacturer and seller of the trampoline, the University, the Beta Theta Pi fraternity and its local chapter, reaching settlements with all Defendants except the University.

At trial, the jury returned a verdict in favor of Whitlock, assessing his total damages at $ 7,300,000. The jury attributed twenty-eight percent of causal negligence to the conduct of Whitlock and seventy-two percent of causal negligence to the conduct of the University. The trial court accordingly reduced the amount of the award against the University to $ 5,256,000. On appeal, the court of appeals held that the University owed Whitlock a duty of due care to remove the trampoline from the fraternity premises or to supervise its use. The University then appealed to the state Supreme Court.

JUSTICE LOHR delivered the Opinion of the Court.

II.

A negligence claim must fail if based on circumstances for which the law imposes no duty of care upon the defendant for the benefit of the plaintiff. …

Whether the law should impose a duty requires consideration of many factors including, for example, the risk involved, the foreseeability and likelihood of injury as weighed against the social utility of the actor's conduct, the magnitude of the burden of guarding against injury or harm, and the consequences of placing the burden upon the actor.

…

We believe that the fact that the University is charged with negligent failure to act rather than negligent affirmative action is a critical factor that strongly militates against imposition of a duty on the University under the facts of this case. In determining whether a defendant owes a duty to a particular plaintiff, the law has long recognized a distinction between action and a failure to act. …

The fact that an actor realizes or should realize that action on his part is necessary for another's aid or protection does not of itself impose upon him a duty to take such action.

Imposition of a duty in all such cases would simply not meet the test of fairness under contemporary standards.

…

III.

The present case involves the alleged negligent failure to act, rather than negligent action. The plaintiff does not complain of any affirmative action taken by the University, but asserts instead that the University owed to Whitlock the duty to assure that the fraternity's trampoline was used only under supervised conditions comparable to those in a gymnasium class, or in the alternative to cause the trampoline to be removed from the front lawn of the Beta house.…

A.

The student-university relationship has been scrutinized in several jurisdictions, and it is generally agreed that a university is not an insurer of its students' safety. [Citations]

…By imposing a duty on the University in this case, the University would be encouraged to exercise more control over private student recreational choices, thereby effectively taking away much of the responsibility recently recognized in students for making their own decisions with respect to private entertainment and personal safety. …

…

Aside from advising the Beta house on one occasion to put the trampoline up when not in use, there is no evidence that the University officials attempted to assert control over trampoline use by the fraternity members. We conclude from this record that the University's very limited actions concerning safety of student recreation did not give Whitlock or the other members of campus fraternities or sororities any reason to depend upon the University for evaluation of the safety of trampoline use.…Therefore, we conclude that the student-university relationship is not a special relationship of the type giving rise to a duty of the University to take reasonable measures to protect the members of fraternities and sororities from risks of engaging in extra-curricular trampoline jumping.…

We [also] conclude that the relationship between the University and Whitlock was not one of dependence with respect to the activities at issue here, and provides no basis for the recognition of a duty of the University to take measures for protection of Whitlock against the injury that he suffered.

…

IV.

Considering all of the factors presented, we are persuaded that under the facts of this case the University of Denver had no duty to Whitlock to eliminate the private use of trampolines on its campus or to supervise that use. There exists no special relationship between the parties that justifies placing a duty upon the University to protect Whitlock from the well-known dangers of using a trampoline. Here, a conclusion that a special relationship existed between Whitlock and the University sufficient to warrant the imposition of liability for nonfeasance would directly contravene the competing social policy of fostering an educational environment of student autonomy and independence.

We reverse the judgment of the court of appeals and return this case to that court with directions to remand it to the trial court for dismissal of Whitlock's complaint against the University.

Case questions

1. How are comparative negligence numbers calculated by the trial court? How can the jury say that the University is 72 percent negligent and that Whitlock is 28 percent negligent?
2. Why is this not an assumption of risk case?
3. Is there any evidence that Whitlock was contributorily negligent? If not, why would the court engage in comparative negligence calculations?

Breach of Duty of Care

Breach of **duty** of care occurs when the defendant fails to meet the standard of care that a reasonably prudent person would have exercised in similar circumstances. A plaintiff must demonstrate that the defendant's actions (or inactions) fell below the expected standard of care, indicating negligence. Essentially, the defendant's behavior did not meet the level of care that a reasonable person would have taken.

Establishing a breach of the duty of due care where the defendant has violated a statute or municipal ordinance is eased considerably with the doctrine of **negligence per se**, a doctrine common to all U.S. state courts. If a legislative body sets a minimum standard of care for particular kinds of acts to protect a certain set of people from **harm** and a violation of that standard causes harm to someone in that set, the defendant is negligent per se. For example, If Harvey is driving sixty-five miles per hour in a fifty-five-mile-per-hour zone when he crashes into Haley's car and the police accident report establishes that or he otherwise admits to going ten miles per hour over the speed limit, Haley does not have to prove that Harvey has breached a duty of due care. She will only have to prove that the speeding was

an actual and proximate cause of the collision and will also have to prove the extent of the resulting damages to her.

Causation: Actual Cause and Proximate Cause

Causation involves establishing a direct link between the defendant's **breach** of **duty** and the **harm** suffered by the plaintiff. In tort theory, there are two kinds of causes that a plaintiff must prove: **actual cause** and **proximate cause**.Actual cause (causation in fact) can be found if the connection between the defendant's act and the plaintiff's injuries passes the "but for" test: if an injury would not have occurred "but for" the defendant's conduct, then the defendant is the cause of the injury. Still, this is not enough causation to create **liability**. The injuries to the plaintiff must also be foreseeable, or not "too remote," for the defendant's act to create liability. This is proximate cause: a cause that is not too remote or unforeseeable. For proximate cause, foreseeability is key. The harm suffered by the plaintiff must have been a foreseeable consequence of the defendant's breach of duty.

CASE 4.3

Palsgraf v. Long Island R.R., 248 N.Y. 339,162 N.E. 99 (N.Y. 1928)

CARDOZO, C. J.

Plaintiff was standing on a platform of defendant's railroad after buying a ticket to go to Rockaway Beach. A train stopped at the station, bound for another place. Two men ran forward to catch it. One of the men reached the platform of the car without mishap, though the train was already moving. The other man, carrying a package, jumped aboard the car, but seemed unsteady as if about to fall. A guard on the car, who had held the door open, reached forward to help him in, and another guard on the platform pushed him from behind. In this act, the package was dislodged, and fell upon the rails. It was a package of small size, about fifteen inches long, and was covered by a newspaper. In fact it contained fireworks, but there was nothing in its appearance to give notice of its contents. The fireworks when they fell exploded. The shock of· the explosion threw down some scales at the other end of the platform many feet away. The scales struck the plaintiff, causing injuries for which she sues.

The conduct of the defendant's guard, if a wrong in its relation to the holder of the package, was not a wrong in its relation to the plaintiff, standing far away. Relatively to her it was not negligence at all. Nothing in the situation gave notice that the falling package had in it the potency of peril to persons thus removed. Negligence is not actionable unless it involves the invasion of a legally protected interest, the violation of a right. "Proof of negligence in the air, so to speak, will not do.…If no hazard was apparent to the eye of ordinary vigilance, an act innocent and harmless, at least to outward seeming, with reference to her, did not take to itself the quality of a tort because it happened to be a wrong, though apparently not one involving the risk of bodily insecurity, with reference to someone else.…The plaintiff sues in her own right for a wrong personal to her, and not as the vicarious beneficiary of a breach of duty to another.

A different conclusion will involve us, and swiftly too, in a maze of contradictions. A guard stumbles over a package which has been left upon a platform.

It seems to be a bundle of newspapers. It turns out to be a can of dynamite. To the eye of ordinary vigilance,

the bundle is abandoned waste, which may be kicked or trod on with impunity. Is a passenger at the other end of the platform protected by the law against the unsuspected hazard concealed beneath the waste? If not, is the result to be any different, so far as the distant passenger is concerned, when the guard stumbles over a valise which a truckman or a porter has left upon the walk?…The orbit of the danger as disclosed to the eye of reasonable vigilance would be the orbit of the duty. One who jostles one's neighbor in a crowd does not invade the rights of others standing at the outer fringe when the unintended contact casts a bomb upon the ground. The wrongdoer as to them is the man who carries the bomb, not the one who explodes it without suspicion of the danger. Life will have to be made over, and human nature transformed, before prevision so extravagant can be accepted as the norm of conduct, the customary standard to which behavior must conform.

The argument for the plaintiff is built upon the shifting meanings of such words as "wrong" and "wrongful" and shares their instability. For what the plaintiff must show is a "wrong" to herself; i.e., a violation of her own right, and not merely a "wrong" to someone else, nor conduct "wrongful" because unsocial, but not a "wrong" to anyone. We are told that one who drives at reckless speed through a crowded city street is guilty of a negligent act and therefore of a wrongful one, irrespective of the consequences.

Negligent the act is, and wrongful in the sense that it is unsocial, but wrongful and unsocial in relation to other travelers, only because the eye of vigilance perceives the risk of damage. If the same act were to be committed on a speedway or a race course, it would lose its wrongful quality. The risk reasonably to be perceived defines the duty to be obeyed, and risk imports relation; it is risk to another or to others within the range of apprehension. This does not mean, of course, that one who launches a destructive force is always relieved of liability, if the force, though known to be destructive, pursues an unexpected path.…Some acts, such as shooting are so imminently dangerous to anyone who may come within reach of the missile however unexpectedly, as to impose a duty of prevision not far from that of an insurer. Even today, and much oftener in earlier stages of the law, one acts sometimes at one's peril.…These cases aside, wrong-is defined in terms of the natural or probable, at least when unintentional.…Negligence, like risk, is thus a term of relation.

Negligence in the abstract, apart from things related, is surely not a tort, if indeed it is understandable at all.…One who seeks redress at law does not make out a cause of action by showing without more that there has been damage to his person. If the harm was not willful, he must show that the act as to him had possibilities of danger so many and apparent as to entitle him to be protected against the doing of it though the harm was unintended.

* * *

The judgment of the Appellate Division and that of the Trial Term should be reversed, and the complaint dismissed, with costs in all courts.

Case questions

1. Is there actual cause in this case? How can you tell?
2. Why should Mrs. Palsgraf (or her insurance company) be made to pay for injuries that were

caused by the negligence of the Long Island Rail Road?

3. How is this accident not foreseeable?

Damages

Damages refer to the actual **harm**, injury, or loss suffered by the plaintiff as a result of the defendant's negligent action. To have a valid negligence claim, the plaintiff must show that they suffered some form of harm, whether it's physical injuries, financial losses, emotional distress, or damage to property. Damages are a critical component because without damages, there can be no claim.

The fear that she might be injured in the future is not a sufficient basis for a plaintiff to bring a lawsuit. This rule has proved troublesome in medical malpractice and industrial disease cases. A doctor's negligent act or a company's negligent exposure of a worker to some form of contamination might not become manifest in the body for years. In the meantime, the tort statute of limitations might have run out, barring the victim from suing at all. An increasing number of courts have eased the plaintiff's predicament by ruling that the statute of limitations does not begin to run until the victim discovers that she has been injured or contracted a disease.

The law allows an exception to the general rule that damages must be shown when the plaintiff stands in danger of immediate injury from a **hazardous activity**. If you discover your neighbor experimenting with explosives in his basement, you could bring suit to enjoin him from further experimentation, even though he has not yet blown up his house—and yours.

Problems of Proof

The plaintiff in a tort suit, as in any other, has the burden of proving his allegations.

He must show that the defendant took the actions complained of as negligent, demonstrate the circumstances that make the actions negligent, and prove the occurrence and extent of injury. Factual issues are for the jury to resolve. Since it is frequently difficult to make out the requisite proof, the law allows certain presumptions and rules of evidence that ease the plaintiff's burden, on the ground that without them substantial injustice would be done. One important rule goes by the Latin phrase *res ipsa loquitur*, meaning "the thing speaks for itself." The best evidence is always the most direct evidence: an eyewitness account of the acts in question. But eyewitnesses are often unavailable, and in any event, they frequently cannot testify directly to the reasonableness of someone's conduct, which inevitably can only be inferred from the circumstances.

In many cases, therefore, circumstantial evidence (evidence that is indirect) will be the only evidence

or will constitute the bulk of the evidence. Circumstantial evidence can often be quite telling: though no one saw anyone leave the building, muddy footprints tracing a path along the sidewalk are fairly conclusive. Res ipsa loquitur is a rule of circumstantial evidence that permits the jury to draw an inference of negligence. A common statement of the rule is the following: "There must be reasonable evidence of negligence but where the thing is shown to be under the management of the defendant or his servants, and the accident is such as in the ordinary course of things does not happen if those who have the management use proper care, it affords reasonable evidence, in the absence of explanation by the defendants, that the accident arose from want of care."

If a barrel of flour rolls out of a factory window and hits someone, or a soda bottle explodes, or an airplane crashes, courts in every state permit juries to conclude, in the absence of contrary explanations by the defendants, that there was negligence. The plaintiff is not put to the impossible task of explaining precisely how the accident occurred. A defendant can always offer evidence that he acted reasonably—for example, that the flour barrel was securely fastened and that a bolt of lightning, for which he was not responsible, broke its bands, causing it to roll out of the window. But testimony by the factory employees that they secured the barrel, in the absence of any further explanation, will not usually serve to rebut the inference. That the defendant was negligent does not conclude the inquiry or automatically entitle the plaintiff to a judgment. Tort law provides the defendant with several excuses, some of which are discussed briefly in the next section.

EXCUSES

There are more excuses (defenses) than are listed here, but **contributory negligence** or **comparative negligence**, **assumption of risk**, and act of God are among the principal defenses that will completely or partially excuse the negligence of the defendant.

Contributory and Comparative Negligence

Under an old common-law rule for **contributory negligence**, it was a complete defense to show that the plaintiff in a negligence suit was himself negligent. Even if the plaintiff was only mildly negligent, most of the **fault** being chargeable to the defendant, the court would dismiss the suit if the plaintiff's conduct contributed to his injury. In a few states today, this rule of contributory negligence is still in effect. However, because the result of such a rule is manifestly unjust, this rule has been changed in many states to some version of **comparative negligence**. Under the rule of comparative negligence, **damages** are apportioned according to the degree of culpability of each of the parties involved. For example, if the plaintiff has sustained a $100,000 injury and is 20 percent responsible, the defendant will be liable for $80,000 in damages. In the Whitlock case (Case 4.2) above, at trial, the jury used comparative negligence to apportion responsibility between Plaintiff Whitlock and the University.

Assumption of Risk

Assumption of risk is a legal defense that a defendant can use in a **negligence** lawsuit if it can be shown that the plaintiff voluntarily and knowingly accepted the risks associated with a certain activity or situation, and therefore, the defendant should not be held liable for any resulting injuries or **harm**. In other words, the defendant asserts that the plaintiff cannot recover **damages** because they willingly exposed themselves to the danger and are responsible for their own injuries.

The assumption of risk doctrine arises in a few ways. The plaintiff may have formally agreed with the defendant before entering a risky situation that he will relieve the defendant of **liability** should injury occur. ("You can borrow my car if you agree not to sue me if the brakes fail, because they're worn and I haven't had a chance to replace them.") Or the plaintiff may have entered into a relationship with the defendant knowing that the defendant is not in a position to protect him from known risks (the fan who is hit by a line drive in a ballpark). Or the plaintiff may act in the face of a risky situation known in advance to have been created by the defendant's negligence (failure to leave, while there was an opportunity to do so, such as getting into an automobile when the driver is known to be drunk).

In some cases, the plaintiff might explicitly agree to waive their right to sue for injuries arising from a specific activity in a written waiver or release of liability. In still other situations, the actions of the plaintiff may show that they understand and accept the risk associated with certain activities like skydiving or rock climbing.

Act of God

Technically, the rule that no one is responsible for an "act of God," or *force majeure* as it is sometimes called, is not an excuse but a defense premised on a lack of **causation**. If a force of nature caused the **harm**, then the defendant was not **negligent** in the first place. A marina, obligated to look after boats moored at its dock, is not liable if a sudden and fierce storm against which no precaution was possible destroys someone's vessel. However, if it is foreseeable that harm will result from a negligent condition triggered by a natural event, then there is liability. For example, a work crew failed to remove residue explosive gas from an oil barge. Lightning hit the barge, exploded the gas, and injured several workmen. The plaintiff recovered **damages** against the company because the negligence consisted of the failure to guard against any one of a number of chance occurrences that could ignite the gas.

Vicarious Liability

Liability for **negligent** acts does not always end with the one who was negligent. Under certain circumstances, the liability is imputed to others. For example, an employer is responsible for the negligence of his employees if they were acting in the scope of employment. This rule of **vicarious liability** is often called *respondeat superior*, meaning that the higher authority must respond to claims brought against one of its agents. *Respondeat superior* is not limited to the employment relationship but extends to a number of other agency relationships as well.

Legislatures in many states have enacted laws that make people vicariously liable for acts of certain people with whom they have a relationship, though not necessarily one of agency. It is common, for example, for the owner of an automobile to be liable for the negligence of one to whom the owner lends the car. So-called dram shop statutes place liability on bar and tavern owners and others who serve too much alcohol to one who, in an intoxicated state, later causes injury to others. In these situations, although the injurious act of the drinker stemmed from negligence, the one whom the law holds vicariously liable (the bartender) is not himself necessarily negligent—the law is holding him *strictly liable*, and to this concept we now turn.

4.5 STRICT LIABILITY

Thus far, we have considered principles of **liability** that in some sense depend upon the "**fault**" of the tortfeasor. In intentional torts, the concept of "fault" relates to the deliberate and intentional actions of the defendant that led to **harm** or injury to the plaintiff. The fault in negligence cases can be seen in the defendant's failure to meet a certain standard of care. Strict liability is a legal doctrine that holds a party legally responsible for certain actions or activities, regardless of their fault. In strict liability cases, the focus is not on whether the defendant acted negligently or intentionally, but rather on whether they engaged in a certain activity that caused harm, even if they took precautions to prevent that harm.

Strict liability cases do not require proving the defendant's intent or fault. The focus is on the act itself and its consequences. Strict liability often applies to activities or products that are considered inherently dangerous or pose significant risks to the public. Examples include storing hazardous materials, keeping wild animals, and manufacturing certain products.

HAZARDOUS ACTIVITIES

it has long been held that someone who engages in ultrahazardous (or sometimes, abnormally dangerous) activities is liable for damage that he causes, even though he has taken every possible precaution to avoid **harm** to someone else. Strict liability often applies to ultrahazardous activities, which are inherently dangerous actions that have the potential to cause significant harm or damage. The concept of strict liability in **hazardous activities** means that those who engage in such activities can be held legally responsible for any harm that occurs, regardless of their intent or level of care. Examples of such activities include setting explosives, handling toxic materials, operating heavy machinery, blasting operations, storing and transporting hazardous chemicals, and operating power plants.

ACTIVITY 4D

Debate: Strict Liability

Strict liability, or liability without fault, is often justified as promoting public safety. Does it?

Search the internet for an article that addresses the reasons for holding defendants strictly liable even when there is no fault behind an injury. Does this promote public safety? Would society be better served if negligence were required to hold a defendant liable in the event of an injury?

ANIMALS

Strict liability can apply to cases involving damages caused by animals, particularly those that are considered inherently dangerous or have a propensity for causing **harm**. Animal owners can be held strictly liable for any injuries or damages their animals cause, regardless of whether the owner was negligent or had knowledge of the animal's behavior. This can include wild animals, certain breeds of

dogs with aggressive tendencies, and animals that are commonly used for their strength or guarding abilities. Unlike negligence cases, where the plaintiff needs to prove that the defendant's lack of reasonable care led to the harm, strict liability doesn't require proving negligence. In cases involving dangerous animals, the owner can be held liable for any injuries caused by their animal, even if they took precautions to prevent harm.

CASE 4.4

Klein v. Pyrodyne Corporation, 810 P.2d 917 (Supreme Court of Washington, 1991)

Pyrodyne Corporation (Pyrodyne) is a licensed fireworks display company that contracted to display fireworks at the Western Washington State Fairgrounds in Puyallup, Washington, on July 4, 1987. During the fireworks display, one of the mortar launchers discharged a rocket on a horizontal trajectory parallel to the earth. The rocket exploded near a crowd of onlookers, including Danny Klein. Klein's clothing was set on fire, and he suffered facial burns and serious injury to his eyes. Klein sued Pyrodyne for strict liability to recover for his injuries. Pyrodyne asserted that the Chinese manufacturer of the fireworks was negligent in producing the rocket and therefore Pyrodyne should not be held liable. The trial court applied the doctrine of strict liability and held in favor of Klein. Pyrodyne appealed.

Section 519 of the Restatement (Second) of Torts provides that any party carrying on an "abnormally dangerous activity" is strictly liable for ensuing damages. The public display of fireworks fits this definition. The court stated: "Any time a person ignites rockets with the intention of sending them aloft to explode in the presence of large crowds of people, a high risk of serious personal injury or property damage is created. That risk arises because of the possibility that a rocket will malfunction or be misdirected." Pyrodyne argued that its liability was cut off by the Chinese manufacturer's negligence. The court rejected this argument, stating, "Even if negligence may properly be regarded as an intervening cause, it cannot function to relieve Pyrodyne from strict liability."

The Washington Supreme Court held that the public display of fireworks is an abnormally dangerous activity that warrants the imposition of strict liability.

Affirmed.

Case questions

1. Why would certain activities be deemed ultrahazardous or abnormally dangerous so that strict liability is imposed?
2. If the activities are known to be abnormally dangerous, did Klein assume the risk?
3. Assume that the fireworks were negligently manufactured in China. Should Klein's only remedy be against the Chinese company, as Pyrodyne argues? Why or why not?

STRICT LIABILITY FOR PRODUCTS

Strict liability may also apply as a legal standard for products, even those that are not ultrahazardous. **Strict product liability** was initially was created by a California Supreme Court decision in the 1962 case of *Greenman v. Yuba Power Products, Inc.* In *Greenman*, the plaintiff had used a home power saw and bench, the Shopsmith, designed and manufactured by the defendant. He was experienced in using power tools and was injured while using the approved lathe attachment to the Shopsmith to fashion a wooden chalice. The case was decided on the premise that Greenman had done nothing wrong in using the machine but that the machine had a defect that was "latent" (not easily discoverable by the consumer). Rather than decide the case based on warranties, or by requiring that Greenman prove how the defendant had been negligent, Justice Traynor found for the plaintiff based on the overall social utility of strict liability in cases of defective products. According to his decision, the purpose of such liability is to ensure that the "cost of injuries resulting from defective products is borne by the manufacturers…rather than by the injured persons who are powerless to protect themselves."

Today, the majority of U.S. states recognize strict liability for defective products, although some states limit strict liability actions to damages for personal injuries rather than property damage. Injured plaintiffs have to prove the product caused the **harm** but do not have to prove exactly how the manufacturer was careless. Purchasers of the product, as well as injured guests, bystanders, and others with no direct relationship to the product, may sue for damages caused by the product.

The Restatement specifies six requirements all of which must be met for a plaintiff to recover using strict liability for a product that the plaintiff claims is defective:

- The product must be in a defective condition when the defendant sells it.
- The defendant must normally be engaged in the business of selling or otherwise distributing the product.
- The product must be unreasonably dangerous to the user or consumer because of its defective condition.
- The plaintiff must incur physical harm to self or to property by using or consuming the product.
- The defective condition must be the **proximate cause** of the injury or damage.
- The goods must not have been substantially changed from the time the product was sold to the time the injury was sustained.

For defendants, who can include manufacturers, distributors, processors, assemblers, packagers, bottlers, retailers, and wholesalers, there are a number of defenses that are available, including **assumption of risk**, product misuse and **comparative negligence**, commonly known dangers, and the knowledgeable-user defense. We have already seen assumption of risk and comparative negligence in terms of negligence actions; the application of these is similar in products-liability actions.

Under product misuse, a plaintiff who uses a product in an unexpected and unusual way will not recover for injuries caused by such misuse. For example, suppose that someone uses a rotary lawn

mower to trim a hedge and that after twenty minutes of such use loses control of the mower because of its weight and suffers serious cuts to his abdomen after dropping it. Here, there would be a defense of product misuse, as well as **contributory negligence**. Consider the urban (or Internet) legend of Mervin Gratz, who supposedly put his Winnebago on autopilot to go back and make coffee in the kitchen, then recovered millions after his Winnebago turned over and he suffered serious injuries. There are multiple defenses to this alleged action; these would include the defenses of contributory negligence, comparative negligence, and product misuse. (There was never any such case, and certainly no such recovery; it is not known who started this legend, or why.)

Another defense against strict liability as a cause of action is the knowledgeable-user defense. If the parents of obese teenagers bring a lawsuit against McDonald's, claiming that its fast-food products are defective and that McDonald's should have warned customers of the adverse health effects of eating its products, a defense based on the knowledgeable user is available. In one case, the court found that the high levels of cholesterol, fat, salt, and sugar in McDonald's food is well known to users. The court stated, "If consumers know (or reasonably should know) the potential ill health effects of eating at McDonald's, they cannot blame McDonald's if they, nonetheless, choose to satiate their appetite with a surfeit of supersized McDonald's products."

End of Chapter Exercises

1. A woman fell ill in a store. An employee put the woman in an infirmary but provided no medical care for six hours, and she died. The woman's family sued the store for wrongful death. What arguments could the store make that it was not liable? What arguments could the family make? Which seem the stronger arguments? Why?
2. The signals on a railroad crossing are defective. Although the railroad company was notified of the problem a month earlier, the railroad inspector has failed to come by and repair them. Seeing the all-clear signal, a car drives up and stalls on the tracks as a train rounds the bend. For the past two weeks the car had been stalling, and the driver kept putting off taking the car to the shop for a tune-up. As the train rounds the bend, the engineer is distracted by a conductor and does not see the car until it is too late to stop. Who is negligent? Who must bear the liability for the damage to the car and to the train?
3. Suppose in the *Katko v. Briney* case that instead of setting such a device, the defendants had simply let the floor immediately inside the front door rot until it was so weak that anybody who came in and took two steps straight ahead would fall through the floor and to the cellar. Will the defendant be liable in this case? What if they invited a realtor to appraise the place and did not warn her of the floor? Does it matter whether the injured person is a trespasser or an invitee?
4. Plaintiff's husband died in an accident, leaving her with several children and no money except a valid insurance policy by which she was entitled to $5,000. Insurance Company refused to pay, delaying and refusing payment and meanwhile "inviting" Plaintiff to accept less than $5,000, hinting that it had a defense. Plaintiff was reduced to accepting housing and charity from relatives. She sued the insurance company for bad-faith refusal to settle the claim and for the intentional infliction of emotional distress. The lower court dismissed the case. Should the

court of appeals allow the matter to proceed to trial?

REFERENCES

Johnson v. Kosmos Portland Cement Co., 64 F.2d 193 (6th Cir. 1933).

Katko v. Briney, 183 N.W.2d 657 (Iowa 1971).

New York Times v. Sullivan, 376 U.S. 254 (1964).

Pellman v. McDonald's Corp., 237 F.2d 512 (S.D.N.Y. 2003).

Restatement (Second) of Torts, Section 559 (1965).

Scott v. London & St. Katherine Docks Co., 3 H. & C. 596, 159 Eng.Rep. 665 (Q.B. 1865).

Tarasoff v. Regents of University of California, 551 P.2d 334 (Calif. 1976).

CHAPTER 5 - INTRODUCTION TO CONTRACT LAW

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the sources of contract law.
2. Discuss a basic taxonomy for classifying contracts.
3. Describe the key terms that are used to identify types of contracts.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=51#h5p-12

5.1 GENERAL PERSPECTIVES ON CONTRACTS

INTRODUCTION TO CONTRACT LAW

Contract is probably the most familiar legal concept in our society because it is so central to our political, economic, and social life. So commonplace is the concept of contract—and our freedom to make contracts with each other—that it is difficult to imagine a time when contracts were rare, when people's everyday associations with one another were not freely determined.

HISTORICAL PERSPECTIVE

Yet in historical terms, it was not so long ago that contracts were rare, entered into by very few: that affairs should be ordered based on mutual assent was mostly unknown. In primitive societies and in feudal Europe, relationships among people were largely fixed; traditions spelled out duties that each person owed to family, tribe, or manor. People were born into an ascribed position—a status (not unlike the caste system still existing in India)—and social mobility was limited. Sir Henry Maine, a nineteenth-century British historian, wrote that "the movement of the progressive societies has…been a movement from status to contract." This movement was not accidental—it developed with the emerging industrial order. From the fifteenth to the nineteenth century, England evolved into a booming mercantile economy, with flourishing trade, growing cities, an expanding monetary

system, the commercialization of agriculture, and mushrooming manufacturing. This evolution necessitated the creation of contract law.

Contract law did not develop according to a conscious plan, however, but it was a response to changing conditions. Not until the nineteenth century, in both the United States and England, did a full-fledged judge-made law of contracts arise together with, and help create, modern capitalism. Today, the contract determines the nature of most economic transactions.

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

THE DEFINITION OF CONTRACT

The **Restatement (Second) of Contracts** (Section 1) says, "A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." Similarly, the **Uniform Commercial Code (UCC)** says, "'Contract' means the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law." As operational definitions, these two are circular; in effect, a contract is defined as an agreement that the law will hold the parties to.

Most simply, a contract is a legally enforceable promise between two or more parties. Not every promise or agreement creates a binding contract, so a contract requires more than just an agreement. The law of contracts takes into account the way in which contracts are made, by whom they are made, and for what purposes they are made.

OVERVIEW OF THE STUDY OF CONTRACTS

Although contract law has many nuances, it consists of several principal inquiries, each of which will be taken up in subsequent Chapters.

Did the parties create a valid contract? One party to a contract must make a clear and unequivocal **offer** to the other party which in turn must accept the offer without any conditions or changes. Each party must exchange something of value (**consideration**) with the other party. Both parties must have the legal **capacity** to enter into a contract. And finally, the contract must be for a lawful purpose.

Did the parties intend to enter a valid contract? Both parties must have a genuine intent to create a legally binding agreement. If it turns out that one or both parties did not have the requisite intent, the attempt at contract may not be valid.

Do we know what the contract means and can it be carried out? Many contracts can be oral, but sometimes contracts need to be in writing (or evidenced by some writing), or they can't be enforced. If the terms of a contract are unclear, a court has to interpret the contract, or it can't be enforced.

Do persons other than the contracting parties have rights or duties under the contract? Sometimes third parties may have rights in the contracts of others, and so we must determine if any other parties have rights in the contract that is under review.

How do we know when the contract has come to an end? A contract can be terminated with performance, without performance, and sometimes a contract may be breached. A contract that is not fully performed may have remedies available, and we will study how those remedies will be assigned and calculated.

Together, the answers to the questions outlined above determine the rights and obligations of contracting parties.

5.2 SOURCES OF CONTRACT LAW

The most important sources of contract law are state case law and state statutes (though there are also many federal statutes governing how contracts are made by and with the federal government).

CASE LAW

Law made by judges is called case law. Because contract law was made up in the common-law courtroom by individual judges as they applied rules to resolve disputes before them, it grew over time to formidable proportions. Because of this, much of U.S. contract law is rooted in common law principles. **Common law** is law that has developed over time through judicial decisions in individual contract disputes and claims. Courts in the United States have issued rulings in contract-related cases for centuries, creating a body of precedent that serves as the foundation of contract law. Thus, by the early twentieth century, tens of thousands of contract disputes had been submitted to the courts for resolution, and the published opinions written by judges, if collected in one place, would have filled dozens of bookshelves. Clearly this mass of material was too unwieldy for efficient use. A similar problem also had developed in the other leading branches of the common law.

THE RESTATEMENT (SECOND) OF CONTRACTS

Disturbed by the plethora of cases, the difficulty in finding a specific case, and the resulting uncertainty of the law, a group of prominent American judges, lawyers, and law teachers founded the American Law Institute (ALI) in 1923 to attempt to clarify, simplify, and improve the law. One of the ALI's first projects, and ultimately one of its most successful, was the drafting of the Restatement of the Law of Contracts, completed in 1932. A revision—the Restatement (Second) of Contracts—was undertaken in 1964 and completed in 1979. Hereafter, references to "the Restatement" pertain to the **Restatement (Second) of Contracts**.

The Restatements (they also exist in the other fields of law besides contracts, including torts and property) are detailed analyses of the decided cases in each field. Encompassing a wide range of disciplines, the Restatements summarize the common law principles as they have evolved across the majority of U.S. jurisdictions. In addition to presenting common law doctrines, the Restatements offer commentary, hypothetical scenarios illustrating the application of these principles, and summaries of relevant cases.

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

Today, common law or case law (the terms are mostly synonymous) governs contracts for the sale of real estate and services. "Services" refers to acts or deeds (like plumbing, drafting documents, driving a car) as opposed to the sale of property.

STATUTORY LAW: THE UNIFORM COMMERCIAL CODE

Common-law contract principles govern contracts for real estate and services. Because of the historical development of the English legal system, contracts for the sale of goods came to be governed by a different body of legal rules. In its modern American manifestation, that body of rules is an important statute: the **Uniform Commercial Code (UCC)**, especially Article 2, which deals with the sale of goods.

History of the Uniform Commercial Code

In addition to the overabundance of cases that was discussed above, in commercial transactions there was an another barrier to legal efficiency in contracting. The development of the common law through judicial interpretation meant that the law varied, sometimes greatly, from state to state. This was a serious impediment to business as the American economy became nationwide during the twentieth century. Although there had been some uniform laws concerned with commercial deals—including the Uniform Sales Act, first published in 1906—few were widely adopted and none nationally.

Enter the **Uniform Commercial Code (UCC)**. The UCC is a model law developed by the ALI and the National Conference of Commissioners on Uniform State Laws; it has been adopted in one form or another by the legislatures in all fifty states, the District of Columbia, and the American territories. It is a "national" law not enacted by Congress—it is not federal law but uniform state law.

Initial drafting of the UCC began in 1942 and was ten years in the making, involving the efforts of hundreds of practicing lawyers, law teachers, and judges. A final draft, promulgated by the ALI, was endorsed by the American Bar Association and published in 1951. Various revisions followed in different states, threatening the uniformity of the UCC. The ALI responded by creating a permanent editorial board to oversee future revisions. In one or another of its various revisions, the UCC has been adopted in whole or in part in all American jurisdictions. The UCC is now a basic law of relevance to every business and business lawyer in the United States, even though it is not entirely uniform because different states have adopted it at various stages of its evolution—an evolution that continues still.

Organization of the UCC

The UCC consists of nine major substantive articles, each dealing with separate though related subjects. The articles are as follows:

- Article 1: General Provisions

- Article 2/2A: Sales and Leases of Goods
- Article 3: Commercial Paper
- Article 4/4A: Bank Deposits and Collections and Funds Transfers
- Article 5: Letters of Credit
- Article 6: Bulk Transfers
- Article 7: Warehouse Receipts, Bills of Lading, and Other Documents of Title
- Article 8: Investment Securities
- Article 9: Secured Transactions

Article 2 deals with the sale of goods, which the UCC defines as "all things…which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid." As these sales/leases are accomplished by contracting, agreements covered by Articles 2/2A which relate to the present or future sale of goods also make up the law of contracts.

Figure 5.1 Sources of Law

Type of Contract	Source of Law	
	Common Law	UCC
Real Estate	✓	
Services	✓	
Sale of Goods		✓

INTERNATIONAL SALES LAW

The Convention on Contracts for the International Sale of Goods

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

The CISG is significant for three reasons. First, it is a uniform law governing the sale of goods—in effect, an international Uniform Commercial Code. The major goal of the drafters was to produce a uniform law acceptable to countries with different legal, social, and economic systems. Second, although provisions in the CISG are generally consistent with the UCC, there are significant differences. For instance, under the CISG, **consideration** is not required to form a contract, and there is no Statute of Frauds (a requirement that certain contracts be evidenced by a writing). Third, the CISG represents the first attempt by the U.S. Senate to reform the private law of business through its treaty powers, for the CISG preempts the UCC. The CISG is not mandatory; parties to an international contract for the sale of goods may choose to have their agreement governed by different

law, perhaps the UCC, or, say, Japanese contract law. The CISG does not apply to contracts for the sale of (1) ships or aircraft, (2) electricity, or (3) goods bought for personal, family, or household use, nor does it apply (4) where the party furnishing the goods does so only incidentally to the labor or services part of the contract.

5.3 OBJECTIVE THEORY OF CONTRACTS

The **objective theory of contracts** is a fundamental principle in contract law that focuses on the objective intent of the parties involved in a contract rather than their subjective beliefs or intentions. Using the objective theory of contracts, a contract is formed based on the outward, objective manifestations of the parties' intentions, as perceived by a reasonable person. In other words, it's not necessary for the parties to share the same internal, subjective understanding of the contract terms; what matters is how their words and actions would be reasonably understood by an outside observer. This standard takes into account the parties' communications, actions, and conduct leading up to and including the time of the contract's formation. Courts will therefore look at the objective evidence of the parties' intent, rather than their individual, subjective beliefs or unexpressed intentions. This means that even if one party secretly harbored a different intention, the contract is based on what they objectively conveyed to the other party. The objective theory of contracts promotes clarity and predictability in contract law and provides a foundation for enforcing agreements based on the parties' objective expressions of intent.

5.4 CLASSIFICATIONS OF CONTRACTS

Contracts are classified in different ways. Ascribing a classification to a contract helps to learn about that contract, and potential rights and obligations under that contract. This section will describe the primary ways that contracts are classified.

EXPRESS, IMPLIED OR QUASI CONTRACTS

A contract is either **express**, **implied-in-fact** (implied) or imposed by the court as an **implied in law contract** (**quasi**).

Express Contract

An express contract is a contract in which the terms and conditions are explicitly stated, either orally or in writing, with the intent of both parties to enter a contract. It's a clear and definite agreement between the parties. For example, a homeowner hires a plumber to fix a leaky hose fixture outside their house. The homeowner and the plumber have a written agreement that outlines the specific terms of the plumbing service, such as the scope of work, the cost, and the timeline for completion. Even if neither party signs the document, this would still be an express contract, as the agreement is clearly expressed in words.

Implied Contract (Implied in Fact)

An **implied contract** is a contract in which the agreement is not explicitly stated in words but is inferred from the conduct and actions of the parties involved. An implied contract between the homeowner and the plumber could arise if the homeowner calls the plumber and the plumber performs the work, fixing the leaky hose fixture outside the house without discussing specific terms

of the agreement. Clearly, both parties intended for the plumber to be paid for any work completed, but the detailed understanding between the two parties was not directly discussed, resulting in an implied contract.

Quasi Contract

Unlike both **express** and **implied contracts**, which embody an actual agreement of the parties, a **quasi contract** does not arise from the agreement of the parties. In fact, there is a lack of agreement in quasi contract situations. This is why a quasi contract is an obligation said to be "imposed by law" in order to avoid unjust enrichment of one person at the expense of another. In other words, it is an obligation imposed by a judge to prevent injustice, and not a contract at all. Suppose, for example, that a local plumbing company mistakenly sends a plumber to your house, thinking it your it belongs to the neighbor on the next block who had called for a repair to the leaky hose outside their house. On arrival to your home, the plumber actually does find a leaking hose and fixes it while you are home. You never communicated with the plumbing company even though you saw the repair taking place. Although it is true there is no contract, the law implies a contract for the value of the material: of course you will have to pay for the service you received.

CASE 5.1

Roger's Backhoe Service, Inc. v. Nichols, 681 N.W.2d 647 (Iowa 2004)

CARTER, J.

Defendant, Jeffrey S. Nichols, is a funeral director in Muscatine.…In early 1998 Nichols decided to build a crematorium on the tract of land on which his funeral home was located. In working with the Small Business Administration, he was required to provide drawings and specifications and obtain estimates for the project. Nichols hired an architect who prepared plans and submitted them to the City of Muscatine for approval. These plans provided that the surface water from the parking lot would drain onto the adjacent street and alley and ultimately enter city storm sewers. These plans were approved by the city.

Nichols contracted with Roger's [Backhoe Service, Inc.] for the demolition of the foundation of a building that had been razed to provide room for the crematorium and removal of the concrete driveway and sidewalk adjacent to that foundation. Roger's completed that work and was paid in full.

After construction began, city officials came to the jobsite and informed Roger's that the proposed drainage of surface water onto the street and alley was unsatisfactory. The city required that an effort be made to drain the surface water into a subterranean creek, which served as part of the city's storm sewer system. City officials indicated that this subterranean sewer system was about fourteen feet below the surface of the ground.…Roger's conveyed the city's mandate to Nichols when he visited the jobsite that same day.

It was Nichols' testimony at trial that, upon receiving this information, he advised…Roger's that he was refusing permission to engage in the exploratory excavation that the city required. Nevertheless, it appears without dispute that for the next three days Roger's did engage in digging down to the subterranean sewer system, which was located approximately twenty feet below the surface. When the underground creek was located, city officials examined the brick walls in which it was encased and determined that it was not

feasible to penetrate those walls in order to connect the surface water drainage with the underground creek. As a result of that conclusion, the city reversed its position and once again gave permission to drain the surface water onto the adjacent street and alley.

[T]he invoices at issue in this litigation relate to charges that Roger's submitted to Nichols for the three days of excavation necessary to locate the underground sewer system and the cost for labor and materials necessary to refill the excavation with compactable materials and attain compaction by means of a tamping process.…The district court found that the charges submitted on the…invoices were fair and reasonable and that they had been performed for Nichols' benefit and with his tacit approval.…

The court of appeals…concluded that a necessary element in establishing an implied-in-fact contract is that the services performed be beneficial to the alleged obligor. It concluded that Roger's had failed to show that its services benefited Nichols.…

In describing the elements of an action on an implied contract, the court of appeals stated in [Citation], that the party seeking recovery must show:

(1) the services were carried out under such circumstances as to give the recipient reason to understand:

> (a) they were performed for him and not some other person, and
>
> (b) they were not rendered gratuitously, but with the expectation of compensation from the recipient; and

(2) the services were beneficial to the recipient.

In applying the italicized language in [Citation] to the present controversy, it was the conclusion of the court of appeals that Roger's' services conferred no benefit on Nichols. We disagree. There was substantial evidence in the record to support a finding that, unless and until an effort was made to locate the subterranean sewer system, the city refused to allow the project to proceed. Consequently, it was necessary to the successful completion of the project that the effort be made. The fact that examination of the brick wall surrounding the underground creek indicated that it was unfeasible to use that source of drainage does not alter the fact that the project was stalemated until drainage into the underground creek was fully explored and rejected. The district court properly concluded that Roger's' services conferred a benefit on Nichols.…

Decision of court of appeals vacated; district court judgment affirmed.

Case questions

1. What facts must be established by a plaintiff to show the existence of an implied contract?
2. What argument did Nichols make as to why there was no implied contract here?
3. How would the facts have to be changed to make an express contract?

BILATERAL OR UNILATERAL CONTRACTS

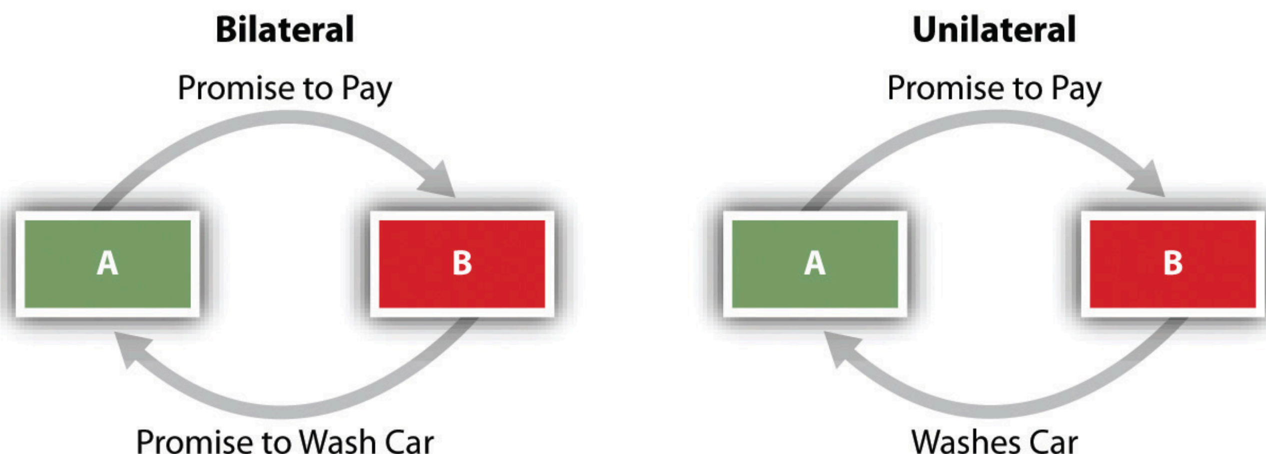
Bilateral Contracts

The typical contract is one in which both parties make mutual promises. Each is both **promisor** and **promisee**; that is, each pledges to do something, and each is the recipient of such a pledge. This type of contract is called a **bilateral contract**. The example above where the homeowner and the plumber enter a contract with express terms to fix the leaky fixture outside the house also illustrates a bilateral contract. The homeowner has offered payment, and the plumber has promised the repair.

Unilateral Contract

A **unilateral contract** is a contract where one party makes a promise and the other party can accept that promise only by performing a specific act. Unilateral contracts are as **valid** as bilateral contracts. Suppose that the homeowner puts a sign on their lawn that says "I will pay $100 to the first person to fix the leaky fixture outside my home." A plumber sees the sign, says nothing, but goes to the pipe, gets to work, and repairs the leak. This is a unilateral contract. In a unilateral contract, the **acceptance** of the promise is indicated through performance, rather than by making a reciprocal promise.

Figure 5.2 Bilateral and Unilateral Contracts



CASE 5.2

Woolley v. Hoffmann-La Roche, Inc., 491 A.2d 1257 (N.J. 1985)

WILNTZ, C. J.

Plaintiff, Richard Woolley, was hired by defendant, Hoffmann-La Roche, Inc., in October 1969, as an Engineering Section Head in defendant's Central Engineering Department at Nutley. There was no written employment contract between plaintiff and defendant. Plaintiff began work in mid-November 1969. Sometime in December, plaintiff received and read the personnel manual on which his claims are based.

[The company's personnel manual had eight pages;] five of the eight pages are devoted to "termination." In

addition to setting forth the purpose and policy of the termination section, it defines "the types of termination" as "layoff," "discharge due to performance," "discharge, disciplinary," "retirement" and "resignation." As one might expect, layoff is a termination caused by lack of work, retirement a termination caused by age, resignation a termination on the initiative of the employee, and discharge due to performance and discharge, disciplinary, are both terminations for cause. There is no category set forth for discharge without cause. The termination section includes "Guidelines for discharge due to performance," consisting of a fairly detailed procedure to be used before an employee may be fired for cause. Preceding these definitions of the five categories of termination is a section on "Policy," the first sentence of which provides: "It is the policy of Hoffmann-La Roche to retain to the extent consistent with company requirements, the services of all employees who perform their duties efficiently and effectively."

In 1976, plaintiff was promoted, and in January 1977 he was promoted again, this latter time to Group Leader for the Civil Engineering, the Piping Design, the Plant Layout, and the Standards and Systems Sections. In March 1978, plaintiff was directed to write a report to his supervisors about piping problems in one of defendant's buildings in Nutley. This report was written and submitted to plaintiff's immediate supervisor on April 5, 1978. On May 3, 1978, stating that the General Manager of defendant's Corporate Engineering Department had lost confidence in him, plaintiff's supervisors requested his resignation. Following this, by letter dated May 22, 1978, plaintiff was formally asked for his resignation, to be effective July 15, 1978.

Plaintiff refused to resign. Two weeks later defendant again requested plaintiff's resignation, and told him he would be fired if he did not resign. Plaintiff again declined, and he was fired in July.

Plaintiff filed a complaint alleging breach of contract.…The gist of plaintiff's breach of contract claim is that the express and implied promises in defendant's employment manual created a contract under which he could not be fired at will, but rather only for cause, and then only after the procedures outlined in the manual were followed. Plaintiff contends that he was not dismissed for good cause, and that his firing was a breach of contract.

Defendant's motion for summary judgment was granted by the trial court, which held that the employment manual was not contractually binding on defendant, thus allowing defendant to terminate plaintiff's employment at will. The Appellate Division affirmed. We granted certification.

The employer's contention here is that the distribution of the manual was simply an expression of the company's "philosophy" and therefore free of any possible contractual consequences. The former employee claims it could reasonably be read as an explicit statement of company policies intended to be followed by the company in the same manner as if they were expressed in an agreement signed by both employer and employees.…

This Court has long recognized the capacity of the common law to develop and adapt to current needs.…The interests of employees, employers, and the public lead to the conclusion that the common law of New Jersey should limit the right of an employer to fire an employee at will.

In order for an offer in the form of a promise to become enforceable, it must be accepted. Acceptance will depend on what the promisor bargained for: he may have bargained for a return promise that, if given, would result in a bilateral contract, both promises becoming enforceable. Or he may have bargained for some action or nonaction that, if given or withheld, would render his promise enforceable as a unilateral contract. In most of the cases involving an employer's personnel policy manual, the document is prepared without any negotiations and is voluntarily distributed to the workforce by the employer. It seeks no return

promise from the employees. It is reasonable to interpret it as seeking continued work from the employees, who, in most cases, are free to quit since they are almost always employees at will, not simply in the sense that the employer can fire them without cause, but in the sense that they can quit without breaching any obligation. Thus analyzed, the manual is an offer that seeks the formation of a unilateral contract—the employees' bargained-for action needed to make the offer binding being their continued work when they have no obligation to continue.

The unilateral contract analysis is perfectly adequate for that employee who was aware of the manual and who continued to work intending that continuation to be the action in exchange for the employer's promise; it is even more helpful in support of that conclusion if, but for the employer's policy manual, the employee would have quit. See generally M. Petit, "Modern Unilateral Contracts," 63 Boston Univ. Law Rev. 551 (1983) (judicial use of unilateral contract analysis in employment cases is widespread).

…All that this opinion requires of an employer is that it be fair. It would be unfair to allow an employer to distribute a policy manual that makes the workforce believe that certain promises have been made and then to allow the employer to renege on those promises. What is sought here is basic honesty: if the employer, for whatever reason, does not want the manual to be capable of being construed by the court as a binding contract, there are simple ways to attain that goal. All that need be done is the inclusion in a very prominent position of an appropriate statement that there is no promise of any kind by the employer contained in the manual; that regardless of what the manual says or provides, the employer promises nothing and remains free to change wages and all other working conditions without having to consult anyone and without anyone's agreement; and that the employer continues to have the absolute power to fire anyone with or without good cause.

Reversed and remanded for trial.

Case questions

1. What did Woolley do to show his acceptance of the terms of employment offered to him?
2. In part of the case not included here, the court notes that Mr. Woolley died "before oral arguments on this case." How can there be any damages if the plaintiff has died? Who now has any case to pursue?
3. The court here is changing the law of employment in New Jersey. It is making case law, and the rule here articulated governs similar future cases in New Jersey. Why did the court make this change? Why is it relevant that the court says it would be easy for an employer to avoid this problem?

VALID, VOID, VOIDABLE AND UNENFORCEABLE

Valid

A **valid contract** is a legally binding and enforceable agreement that meets all the essential elements required by contract law. If a contract contains all of the required elements and complies with

all relevant laws and regulations, it is valid and enforceable. Parties to a valid contract have legal obligations to fulfill their promises.

Void

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

Voidable

By contrast, a **voidable contract** is one that may become unenforceable by one party but can be enforced by the other. For example, a minor (any person under eighteen, in most states) may "avoid" a contract with an adult; the adult may not enforce the contract against the minor if the minor refuses to carry out the bargain. But the adult has no choice if the minor wishes the contract to be performed.

A voidable contract remains a **valid contract** until it is voided. Thus a contract with a minor remains in force unless the minor decides he or she does not wish to be bound by it. When the minor reaches majority, he or she may "**ratify**" the contract—that is, agree to be bound by it—in which case the contract will no longer be voidable and will thereafter be fully enforceable.

Unenforceable

An **unenforceable contract** is one that some rule of law bars a court from enforcing. For example, Tom owes Pete money, but Pete has waited too long to collect it and the statute of limitations has run out. The contract for repayment is unenforceable because he's simply waited too long, and Pete is out of luck.

The doctrine of promissory estoppel

A promise or what seems to be a promise is usually enforceable only if it is otherwise embedded in the elements necessary to make that promise a contract. Sometimes, though, people say things that seem like promises, and on which another person relies. In some circumstances courts have recognized that insisting on the existence of the traditional elements of contract to determine whether a promise is enforceable could work an injustice where there has been reliance. Thus developed the equitable doctrine of **promissory estoppel**, which has become an important adjunct to contract law. The Restatement (Section 90) puts it this way: "A promise which the **promisor** should reasonably expect to induce action or forbearance on the party 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." To be "estopped" means to be prohibited from denying now the validity of a promise you made before. Contract protects agreements; promissory estoppel protects reliance, and that's a significant difference. Practically speaking, promissory estoppel may serve to provide a remedy in situations where under traditional contract law, a party may have none.

EXECUTORY V. EXECUTED

Executory and executed are terms used to describe the current status of a contract based on whether

or not the parties have fulfilled their respective obligations at the moment of the classification. This helps us understand where the contract stands in terms of performance.

Executory

An **executory contract** is a contract in which one or more parties have not yet fulfilled their obligations or duties. In other words, the contractual promises made by one or more parties remain uncompleted or "in progress." The completion of these promises is expected to occur in the future, and the contract is still active. Until all parties have performed their respective obligations, the contract remains executory. For example, if the homeowner has made an agreement with the plumber to come to their home to repair the leaky fixture, but the repair is not complete yet, the contract is executory.

Executed

An **executed contract** is a contract in which all parties involved have fully performed and completed their obligations. All promises made in the contract have been fulfilled, and there are no remaining duties or outstanding actions required. Once a contract is executed, it is considered closed, and the parties no longer have any legal obligations under that specific contract. The plumbing contract would be executed when the pipe leak is repaired, and the homeowner has paid the plumber for the service.

FORMAL AND INFORMAL CONTRACTS

Formal contracts are contracts that require a specific form or format to be legally valid and enforceable. These formalities typically involve the manner in which the contract is created, executed, and documented. The four types of formal contracts recognized by the Restatement are (1) **contracts under seal**, (2) **recognizances**, (3) **letters of credit**, and (4) **negotiable instruments**.

The primary difference between a formal contract and an **informal contract** lies in the level of formality and the specific requirements for their creation and enforceability. Therefore, an informal contract is a contract that is not a formal contract. Note that this is not a difference between written and unwritten contracts. An informal contract can also be a written contract. The contract would be written and informal if there are no requirements that the contract be written in a specific format.

ACTIVITY 5A

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=51#h5p-33

ADDITIONAL TERMINOLOGY: SUFFIXES EXPRESSING RELATIONSHIPS

Although not really part of the classification of contracts, it is worth highlighting that in legal terminology, common English language *suffixes* (end syllables of words) are used to express relationships between parties. For example:

Offeror. One who makes an **offer**.

Offeree. One to whom an offer is made.

Promisor. One who makes a promise.

Promisee. One to whom a promise is made.

Obligor. One who makes and has an obligation.

Obligee. One to whom an obligation is made.

Transferor. One who makes a transfer.

Transferee. One to whom a transfer is made.

E**Obligor**nd of Chapter Exercises

1. Mr. and Mrs. Smith, an elderly couple, had no relatives. When Mrs. Smith became ill, the Smiths asked a friend, Henrietta, to help with various housekeeping chores, including cleaning and cooking. Although the Smiths never promised to pay her, Henrietta performed the chores for eighteen months. Henrietta now claims that she is entitled to the reasonable value of the services performed. Is she correct? Explain.
2. Assume instead that the Smiths asked Mrs. Smith's sister, Caroline, who lived nearby, to help with the housekeeping. After eighteen months, Caroline claims she is entitled to the reasonable value of the services performed. Is she correct? Explain.
3. A letter from Bridge Builders Inc. to the Allied Steel Company stated, "We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days." Does Bridge Builders intend to create a bilateral or a unilateral contract? Why?

4. Roscoe's barber persuaded him to try a new hair cream called Sansfree, which the barber applied to Roscoe's hair and scalp. The next morning Roscoe had a very unpleasant rash along his hairline. Upon investigation he discovered that the rash was due to an improper chemical compound in Sansfree. If Roscoe filed a breach of contract action against the barber, would the case be governed by the Uniform Commercial Code or common law? Explain.
5. Rachel entered into a contract to purchase a 2004 Dodge from Hanna, who lived in the neighboring apartment. When a dispute arose over the terms of the contract, Hanna argued that, because neither she nor Rachel was a merchant, the dispute should be decided under general principles of common law. Rachel, on the other hand, argued that Hanna was legally considered to be a merchant because she sold the car for profit and that, consequently, the sale was governed by the Uniform Commercial Code. Who is correct? Explain.
6. Lee and Michelle decided to cohabit. When they set up house, Michelle gave up her career, and Lee promised to share his earnings with her on a fifty-fifty basis. Several years later they ended their relationship, and when Lee failed to turn over half of his earnings, Michelle filed suit on the basis of Lee's promise. What kind of contract would Michelle allege that Lee had breached? Explain.
7. Harry and Wilma were divorced in 2008, and Harry was ordered in the divorce decree to pay his ex-wife $10,000. In 2009 and 2010 Harry was hospitalized, incurring $3,000 in bills. He and Wilma discussed the matter, and Wilma agreed to pay the bill with her own money, even though Harry still owed her $5,000 from the divorce decree. When Harry died in late 2010, Wilma made a claim against his estate for $8,000 (the $3,000 in medical bills and the $5,000 from the decree), but the estate was only willing to pay the $5,000 from the decree, claiming she had paid the hospital bill voluntarily and had no contract for repayment. Is the estate correct? Explain.
8. Louie, an adult, entered into a contract to sell a case of scotch whiskey to Leroy, a minor. Is the contract void or voidable? Explain.
9. James Mann owned a manufacturing plant that assembled cell phones. A CPA audit determined that several phones were missing. Theft by one or more of the workers was suspected. Accordingly, under Mann's instructions, the following sign was placed in the employees' cafeteria:

   > *Reward. We are missing phones. I want all employees to watch for thievery. A reward of $500 will be paid for information given by any employee that leads to the apprehension of employee thieves.* —James Mann

   Waldo, a plant employee, read the notice and immediately called Mann, stating, "I accept your offer. I promise to watch other employees and provide you with the requested information." Has a contract been formed? Explain.
10. Almost every day Sally took a break at lunch and went to the International News Stand—a

magazine store—to browse the newspapers and magazines and chat with the owner, Conrad. Often she bought a magazine. One day she went there, browsed a bit, and took a magazine off the rack. Conrad was busy with three customers. Sally waved the magazine at Conrad and left the store with it. What kind of a contract, if any, was created?

11. Joan called Devon Sand & Gravel and ordered two "boxes" (dump-truck loads) of gravel to be spread on her rural driveway by the "shoot and run" method: the tailgate is partially opened, the dump-truck bed is lifted, and the truck moves down the driveway spreading gravel as it goes. The driver mistakenly graveled the driveway of Joan's neighbor, Watson, instead of Joan's. Is Devon entitled to payment by Watson? Explain.

REFERENCES

Sir Henry Maine, Ancient Law (1869), 180–82.

Richard A. Posner, Economic Analysis of Law (New York: Aspen, 1973).

Uniform Commercial Code, Section 1-201(11).

Uniform Commercial Code, Section 2-105.

CHAPTER 6 -THE AGREEMENT

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the three requirements of a valid offer.
2. Describe the mirror image rule of acceptance.
3. Identify the situations under which an offer may be revoked.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=104#h5p-13

6.1 THE AGREEMENT

In this Chapter, we begin the inquiry into how to tell when parties have created a **valid contract**. The answer is not always obvious, but since businesspeople frequently conduct contract negotiations without the assistance of a lawyer, it is important to attend to the legal requirements of a valid contract at the outset. Whether a contract has been formed depends in turn on whether

- the parties reached an agreement (the focus of this Chapter)
- **consideration** was present
- the parties were **legally capable** of contracting
- the agreement was legal, and
- the parties entered into the contract of their own free will, with knowledge of the facts.

THE SIGNIFICANCE OF AGREEMENT

The core of a legal contract is the **agreement** between the parties. As the great student of contract law Samuel Williston put it, "It was a consequence of the emphasis laid on the ego and the individual will that the formation of a contract should seem impossible unless the wills of the parties concurred." Accordingly, we find at the end of the eighteenth century, and the beginning of the nineteenth century, the prevalent idea that there must be a "meeting of the minds" (a new phrase) in order to form a

contract. Although agreements may take any form, including unspoken conduct between the parties, they are usually structured in terms of an **offer** and an **acceptance**. These two components will be the focus of our discussion in this Chapter. In future Chapters, the discussion will turn to the other major functions of the law of contracts: to sort out the agreements that are legally binding—those that are contracts—from those that are not.

THE OBJECTIVE TEST

As we learned in the last Chapter, courts generally apply an objective standard to interpret contracts. This is true in interpreting each of the components of a contract as well. The **Restatement (Second) of Contracts** defines *agreement* as a "manifestation of mutual assent by two or more persons to one another." The **Uniform Commercial Code (UCC)** defines *agreement* as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." As evidenced by both of these definitions, the critical question is what the parties actually said or did, not what they thought they said or did nor not what impression they thought they were making. The objective test will apply throughout this Chapter.

6.2 THE OFFER

To arrive at an **agreement**, we need an **offer** and an **acceptance**. Offer and acceptance may seem to be straightforward concepts, but in a commercial society, the ways of making offers and accepting them are nearly infinite. A retail store advertises its merchandise in the newspaper. A seller makes his offer by mail or over the Internet. A telephone caller states that his offer will stand for ten days. An offer leaves open a crucial term. An auctioneer seeks bids. An offeror gives the offeree a choice. All these situations can raise tricky questions, and so it is important to have legal standards to guide the analysis as to what constitutes an offer that can result in a legal obligation.

The **Restatement** defines offer as "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it." Three key elements are implicit in that definition: the offeree must objectively intend to make an offer, the offer must be communicated, and it must be definite.

OBJECTIVE INTENTION

The party making the **offer** (offeror) must have a genuine intention to be legally bound by the terms of the offer. In other words, the offeror must intend for the **acceptance** of the offer to create a legally enforceable contract. This intention is determined with reference to the **objective standard**.

The distinction between objective and **subjective standards** crops up occasionally when one person claims he spoke in jest, or didn't mean to imply that he wanted to contract. For example, the vice president of a company that manufactured punchboards, used in gambling, testified to the Washington State Game Commission that he would pay $100,000 to anyone who found a "crooked board." Barnes, a bartender, who had purchased two boards that were crooked some time before, brought one to the company office and demanded payment. The company refused, claiming that the statement was made in jest (the audience at the commission hearing even laughed when the offer was made). The court disagreed, holding that it was reasonable to interpret the pledge of $100,000 as a means of promoting punchboards:

If the jest is not apparent and a reasonable hearer would believe that an offer was being made, then the speaker risks the formation of a contract which was not intended. It is the objective manifestations of the offeror that count and not secret, unexpressed intentions. If a party's words or acts, judged by a reasonable standard, manifest an intention to agree in regard to the matter in question, that agreement is established, and it is immaterial what may be the real but unexpressed state of the party's mind on the subject.

CASE 6.1

Lucy v. Zehmer, 84 S.E.2d 516 (Va. 1954)

BUCHANAN, J.

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

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

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

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

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

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

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

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

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

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

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

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

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

Reversed and remanded.

Case questions

1. What objective evidence was there to support the defendants' contention that they were just kidding when they agreed to sell the farm?
2. Suppose the defendants really did think the whole thing was a kind of joke. Would that make any difference?
3. As a matter of public policy, why does the law use an objective standard to determine the

seriousness of intention, instead of a subjective standard?

4. It's 85 degrees in July and 5:00 p.m., quitting time. The battery in Mary's car is out of juice, again. Mary says, "Arrgh! I will sell this stupid car for $50!" Jason, walking to his car nearby, whips out his checkbook and says, "It's a deal. Leave your car here. I'll give you a ride home and pick up your car after you give me the title." Do the parties have a contract?

COMMUNICATION

To have an agreement, each party assents to the terms of the other party. The **offeror** must therefore communicate the offer to the **offeree** . An offer cannot be accepted if the offeree is unaware of its existence. From this general proposition, it follows that no contract can be legally binding unless an offer is in fact communicated to the offeree. If you write an e-mail to a friend with an offer to sell your car for a certain sum and then get distracted and forget to send it, no offer has been made. If your friend coincidentally e-mails you the following day and says that she wants to buy your car and names the same sum, no contract has been made. An offer is not effective until it is received by the offeree because that is the point at which the offer is communicated.

The requirement that an offer be communicated does not mean that every term must be communicated. You call up your friend and offer to sell him your car. You tell him the price and start to tell him that you will throw in the snow tires but will not pay for a new inspection, and that you expect to keep the car another three weeks. Impatiently, he cuts you off and says, "Never mind about all that; I'll accept your offer on whatever terms you want." You and he have an agreement.

These principles apply to unknown offers of reward. An offer of a reward constitutes a unilateral contract that can be made binding only by performing the task for which the reward is offered. Suppose that Bonnie posts on a tree a sign offering a reward for returning her missing dog. If you saw the sign, found the dog, and returned it, you would have fulfilled the essentials of the offer. But if you chanced upon the dog, read the tag around its neck, and returned it without ever having been aware that a reward was offered, then you have not responded to the offer, even if you acted in the hope that the owner would reward you. There is no contractual obligation to do so.

Although a completed act called for by an unknown private offer does not give rise to a contract, partial performance usually does. Suppose Apex Bakery posts a notice offering a one-week bonus to all bakers who work at least six months in the kitchen. Charlene works two months before discovering the notice on the bulletin board. Her original ignorance of the offer will not defeat her claim to the bonus if she continues working up to the six month requirement to collect, for the offer serves as an inducement to complete the performance called for.

DEFINITENESS OF TERMS

The common law reasonably requires that an offer spell out the essential proposed terms with sufficient definiteness—certainty of terms that enables a court to order enforcement or measure damages in the event of a breach. Thus, a supposed promise to sell "such coal as the promisor may wish to sell" is not an enforceable term because the seller, the coal company, undertakes no duty to sell anything unless it wishes to do so. Such an offer would not be sufficiently definite, as essential terms of such an offer would certainly include the parties to the agreement, the price to be exchanged, and the subject matter of the offer – in this case the work to be done. But not every omission is fatal; for example, as long as a missing term can be fixed by referring to some external standard—such as "no later than the first frost"—the offer is sufficiently definite.

In major business transactions involving extensive negotiations, the parties often sign a preliminary "**agreement in principle**" before a detailed contract is drafted. These preliminary agreements may be definite enough to create contract liability even though they lack many of the terms found in a typical contract. For example, in a famous 1985 case, a Texas jury concluded that an agreement made "in principle" between the Pennzoil Company and the Getty Oil Company and not entirely finished was binding and that Texaco had unlawfully interfered with their contract. As a result, Texaco was held liable for over $10 billion, which was settled for $3 billion after Texaco went into bankruptcy.

Contracts with Alternatives

Offers that state alternatives are definitive if each alternative is definite. David offers Sheila the opportunity to buy one of two automobiles at a fixed price, with delivery in two months and the choice of vehicle left to David. Sheila accepts. The contract is **valid**. If one of the cars is destroyed in the interval before delivery, David is obligated to deliver the other car. Sometimes, however, what appears to be an offer in the alternative may be something else. Charles makes a deal to sell his business to Bernie. As part of the bargain, Charles agrees not to compete with Bernie for the next two years, and if he does, to pay $25,000. Whether this is an alternative contract depends on the circumstances and intentions of the parties. If it is, then Charles is free to compete as long as he pays Bernie $25,000. On the other hand, the intention might have been to prevent Charles from competing in any event; hence a court could order payment of the $25,000 as damages for a breach and still order Charles to refrain from competition until the expiration of the two-year period.

The UCC Approach

The UCC is generally more liberal in its approach to definiteness than is the common law. Section 2-204(3) states the rule: "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."

The drafters of the UCC sought to give validity to as many contracts as possible and grounded that validity on the intention of the parties rather than on formalistic requirements. As the official comment to Section 2-204(3) notes, "If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy.…Commercial standards on the point of 'indefiniteness' are

intended to be applied." Other sections of the UCC spell out rules for filling in such open provisions as price, performance, and remedies.

One of these sections, Section 2-306(1), provides that a contract term under which a buyer agrees to purchase the seller's entire output of goods (an "**outputs contract**") or under which a seller agrees to meet all the buyer's requirements (a "**requirements**" or "**needs**" **contract**) must be made in good faith regarding the understanding of "outputs" or "requirements." In other words, a party to such a contract cannot offer or demand a quantity that is "unreasonably disproportionate" to a stated estimate or past quantities.

PROPOSALS THAT ARE NOT OFFERS

Advertisements

Most advertisements, price quotations, and invitations to bid are not construed as offers. The reason is that terms are not sufficiently definite to meet the legal standard for an offer. A notice in the newspaper that a bicycle is on sale for $800 is normally intended only as an invitation to the public to come to the store to make a purchase. At the time the notice is published, it is uncertain who the parties to the offer will be, or if an offer will even result from the notice. Similarly, a statement that a seller can "quote" a unit price to a prospective purchaser is not, by itself, of sufficient definiteness to constitute an offer; quantity, time of delivery, and other important factors are missing from such a statement. Frequently, in order to avoid constructing a statement about price and quantity as an offer, a seller or buyer may say, "Make me an offer." Such a statement obviously suggests that no offer has yet been made. This principle usually applies to invitations for bids (e.g., from contractors on a building project). An invitation for bid is a solicitation of bids from potential suppliers or contractors for the procurement of goods, services, or construction projects. While a bid submitted under an invitation for bid may meet the legal requirements of an offer, the invitation itself would not. Although advertisements, price quotations, and the like are generally not offers, the facts in each case are important. Under the proper circumstances with clear and sufficiently definite terms, an advertised statement can be construed as an offer, as shown in the well-known *Lefkowitz* case.

CASE 6.2

Lefkowitz v. Great Minneapolis Surplus Store, 86 N.W.2d 689 (Minn. 1957)

MURPHY, J.

This is an appeal from an order of the Municipal Court of Minneapolis denying the motion of the defendant for amended findings of fact, or, in the alternative, for a new trial. The order for judgment awarded the plaintiff the sum of $138.50 as damages for breach of contract.

This case grows out of the alleged refusal of the defendant to sell to the plaintiff a certain fur piece which it had offered for sale in a newspaper advertisement. It appears from the record that on April 6, 1956, the defendant published the following advertisement in a Minneapolis newspaper:

Saturday 9 A.M. Sharp

3 Brand New Fur Coats Worth to $100.00

First Come

First Served

$1 Each

[The $100 coat would be worth about $1100 in 2023 dollars.] On April 13, the defendant again published an advertisement in the same newspaper as follows:

Saturday 9 A.M.

2 Brand New Pastel Mink 3-Skin Scarfs

Selling for $89.50

Out they go Saturday. Each…$1.00

1 Black Lapin Stole Beautiful, worth $139.50…$1.00

First Come First Served

The record supports the findings of the court that on each of the Saturdays following the publication of the above-described ads the plaintiff was the first to present himself at the appropriate counter in the defendant's store and on each occasion demanded the coat and the stole so advertised and indicated his readiness to pay the sale price of $1. On both occasions, the defendant refused to sell the merchandise to the plaintiff, stating on the first occasion that by a "house rule" the offer was intended for women only and sales would not be made to men, and on the second visit that plaintiff knew defendant's house rules. …

The defendant contends that a newspaper advertisement offering items of merchandise for sale at a named price is a "unilateral offer" which may be withdrawn without notice. He relies upon authorities which hold that, where an advertiser publishes in a newspaper that he has a certain quantity or quality of goods which he wants to dispose of at certain prices and on certain terms, such advertisements are not offers which become contracts as soon as any person to whose notice they may come signifies his acceptance by notifying the other that he will take a certain quantity of them. Such advertisements have been construed as an invitation for an offer of sale on the terms stated, which offer, when received, may be accepted or rejected and which therefore does not become a contract of sale until accepted by the seller; and until a contract has been so made, the seller may modify or revoke such prices or terms. [Citations]

…On the facts before us we are concerned with whether the advertisement constituted an offer, and, if so, whether the plaintiff's conduct constituted an acceptance.

There are numerous authorities which hold that a particular advertisement in a newspaper or circular letter relating to a sale of articles may be construed by the court as constituting an offer, acceptance of which would complete a contract. [Citations]

The test of whether a binding obligation may originate in advertisements addressed to the general public is

"whether the facts show that some performance was promised in positive terms in return for something requested." 1 Williston, Contracts (Rev. ed.) s 27.

The authorities above cited emphasize that, where the offer is clear, definite, and explicit, and leaves nothing open for negotiation, it constitutes an offer, acceptance of which will complete the contract.…

Whether in any individual instance a newspaper advertisement is an offer rather than an invitation to make an offer depends on the legal intention of the parties and the surrounding circumstances. [Citations] We are of the view on the facts before us that the offer by the defendant of the sale of the Lapin fur was clear, definite, and explicit, and left nothing open for negotiation. The plaintiff having successfully managed to be the first one to appear at the seller's place of business to be served, as requested by the advertisement, and having offered the stated purchase price of the article, he was entitled to performance on the part of the defendant. We think the trial court was correct in holding that there was in the conduct of the parties a sufficient mutuality of obligation to constitute a contract of sale.

Case questions

1. If the normal rule is that display advertisements in newspapers and the like are not offers, but rather invitations to make an offer, why was this different? Why did the court hold that this was an offer?
2. What is the rationale for the rule that a display ad is usually not an offer?
3. If a newspaper display advertisement reads, "This offer is good for two weeks," is it still only an invitation to make an offer, or is it an offer?
4. Is a listing by a private seller for the sale of a trailer on Craigslist or in the weekly classified advertisements an offer or an invitation to make an offer?

Despite the common-law rule that advertisements are normally to be considered invitations rather than offers, legislation and government regulations may offer redress. For many years, retail food stores have been subject to a rule, promulgated by the Federal Trade Commission (FTC), that goods advertised as "specials" must be available and must be sold at the price advertised. It is unlawful for a retail chain not to have an advertised item in each of its stores and in sufficient quantity, unless the advertisement specifically states how much is stocked and which branch stores do not carry it. Many states have enacted consumer protection statutes that parallel the FTC rule. It is noteworthy here that such remedies, when they exist, are not granted under contract law.

Invitations to Bid at Auction

Invitations to **bid** are also not generally construed as offers. At an auction, offering an item for bidding is not an offer, but rather an invitation for potential buyers (bidders) to make offers. A prospective buyer becomes an **offeror** when making a bid at the auction, typically indicating their interest in purchasing the auctioned item by raising a paddle, making verbal offers, or submitting bids by mail or online, depending on the type of auction.

When a bidder makes a **bid**, they are essentially making an **offer** to purchase the auctioned item at the bid price. The agreement is formed when the auctioneer accepts the highest bid by calling "Sold!" or otherwise indicating **acceptance**. At this point, a legally binding contract is created between the successful bidder (offeror) and the auctioneer (offeree).

6.3 DURATION OF OFFER

An **offer** need not be accepted on the spot. Because there are numerous ways of conveying an offer and numerous contingencies that may be part of the offer's subject matter, the offeror might find it necessary to give the offeree considerable time to accept or reject the offer. By the same token, an offer cannot remain open forever, so that once given, it never lapses and cannot be terminated. The law recognizes several ways by which the offer can expire (besides **acceptance**, of course): **revocation**, rejection by the offeree, **counteroffer**, lapse of time, death or insanity of a person or destruction of an essential term, and illegality. We will examine each of these in turn.

REVOCATION

Just as people are free to make **offers**, they are generally free to revoke those offers as they see fit. The general rule, both in common law and under the UCC, is that the offeror may revoke an offer at any time before **acceptance**, even if the offer states that it will remain open for a specified period of time. Thus, Neil offers Arlene his car for $5,000 and promises to keep the offer open for ten days. Two days later, Neil calls Arlene to revoke the offer. The offer is revoked and Arlene can no longer accept even though the 10-day period has not expired.

To be effective, the **revocation** must be communicated to the offeree. This means that the offeree must be made aware of the offeror's decision to revoke the offer. So, if Neil had sent his revocation by mail it would not be effective unless it was received by Arlene. This means that if, before receiving a revocation, Arlene telephoned her acceptance, there would be a valid agreement. Revocation may be communicated indirectly. If Arlene had learned from a friend that Neil had sold his car to someone else during the 10-day period, she would have had sufficient notice. Any attempt to accept Neil's offer would have been futile.

There is an exception to the rule providing for direct communication of revocation for offers made to the public through a notice or newspaper. Public offers are open to anyone who meets the criteria specified in the offer. They are not limited to a specific individual or a small, private group. The offeror typically communicates the public offer through various means, such as advertisements, announcements, postings, or other forms of public communication. The offeror may revoke a public offering by notifying the public by the same means used to communicate the offer. If no better means of notification is reasonably available, the offer is terminated even if a particular offeree had no actual notice.

Irrevocable Offers

Not every type of offer is revocable. One type of offer that is **irrevocable** (cannot be revoked) is the **option contract**. An option contract occurs when an **offeree** has provided **consideration** (usually a payment) to the **offeror** in exchange for a promise to keep the offer open for a specified period. Arlene tells Neil that she cannot make up her mind in ten days but that she will pay him $25 to hold the offer

open for thirty days. Neil agrees. Arlene now has a 30-day option to buy the car for $5,000; if Neil should sell it to someone else during the thirty days, he will have breached the contract with Arlene. Note that the transactions involving Neil and Arlene consist of two different contracts. One is the promise of a thirty-day option for the promise of $25. It is this contract that makes the option binding and is independent of the original offer to sell the car for $5,000. The offer can be accepted and made part of an independent contract during the option period.

Partial performance of a **unilateral contract** creates an option. Although the option is not stated explicitly, it is recognized by law in the interests of justice. Otherwise, an offeror could induce the offeree to go to expense and trouble without ever being liable to fulfill his or her part of the bargain. Before the offeree begins to carry out the contract, the offeror is free to revoke the offer. But once performance begins, the law implies an option, allowing the offeree to complete performance according to the terms of the offer. If, after a reasonable time, the offeree does not fulfill the terms of the offer, then it may be revoked.

Revocability under the UCC

The UCC changes the common-law rule for offers by merchants. Under Section 2-205, a merchant can make a firm offer. A firm offer is a written and signed promise by a merchant to hold an offer to buy or sell goods for some period of time. A merchant's firm offer is **irrevocable**. The offer must remain open for the time period stated or, if no time period is given, for a reasonable period of time, not to exceed three months.

Irrevocability by Law

By law, certain types of offers may not be revoked (statutory irrevocability), despite the absence of language to that effect in the offer itself. One major category of such offers is that of the contractor submitting a bid to a public agency. The general rule is that once the period of bidding opens, a bidder on a public contract may not withdraw his or her bid unless the contracting authority consents. The contractor who purports to withdraw is awarded the contract based on the original bid and may be sued for damages for nonperformance.

REJECTION BY THE OFFEREE

When an **offeree** decides not to accept an offer from an **offeror**, the offeree will reject the offer. A rejection is a manifestation of refusal to agree to the terms of an offer, and is effective at the time that the offeror receives it. Arlene calls Neil to reject his offer. As soon as Neil receives the rejection, he is free to sell to someone else. Even if Arlene reconsiders the rejection, calling the next day to try to accept after all, there is no open offer, and therefore no agreement. Having rejected the original offer, Arlene, by her second call, is not accepting but making an offer to buy. Arlene is now the offeror, and Neil is free to accept or reject Arlene's offer.

COUNTEROFFER

A **counteroffer** in contract law is a response made by the offeree to the offeror that proposes different terms or conditions than those contained in the original offer. When a counteroffer is made, it essentially rejects the original offer and replaces it with a new offer. If Neil offers to sell his car to Arlene for $5,000, and Arlene would like to purchase the car but at a lower price, she may offer to buy

Neil's car for $4,000. Arlene's counteroffer has rejected Neil's original offer, and her offer is available to Neil who can then accept, reject, or even counter, Arlene's offer.

When negotiating an agreement, an offeree may want to accept most of the agreement while changing a part of it. Normally this would result in a counteroffer which has the results described above. To avoid presenting a counteroffer, it is also possible to accept an agreement by requesting a change or an addition to the offer that does not require the offeror's assent. In this case, the acceptance of the original offer is valid and does not constitute a counteroffer. Consider the following different scenarios. The broker at Friendly Real Estate offers you a house for $320,000. You accept but require as part of your acceptance that the deal include "the vacant lot next door." Your acceptance is a counteroffer, which serves to terminate the original offer. If, instead, you had said, "It's a deal, but I'd prefer it with the vacant lot next door," then you have accepted the original offer and there is a contract, because you are not demanding that the broker abide by your request in order for you to accept the offer. If you had said, "It's a deal, and I'd also like the vacant lot next door," you have also have a contract under the original terms, because the request for the lot is a separate offer, not a counteroffer that rejects the original proposal.

The UCC and Counteroffers

The UCC is more liberal than the common law in allowing contracts to be formed despite **counteroffers** and in incorporating the counteroffers into the contracts. This UCC provision is necessary because the use of routine forms for contracts is very common, and if the rule were otherwise, much valuable time would be wasted by drafting clauses tailored to the precise wording of routine printed forms. A buyer and a seller send out documents accompanying or incorporating their offers and acceptances, and the provisions in each document rarely correspond precisely. Indeed, it is often the case that one side's form contains terms favorable to it but inconsistent with terms on the other side's form. Section 2-207 of the UCC attempts to resolve this "battle of the forms" by providing that additional terms or conditions in an acceptance operate as such unless the acceptance is conditioned on the offeror's consent to the new or different terms. The new terms are construed as offers but are automatically incorporated in any contract between merchants for the sale of goods unless "(a) the offer expressly limits acceptance to the terms of the offer; (b) [the terms] 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."

An example of terms that become part of the contract without being expressly agreed to are clauses providing for interest payments on overdue bills. Examples of terms that would materially alter the contract and hence need express approval are clauses that negate the standard warranties that sellers give buyers on their merchandise.

Frequently, parties use contract provisions to prevent the automatic introduction of new terms. A typical seller's provision is as follows:

> Amendments – Any modification of this document by the Buyer, and all additional or different terms included in Buyer's purchase order or any other document responding to this offer, are hereby objected to. BY ORDERING THE GOODS HERE FOR SHIPMENT, BUYER AGREES

> TO ALL THE TERMS AND CONDITIONS CONTAINED ON BOTH SIDES OF THIS DOCUMENT.

Section 2-207 of the UCC, liberalizing the **mirror image rule**, is pervasive, covering all sorts of contracts, from those between industrial manufacturers to those between friends.

LAPSE OF TIME

Offers are not open indefinitely; even offers that do not have a date, day, or time of expiration will lapse after some period of time. In the absence of an expressly stated time limit, the common-law rule is that the offer expires at the end of a "reasonable" time. Such a period is a factual question in each case and depends on the particular circumstances, including the nature of the service or property being contracted for, the manner in which the offer is made, and the means by which the acceptance is expected to be made. Whenever the contract involves a speculative transaction—the sale of securities or land, for instance—the time period will depend on the nature of the security and the risk involved. In general, the greater the risk to the seller, the shorter the period of time. Karen offers to sell Gary a block of oil stocks that are fluctuating rapidly hour by hour. Gary receives the offer an hour before the market closes; he accepts by fax two hours after the market has opened the next morning and after learning that the stock has jumped up significantly. The time period has lapsed if Gary was accepting a fixed price that Karen set, but it may still be open if the price is market price at time of delivery. For unilateral contracts, both the common law and the UCC require the offeree to notify the offeror that he has begun to perform the terms of the contract. Without notification, the offeror may, after a reasonable time, treat the offer as having lapsed.

DEATH OR INSANITY OF THE OFFEROR

If the offeror dies before the offeree has accepted the offer, the offer is automatically terminated; the offer is said to die with the offeror. The same is true of the offeree. If the offeree dies before accepting the offer, the offer is automatically terminated. Similar to death, if either the offeror or the offeree becomes legally insane or mentally incapacitated to the extent that they cannot understand the terms of the offer or the nature of a contract, the offer is typically considered terminated. Notice, however, that these rules apply to attempts at offers, and would not necessarily apply to a contract between parties made prior to death or insanity.

DESTRUCTION OF SUBJECT MATTER ESSENTIAL TO THE OFFER

Similar to the rule above, if the subject matter of the **offer** is destroyed, the offer is terminated. You offer to sell your car, but the car is destroyed in an accident before your offer is accepted; the offer is terminated.

POSTOFFER ILLEGALITY

Finally, it is possible for an offer to become illegal only after that offer is made. For example, an offer to sell a quantity of herbal weight-loss supplements will terminate if the Food and Drug Administration subsequently outlaws the sale of such supplements.

6.4 THE ACCEPTANCE

To result in a legally binding contract, an offer must be accepted by the offeree. Just as the law helps define and shape an **offer** and its duration, so too does the law govern the nature and manner of **acceptance**. The Restatement defines acceptance of an offer as "a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer." In showing that there is an assent to an offer, the acceptance will reflect back the intention and terms of the offer, either by the making of a mutual promise or by performance or partial performance of a requested action. If there is doubt about whether the offer requests a return promise or a return act, the Restatement, Section 32, provides that the offeree may accept with either a promise or performance. The UCC also adopts this view; under Section 2-206(1)(a), "an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances" unless the offer unambiguously requires a certain mode of acceptance.

The person to whom a promise is directed is ordinarily the person whom the offeror contemplates will make a return promise or perform the act requested. As such, in the typical case, the offeror directs the offer to the offeree, and that party is then in the position to accept the offer, or decide not to accept. Under the common law, whoever is invited to furnish consideration to the offeror is the offeree, and only an offeree may accept an offer. Yet in some situations, a promise can be made to one person who is not expected to do anything in return. In this case, consideration necessary to weld the offer and acceptance into a legal contract can be given by a third party. A common example is sale to a minor. George promises to sell his automobile to Bartley, age seventeen, if Bartley's father will promise to pay $3,500 to George. Bartley is the promisee (the person to whom the promise is made) but not the offeree; Bartley cannot legally accept George's offer. Only Bartley's father, who is called on to pay for the car, can accept, by making the promise requested. And notice what might seem obvious: a *promise* to perform as requested in the offer is itself a binding acceptance.

WHEN IS ACCEPTANCE EFFECTIVE?

As noted previously, an **offer**, a **revocation** of the offer, and a rejection of the offer are not effective until received. However, the same rules will not apply when evaluating whether an acceptance is effective. When communications are instantaneous, such as in a face-to-face negotiation, the precise moment of acceptance is not in question. So, too, would be negotiations taking place over telephone or other means of communicating in real time such as Facetime, or Zoom. But disagreements can arise in contracts that are negotiated via means that are not in real time, such as via email.

Stipulations as to Acceptance

One common situation arises when the offeror stipulates the mode of **acceptance** (e.g., return mail, fax, or carrier pigeon). If the offeree uses the stipulated mode, then the acceptance is deemed effective when it is sent. Even though the offeror has no knowledge of the acceptance at that moment, the contract has been formed. Moreover, according to the Restatement, if the offeror says that the offer can be accepted only by the specified mode, that mode must be used or any acceptance by an alternative mode is invalid.

If the offeror specifies no particular mode, then acceptance is effective when transmitted, as long as

the offeree uses a reasonable method of acceptance. It is implied that the offeree can use the same means used by the offeror or a means of communication customary to the industry.

The "Mailbox Rule"

The use of the postal service is customary, so **acceptances** are considered effective when mailed, regardless of the method used to transmit the offer. In other words, under the **mailbox rule**, an acceptance is generally effective and binding on the parties at the moment it is sent or deposited in a mailbox.

The mailbox rule may seem to create particular difficulties for people in business. As the acceptance is effective when sent, the offeror is unaware of the acceptance. The offeror will eventually become aware of the acceptance when it is ultimately received, but that will be after the agreement is formed. It is even possible that the letter notifying the offeror of an acceptance is lost and never arrives. Despite this concern, the law recognizes that in contracts negotiated through correspondence, this burden will always fall to one of the parties. So, if the rule were that the acceptance is not effective until received by the offeror, then the offeree would not be able to rely on the existence of an agreement. As between the two, it seems fairer to place the burden on the offeror, since he or she alone has the power to fix the moment of effectiveness. All the offeror need do is specify in the offer that acceptance is not effective until received.

The mailbox rule eliminates an additional burden of acknowledging the acceptance in order for the agreement to become effective. But note that the offeree must use a mode of acceptance that is reasonable—acceptance is deemed effective only when received.

Acceptance "Outruns" Rejection

When the offeree sends a rejection first and then later transmits a superseding **acceptance**, the "effective when received" rule also applies. Suppose a seller offers a buyer two cords of firewood and says the offer will remain open for a week. On the third day, the buyer writes the seller, rejecting the offer. The following evening, the buyer rethinks his firewood needs, and on the morning of the fifth day, he sends an e-mail accepting the seller's terms. The previously mailed letter arrives the following day. Since the letter rejecting the offer had not yet been received, the offer had not been rejected. For there to be a valid contract, the e-mailed acceptance must arrive before the mailed rejection. If the e-mail were hung up in cyberspace, through no fault of the buyer, so that the letter arrived first, the seller would be correct in assuming the offer was terminated—even if the e-mail arrived a minute later. In short, where "the acceptance outruns the rejection" the acceptance is effective.

Figure 9.1– Summary of Rules for Timing of Offer and Acceptance

	When Sent	When Recieved
1. Offer		✓
2. Revocation of Offer		✓
3. Rejection		✓
4. Acceptance	If reasonable or by specified mode	If unreasonable or mode not specified or after rejection sent

ELECTRONIC COMMUNICATIONS

Electronic communications are increasingly common. Many contracts are negotiated by e-mail, accepted and "signed" electronically. Generally speaking, this does not change the rules. The **Uniform Electronic Transactions Act (UETA)** was promulgated (i.e., disseminated for states to adopt) in 1999. It is one of a number of uniform acts, like the Uniform Commercial Code. As of June 2010, forty-seven states and the U.S. Virgin Islands had adopted the statute. The introduction to the act provides that "the purpose of the UETA is to remove barriers to electronic commerce by validating and effectuating electronic records and signatures." In general, the UETA provides the following:

- A record or signature may not be denied legal effect or enforceability solely because it is in electronic form
- A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation
- If a law requires a record to be in writing, an electronic record satisfies the law
- If a law requires a signature, an electronic signature satisfies the law

The UETA, though, doesn't address all the problems with electronic contracting. Clicking on a computer screen may constitute a valid **acceptance** of a contractual **offer**, but only if the offer is clearly communicated. In *Specht v. Netscape Communications Corp.*, customers who had downloaded a free online computer program complained that it effectively invaded their privacy by inserting into their machines "cookies"; they wanted to sue, but the defendant said they were bound to arbitration. They had clicked on the Download button, but hidden below it were the licensing terms, including the arbitration clause. The federal court of appeals held that there was no valid acceptance. The court said, "We agree with the district court that a reasonably prudent Internet user in circumstances such as these would not have known or learned of the existence of the license terms before responding to defendants' invitation to download the free software, and that defendants therefore did not provide reasonable notice of the license terms. In consequence, the plaintiffs' bare act of downloading the software did not unambiguously manifest assent to the arbitration provision contained in the license terms."

If a faxed document is sent but for some reason not received or not noticed, the emerging law is that the **mailbox rule** does not apply. A court would examine the circumstances with care to determine the reason for the nonreceipt or for the offeror's failure to notice its receipt. A person has to have fair

notice that his or her offer has been accepted, and modern communication makes the old-fashioned mailbox rule—that acceptance is effective upon dispatch—problematic.

ACTIVITY 6A

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=104#h5p-26

SILENCE IS NOT ACCEPTANCE

Ordinarily, for there to be a contract, the **offeree** must make some positive manifestation of assent to the **offeror's** terms. The law does not impose on the offeree a duty to speak. Therefore, an offeror cannot usually word his offer in such a way that the offeree's failure to respond can be construed as an acceptance.

Exceptions

The Restatement recognizes three situations in which silence can operate as an **acceptance**. The first occurs when the offeree takes a benefit from the offeror and avails himself of services proffered by the offeror, even though he could have rejected them and had reason to know that the offeror offered them expecting compensation. The second situation occurs when the offer states that the offeree may accept without responding and the offeree, remaining silent, intends to accept. The intention of the offeree is key. The third situation is that of previous dealings, in which only if the offeree intends not to accept is it reasonable to expect him to say so. To illustrate these three exceptions, suppose Emma subscribes to a cloud-based software service, and her subscription is up for renewal. If Emma continues to use the software and benefits from it after the renewal without objecting to the fee or canceling the renewal, she has accepted taking the benefit. If the original terms of use and agreement between the parties explicitly state, "Your subscription will be automatically renewed after one year unless you notify us within 30 days that you wish to cancel," and Emma receives a notice about the renewal but doesn't respond or cancel her subscription within the specified timeframe, this is acceptance as allowed in the offer. Finally, if Emma has been using this software for several years, and every year the software company sends her a renewal notice with similar terms, and she has never canceled her subscription in the past, the software company would base Emma's acceptance on the history of their previous dealings.

CASE 6.3

Hobbs v. Massasoit Whip Co., 33 N.E. 495 (Mass. 1893)

HOLMES, J.

This is an action for the price of eel skins sent by the plaintiff to the defendant, and kept by the defendant some months, until they were destroyed. It must be taken that the plaintiff received no notice that the defendant declined to accept the skins. The case comes before us on exceptions to an instruction to the jury that, whether there was any prior contract or not, if skins are sent to the defendant, and it sees fit, whether it has agreed to take them or not, to lie back, and to say nothing, having reason to suppose that the man who has sent them believes that it is taking them, since it says nothing about it, then, if it fails to notify, the jury would be warranted in finding for the plaintiff.

Standing alone, and unexplained, this proposition might seem to imply that one stranger may impose a duty upon another, and make him a purchaser, in spite of himself, by sending goods to him, unless he will take the trouble, and bear the expense, of notifying the sender that he will not buy. The case was argued for the defendant on that interpretation. But, in view of the evidence, we do not understand that to have been the meaning of the judge and we do not think that the jury can have understood that to have been his meaning. The plaintiff was not a stranger to the defendant, even if there was no contract between them. He had sent eel skins in the same way four or five times before, and they had been accepted and paid for. On the defendant's testimony, it was fair to assume that if it had admitted the eel skins to be over 22 inches in length, and fit for its business, as the plaintiff testified and the jury found that they were, it would have accepted them; that this was understood by the plaintiff; and, indeed, that there was a standing offer to him for such skins.

In such a condition of things, the plaintiff was warranted in sending the defendant skins conforming to the requirements, and even if the offer was not such that the contract was made as soon as skins corresponding to its terms were sent, sending them did impose on the defendant a duty to act about them; and silence on its part, coupled with a retention of the skins for an unreasonable time, might be found by the jury to warrant the plaintiff in assuming that they were accepted, and thus to amount to an acceptance. [Citations] The proposition stands on the general principle that conduct which imports acceptance or assent is acceptance or assent, in the view of the law, whatever may have been the actual state of mind of the party—a principle sometimes lost sight of in the cases. [Citations]

Exceptions overruled.

Case questions

1. What is an eel, and why would anybody make a whip out of its skin?
2. Why did the court here deny the defendant's assertion that it never accepted the plaintiff's offer?

3. If it reasonably seems that silence is acceptance, does it make any difference what the offeree really intended?

ACTIVITY 6B

You be the Judge

In the early days of the internet, an internet services provider called America Online (AOL) dominated the market. One of its sales tactics was to use pop-up ads for products where it would directly bill its customers for those products a customer agreed to purchase by clicking a purchase button. The problem was that many people who received products at their doorstep – like digital cameras, digital CDs, printer fax/ machines, and even a "Gardening for Dummies" book – said they never agreed to purchase the products. Yet, they were charged and billed for their purchase. As you think about this situation, what are the pros and cons of silence as acceptance in relationship to this type of shopping experience. Should we have different rules of law to apply where one party has payment information from the other party, as AOL did for its customers, allowing for billing without an affirmative acceptance?

End of Chapter Exercises

1. Sarah's student apartment was unfurnished. She perused Doug's List, an online classified ad service (for nonmerchants), and saw this advertisement: "Moving. For sale: a very nice brown leather couch, almost new, $600." There was an accompanying photo and contact information. Sarah e-mailed the contact, saying she wanted to buy the couch. Does Sarah have a contract with the seller? Explain.
2. Seller called Buyer on the telephone and offered to sell his used stereo. Buyer agreed to buy it without asking the price. The next day Buyer changed her mind and attempted to back out of the agreement. Do the parties have a contract? Explain.
3. On August 1, Ernie wrote to Elsie offering to sell Elsie his car for $7,600, and he promised to hold the offer open for ten days. On August 4 Ernie changed his mind; he sent Elsie a letter revoking the offer. On August 5 Elsie e-mailed Ernie, accepting the offer. Ernie's letter of revocation arrived on August 6. Is there a contract? Explain.
4. On August 1 Grover visited a local electronics shop to purchase a new television. He saw one he

liked but wasn't sure if he could afford the $750. The store owner agreed to write up and sign an offer stating that it would be held open for ten days, which he did. On August 2 the owner changed his mind and sent Grover an e-mail revoking the offer, which Grover received immediately. On August 3 Grover sent a reply e-mail accepting the original offer. Is there a contract? Explain.

5. On November 26, Joe wrote to Kate offering to purchase a farm that she owned. Upon receiving the letter on November 28, Kate immediately sent Joe a letter of acceptance. However, shortly after mailing the letter, Kate had second thoughts and called Joe to advise him that she was rejecting his offer. The call was made before Joe received the letter of acceptance. Has a contract been formed? Why?
6. On a busy day just before April 15, Albert Accountant received a call from a local car dealer. The dealer said, "Hi, Mr. Accountant. Now, while you have income from doing clients' taxes, I have an excellent offer for you. You can buy a new Buick Century automobile completely loaded for $36,000. Al, I know you're busy. If I don't hear from you by the end of the day, I'll assume you want the car." Albert, distracted, did not respond immediately, and the dealer hung up. Then followed an exhausting day of working with anxiety-ridden tax clients. Albert forgot about the conversation. Two days later a statement arrived from the dealer, with instructions on how Albert should pick up the car at the dealership. Is there a contract? Explain.
7. Mr. and Mrs. Mitchell, the owners of a small secondhand store, attended an auction where they bought a used safe for $50. The safe, part of the Sumstad estate, had a locked compartment inside, a fact the auctioneer mentioned. After they bought the safe, the Mitchells had a locksmith open the interior compartment; it contained $32,000 in cash. The locksmith called the police, who impounded the safe, and a lawsuit ensued between the Mitchells and the Sumstadestate to determine the ownership of the cash. Who should get it, and why?
8. Ivan Mestrovic, an internationally renowned artist, and his wife lived for years in a house in Indiana. Ivan died in 1982. His widow remained in the house for some years; upon her death the contents of the house were willed to her children. When the Wilkens bought the house from the estate, it was very cluttered. A bank representative (the executor of the estate) said, "You can clean it yourself and keep whatever items you want, or we—as executor of Mrs. Mestrovic's estate—will hire a rubbish removal service to dispose of it." The Wilkens opted to clean it up themselves, and amid the mess, behind sofas and in odd closets, were six apparently valuable paintings by Mestrovic. The estate claimed them; the Wilkens claimed them. Who gets the paintings, and why?
9. David Kidd's dog bit Mikaila Sherrod. On June 14, 2010, the Kidds offered to settle for $32,000. On July 12 the Sherrods sued the Kidds. On July 20 the Kidds bumped their offer up to $34,000. The suit was subject to mandatory arbitration, which proceeded on April 28, 2011. On May 5 the arbitrator awarded the Sherrods $25,000. On May 9 the Sherrods wrote to the Kidds and purported to accept their last offer of $34,000, made the year before. The Sherrods' attorney moved to enforce that purported $34,000 "settlement agreement." The court concluded that the offer was properly accepted because it had not been withdrawn and entered judgment against the Kidds for $34,000. The Kiddsappealed. What result should they obtain on appeal, and why?
10. Acme Corporation sent the following letter, here set out in its entirety:

January 2, 2012

Acme Corporation

We hereby offer you 100 Acme golden widgets, size 6. This offer will be good for 10 days.

[Signed] Roberta Acme

Owner, Acme Corporation

Is this offer irrevocable for the time stated? Explain.

REFERENCES

Adams v. Lindsell, 1 Barnewall & Alderson 681 (K.B. 1818).

Barnes v. Treece, 549 P.2d 1152 (Wash. App. 1976).

Clow Water Systems Co. v. National Labor Relations Board, 92 F.3d 441 (6th Cir. 1996).

Did AOL send bogus bills? (2002). CNET. https://www.cnet.com/tech/services-and-software/did-aol-send-bogus-bills/

Restatement (Second) of Contracts, Section 24.

Sherrod ex rel. Cantone v. Kidd, 155 P.3d 976 (Wash. Ct. App., 2007).

Specht v. Netscape Communications Corp., 306 F.3d 17 (2d Cir. 2002).

Uniform Commercial Code, Section 1-201(3).

Uniform Commercial Code, Section 2-204(1).

Uniform Commercial Code, Sections 2-305 through 2-310.

Uniform Commercial Code, Section 3.

Samuel Williston, "Freedom of Contract," *Cornell Law Quarterly* 6 (1921), 365.

CHAPTER 7 - CONSIDERATION

Learning Objectives

After studying this chapter, you should be able to:

1. Define consideration.
2. Describe the requirements of consideration.
3. Explain why some attempts to contract lack consideration.
4. Identify exceptions to the requirement of consideration.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=54#h5p-14

7.1 GENERAL PERSPECTIVES ON CONSIDERATION

INTRODUCTION TO CONSIDERATION

Consideration is the main element of a contract and a fundamental principle in contract law. It refers to the exchange of something of value, often money or a promise, between the parties to a contract. In order for a contract to be legally binding, there must be consideration.

Practically speaking, consideration is important in a contract for several reasons. First, it ensures that both parties have something at stake in the agreement. When both parties are required to give something up, they are more likely to take the contract seriously and fulfill their obligations. Being invested in the outcome of a contract helps to prevent a breach of contract while providing a sense of security in the contract to both parties.

Second, consideration reinforces the intention of the parties to be legally bound. In the prior Chapter on Agreement, we learned that the intention to be bound to a contract is an essential element of the offer. When each party gives up something of value for consideration, it demonstrates that they are serious about the agreement and that they intend to be legally bound by it.

Finally, consideration helps ensure that the terms of a contract are fair and reasonable. Assuring that

consideration is present in a contract helps prevent situations where one party is taking advantage of another contracting party.

In this Chapter, we will assume that an agreement has been reached, that there is offer and acceptance, and learn how to identify the existence of consideration.

Which of the following examples best illustrates a scenario where there is consideration?

1. Betty offers to give a book to Lou. Lou accepts.
2. Betty offers Lou the book in exchange for Lou's promise to pay twenty-five dollars. Lou accepts.
3. Betty offers to give Lou the book if Lou promises to pick it up at Betty's house. Lou agrees.

If you recognized that only the second situation contains consideration, you are correct. Scenario two is the only scenario where each party is exchanging something of value with the other party. This best illustrates the concept of consideration which is a set of promises in which each party agrees to give up something to the benefit of the other. This Chapter will explore the meaning and rationale of that statement.

HISTORICAL PERSPECTIVE

The question of what constitutes a binding contract has been answered differently throughout history and in other cultures. For example, under Roman law, a contract without consideration was binding if certain formal requirements were met. And in the Anglo-American tradition, the presence of a seal—the wax impression affixed to a document—was once sufficient to make a contract binding without any other consideration. The seal is no longer a substitute for consideration, although in some states it creates a presumption of consideration; in forty-nine states, the **Uniform Commercial Code (UCC)** has abolished the seal on contracts for the sale of goods. (Louisiana has not adopted UCC Article 2.)

Whatever its original historical purposes, and however apparently arcane, the doctrine of consideration serves some still-useful purposes. It provides objective evidence for asserting that a contract exists; it distinguishes between enforceable and unenforceable bargains; and it is a check against rash, unconsidered action, against thoughtless promise making.

7.2 REQUIREMENTS OF CONSIDERATION

Consideration is said to exist when the **promisor** receives some benefit for his promise and the **promisee** gives up something in return; it is the bargained-for price you pay for what you get. In a simple transaction, working with such a definition may be enough to recognize the consideration in an agreement, or whether that agreement lacks consideration. Business transactions are not always simple, though, which is why it is helpful to break down the concept of consideration into requirements or elements.

Consideration can come in many forms of **legal value**. A common type of consideration in a contract is money. When money is exchanged, the person receiving the money is enriched, quite literally, while the other person gives up the money, an item of value. Other common types of legal value that can

support consideration are a promise ("I promise to sell you my car") or an action (I mow your lawn). Less usual forms of consideration include promising to give up a legal right, called forbearance ("I promise to give up drinking until I am 25"), and the creation or change in a legal relationship. If I represent you in court, I've become your lawyer. This legal relationship has legal value, even if I've taken the case *pro bono* (Latin for *free*).

Once the legal value is identified, the next element is legal sufficiency. **Legal sufficiency** is the identification of the legal detriments in a contract – an action, forbearance, or a promise of such from the promisee. The detriment need not be an actual detriment; it may in fact be a benefit to the promisee, or at least not a loss. For instance, a teacher may find teaching students to be the very best job in the universe, but for purposes of their contract to teach with the school that has hired them, teaching is an action that the promisee must take and therefore is a legal detriment.

The detriment to one side is usually a legal benefit to the other, but the detriment to the promisee need not confer a tangible benefit on the promisor; the promisee can agree to forego something without that something being given to the promisor. For example, if Anjali offers a $100 prize to the first person to win a race, the $100 prize is Anjali's legal detriment. The winner of the race will receive a benefit, but it doesn't matter if that win does not return a tangible benefit to Anjali. There is still legal sufficiency as a result of Anjali's promise.

For a final example, suppose Phil offers George $500 if George will quit smoking for one year. Is Phil's promise binding? Because George is presumably benefiting by making and sticking to the agreement—surely his health will improve if he gives up smoking—you might wonder how this act is considered a legal detriment. There is the legal value of forbearance on George's part: George is legally entitled to smoke, and by contracting not to, he suffers a loss of his legal right to do so. The loss of this legal right is the detriment; consideration does not require a tangible detriment.

A requirement in a contract is the exchange of a legal detriment and a legal benefit; if that happens, the consideration is said to have legal sufficiency.

Whether consideration is legally sufficient has nothing to do with whether it is morally or economically adequate to make the bargain a fair one. Yet to be enforceable, consideration must arise from a **bargained-for exchange**. In other words, we must evaluate whether the legal detriment was bargained for: did the promisor specifically intend the act, forbearance, or promise in return for his promise? Applying this two-pronged test to the three scenarios given at the outset of this Chapter, we can see why only the second scenario has legally sufficient consideration. In the first, Lou incurred no legal detriment; he made no pledge to act or to forbear from acting, nor did he in fact act or forbear from acting. In the third scenario, what might appear to be a promise is not really so. Betty made a promise on a condition that Lou come to her house; the intent clearly is to make a gift.

ACTIVITY 7A

Case Debate: Should forbearance have value?

When William Story II was a teenager, his uncle (William Story I) promised to pay the teen $5000 to abstain from drinking, using tobacco, swearing, or gambling until he turned 21. Story II grew up in the 1800s, so at that time there were no age restrictions on any of these activities. After many years of NOT drinking, NOT using tobacco, NOT swearing, and NOT gambling, Plaintiff sought the promised money from the Uncle's Estate after his passing. The Estate representatives argued that the Uncle derived no benefit and Story was better off for never having participated in such vices.

This is the case of *Hamer v. Sidway*, 27 N.E. 256 (1891), which is featured in many legal classes because how the case was decided still surprises students of law. While this particular case found for the Plaintiff and awarded the money on the principle of forbearance, some legal scholars are skeptical that NOT taking action should amount to valid consideration.

Question: What are some of the reasons why it make sense that forbearance has legal value? In what ways is forbearance similar to other types of consideration? Can you think of an example using forbearance as consideration which makes common sense?

Question: What are some of the reasons why it does not make sense for forbearance to have legal value? In what ways is forbearance different than the other types of consideration? Can you think of an example using forbearance as consideration which does not make common sense?

Question: Consider both sides of the debate about forbearance and whether it indeed has legal value. If you were a judge, would you want to change the requirements for consideration in any way after considering this case?

It is also essential that consideration be adequate. Ordinarily, courts don't question the equivalency of an exchange. This makes it is possible to sell a highly valued item, such as a house, for a small amount of money, say $1.00. Courts will only review the **adequacy of consideration** when there is a suggestion that an imbalance in consideration has resulted from factors that call into question the fairness of the entire transaction – such as an extreme difference in the bargaining power of the parties.

Scrooge offers to buy Caspar's motorcycle, worth $700, for $10 and a shiny new fountain pen (worth $5). Caspar agrees. This agreement is supported by adequate because both have agreed to give up something that is theirs: Scrooge, the cash and the pen; Caspar, the motorcycle. As Judge Richard A. Posner puts it, "To ask whether there is consideration is simply to inquire whether the situation is one of exchange and a bargain has been struck. To go further and ask whether the consideration is adequate would require the court to do what…it is less well equipped to do than the parties—decide whether the price (and other essential terms) specified in the contract are reasonable." In short, "courts do not inquire into the adequacy of consideration."

Of course, one-sided deals like the one above are not the norm, but there are contracts that make use of nominal consideration. For instance, when one party wants to give another party a gift, but wants to do so in such a way that the rights of contract attach to that gift, perhaps they will agree to exchange the item being gifted for $1.00. Another such contract is the option contract, where one party agrees to hold open the right of the other to make a purchase on agreed terms, and nominal consideration like $1.00 is exchanged for that right.

CASE 7.1

Board of Control of Eastern Michigan University v. Burgess, 206 N.W.2d 256 (Mich. 1973)

BURNS, J.

On February 15, 1966, defendant signed a document which purported to grant to plaintiff a 60-day option to purchase defendant's home. That document, which was drafted by plaintiff's agent, acknowledged receipt by defendant of "One and no/100 ($1.00) Dollar and other valuable consideration." Plaintiff concedes that neither the one dollar nor any other consideration was ever paid or even tendered to defendant. On April 14, 1966, plaintiff delivered to defendant written notice of its intention to exercise the option. On the closing date defendant rejected plaintiff's tender of the purchase price. Thereupon, plaintiff commenced this action for specific performance.

At trial defendant claimed that the purported option was void for want of consideration, that any underlying offer by defendant had been revoked prior to acceptance by plaintiff, and that the agreed purchase price was the product of fraud and mutual mistake. The trial judge concluded that no fraud was involved, and that any mutual mistake was not material. He also held that defendant's acknowledgment of receipt of consideration bars any subsequent contention to the contrary. Accordingly, the trial judge entered judgment for plaintiff.

Options for the purchase of land, if based on valid consideration, are contracts which may be specifically enforced. [Citations] Conversely, that which purports to be an option, but which is not based on valid consideration, is not a contract and will not be enforced. [Citations] One dollar is valid consideration for an option to purchase land, provided the dollar is paid or at least tendered. [Citations] In the instant case defendant received no consideration for the purported option of February 15, 1966.

A written acknowledgment of receipt of consideration merely creates a rebuttable presumption that consideration has, in fact, passed. Neither the **parol evidence rule** nor the doctrine of estoppel bars the presentation of evidence to contradict any such acknowledgment. [Citation]

It is our opinion that the document signed by defendant on February 15, 1966, is not an enforceable option, and that defendant is not barred from so asserting.

The trial court premised its holding to the contrary on *Lawrence v. McCalmont*…(1844). That case is significantly distinguishable from the instant case. Mr. Justice Story held that '(t)he guarantor acknowledged the receipt of one dollar, and is now estopped to deny it.' However, in reliance upon the guaranty substantial credit had been extended to the guarantor's sons. The guarantor had received everything she bargained for, save one dollar. In the instant case defendant claims that she never received any of the consideration promised her.

That which purports to be an option for the purchase of land, but which is not based on valid consideration, is a simple offer to sell the same land. [Citation] An option is a contract collateral to an offer to sell whereby the offer is made irrevocable for a specified period. [Citation] Ordinarily, an offer is revocable at the will of the offeror. Accordingly, a failure of consideration affects only the collateral contract to keep the offer open, not the underlying offer.

A simple offer may be revoked for any reason or for no reason by the offeror at any time prior to its

acceptance by the offeree. [Citation] Thus, the question in this case becomes, 'Did defendant effectively revoke her offer to sell before plaintiff accepted that offer?'…

Defendant testified that within hours of signing the purported option she telephoned plaintiff's agent and informed him that she would not abide by the option unless the purchase price was increased. Defendant also testified that when plaintiff's agent delivered to her on April 14, 1966, plaintiff's notice of its intention to exercise the purported option, she told him that 'the option was off'.

Plaintiff's agent testified that defendant did not communicate to him any dissatisfaction until sometime in July, 1966.

If defendant is telling the truth, she effectively revoked her offer several weeks before plaintiff accepted that offer, and no contract of sale was created. If plaintiff's agent is telling the truth, defendant's offer was still open when plaintiff accepted that offer, and an enforceable contract was created. The trial judge thought it unnecessary to resolve this particular dispute. In light of our holding the dispute must be resolved.

An appellate court cannot assess the credibility of witnesses. We have neither seen nor heard them testify. [Citation] Accordingly, we remand this case to the trial court for additional findings of fact based on the record already before the court.…

Reversed and remanded for proceedings consistent with this opinion. Costs to defendant.

Case questions

1. Why did the lower court decide the option given by the defendant was valid?
2. Why did the appeals court find the option invalid?
3. The case was remanded. On retrial, how could the plaintiff (the university) still win?
4. It was not disputed that the defendant signed the purported option. Is it right that she should get out of it merely because she didn't really get the $1.00?

CONSIDERATION REQUIRED FOR CONTRACT MODIFICATION

Just as **consideration** is required for a **valid contract**, consideration is generally required for a modification of a contract to be legally binding. When parties want to modify an existing contract, the modification itself is treated as a new agreement. This means that the same principles that apply to the formation of a new contract, including the requirement of consideration, also apply to contract modifications.

In simple terms, if one party is seeking a modification to the contract, they typically need to offer something of value to the other party in exchange for the modification. Without consideration, the modification may not be enforceable, and the parties might not be legally obligated to follow through with the changes.

For example, a contract with a catering company to provide food and services for a corporate event states that the company will provide a buffet dinner for 100 people at a cost of $5,000. A week before the event the number of guests attending rise to 150 people. Since this is a much larger number, a contract modification is necessary.

The modification would involve an increase in the number of guests and additional costs for food, drinks, and staffing. The catering company agrees to the modification but requests an increase in the contract price to $7,000 to cover the extra expenses.

The breakdown of modifications in consideration in this example is:

- The corporation holding the event offers new consideration of the higher payment ($7,000) to the catering company in exchange for their agreement to provide services for 150 people instead of the original 100.
- The catering company is providing the consideration of providing services for 150 people instead of the original 100, as well as adjusting their preparations and staffing to accommodate the larger event.

This exchange of consideration makes the modified contract legally binding and enforceable.

CASE 7.2

Gross v. Diehl Specialties International, Inc., 776 S.W.2d 879 (Missouri Ct. App. 1989)

SMITH, J.

Plaintiff appeals from a jury verdict and resultant judgment for defendant in a breach of employment contract case.…

Plaintiff was employed under a fifteen year employment contract originally executed in 1977 between plaintiff and defendant. Defendant, at that time called Dairy Specialties, Inc., was a company in the business of formulating ingredients to produce non-dairy products for use by customers allergic to cow's milk. Plaintiff successfully formulated [Vitamite]…for that usage.

Thereafter, on August 24, 1977, plaintiff and defendant corporation entered into an employment contract employing plaintiff as general manager of defendant for fifteen years. Compensation was established at $14,400 annually plus cost of living increases. In addition, when 10% of defendant's gross profits exceeded the annual salary, plaintiff would receive an additional amount of compensation equal to the difference between his compensation and 10% of the gross profits for such year. On top of that plaintiff was to receive a royalty for the use of each of his inventions and formulae of 1% of the selling price of all of the products produced by defendant using one or more of plaintiff's inventions or formulae during the term of the agreement. That amount was increased to 2% of the selling price following the term of the agreement. The contract further provided that during the term of the agreement the inventions and formulae would be owned equally by plaintiff and defendant and that following the term of the agreement the ownership

would revert to plaintiff. During the term of the agreement defendant had exclusive rights to use of the inventions and formulae and after the term of agreement a non-exclusive right of use.

At the time of the execution of the contract, sales had risen from virtually nothing in 1976 to $750,000 annually from sales of Vitamite and a chocolate flavored product formulated by plaintiff called Chocolite. [Dairy's owner] was in declining health and in 1982 desired to sell his company. At that time yearly sales were $7,500,000. [Owner] sold the company to the Diehl family enterprises for 3 million dollars.

Prior to sale Diehl insisted that a new contract between plaintiff and defendant be executed or Diehl would substantially reduce the amount to be paid for [the company]. A new contract was executed August 24, 1982. It reduced the expressed term of the contract to 10 years, which provided the same expiration date as the prior contract. It maintained the same base salary of $14,400 effective September 1982, thereby eliminating any cost of living increases incurred since the original contract. The 10% of gross profit provision remained the same. The new contract provided that plaintiff's inventions and formula were exclusively owned by defendant during the term of the contract and after its termination. The 1% royalty during the term of the agreement remained the same, but no royalties were provided for after the term of the agreement. No other changes were made in the agreement. Plaintiff received no compensation for executing the new contract. He was not a party to the sale of the company by [Owner] and received nothing tangible from that sale.

After the sale plaintiff was given the title and responsibilities of president of defendant with additional duties but no additional compensation. In 1983 and 1984 the business of the company declined severely and in October 1984, plaintiff's employment with defendant was terminated by defendant. This suit followed.…

We turn now to the court's holding that the 1982 agreement was the operative contract. Plaintiff contends this holding is erroneous because there existed no consideration for the 1982 agreement. We agree. A modification of a contract constitutes the making of a new contract and such new contract must be supported by consideration. [Citation] Where a contract has not been fully performed at the time of the new agreement, the substitution of a new provision, resulting in a modification of the obligations on both sides, for a provision in the old contract still unperformed is sufficient consideration for the new contract. While consideration may consist of either a detriment to the promisee or a benefit to the promisor, a promise to carry out an already existing contractual duty does not constitute consideration. [Citation]

Under the 1982 contract defendant assumed no detriment it did not already have. The term of the contract expired on the same date under both contracts. Defendant undertook no greater obligations than it already had. Plaintiff on the other hand received less than he had under the original contract. His base pay was reduced back to its amount in 1977 despite the provision in the 1977 contract for cost of living adjustments. He lost his equal ownership in his formulae during the term of the agreement and his exclusive ownership after the termination of the agreement. He lost all royalties after termination of the agreement and the right to use and license the formulae subject to defendant's right to non-exclusive use upon payment of royalties. In exchange for nothing, defendant acquired exclusive ownership of the formulae during and after the agreement, eliminated royalties after the agreement terminated, turned its non-exclusive use after termination into exclusive use and control, and achieved a reduction in plaintiff's base salary. Defendant did no more than promise to carry out an already existing contractual duty. There was no consideration for the 1982 agreement.

Defendant asserts that consideration flowed to plaintiff because the purchase of defendant by the Diehls might not have occurred without the agreement and the purchase provided plaintiff with continued

employment and a financially viable employer. There is no evidence to support this contention. Plaintiff had continued employment with the same employer under the 1977 agreement. Nothing in the 1982 agreement provided for any additional financial protection to plaintiff. The essence of defendant's position is that [the owner] received more from his sale of the company because of the new agreement than he would have without it. We have difficulty converting [the owner's] windfall into a benefit to plaintiff.

[Remanded to determine how much plaintiff should receive.]

Case questions

1. Why did the court determine that Plaintiff's postemployment benefits should revert to those in his original contract instead being limited to those in the modified contract?
2. What argument did Defendant make as to why the terms of the modified contract should be valid?

COMMON ISSUES IN CONSIDERATION

Now that you are aware of the requirements of **consideration** it is possible to use this knowledge to identify situations were there is a lack of consideration. This section discusses some common situations that may appear to have consideration but when critically analyzed are lacking an important requirement of consideration.

The problem of **preexisting duty** in consideration arises when a party to a contract promises to do something that they are already legally obligated to do. This means that the promise does not represent new consideration, as the party was already obligated to do it anyway. Offering a preexisting duty as consideration lacks legal detriment.

For example, a construction company agrees to build a house for a client for $100,000. Midway through the project, the client requests changes to the design that were not part of the original contract. The construction company agrees to make the changes, but afterward demands an additional $20,000 for the work. In this case, the construction company has a preexisting duty to fulfill their original contract and cannot use the additional work as new consideration. Therefore, the promise of the additional work in exchange for the extra payment will not be enforced since there is no new consideration to support it.

The problem of preexisting duty in consideration can also arise in situations where a party to a contract promises to do something they are already legally obligated to do, but under different terms. For example, if an employee is already obligated to perform certain duties as part of their job, a client cannot offer them additional compensation in exchange for doing those same duties. This is because the employee already had a preexisting duty to do the work as part of their original employment

contract. Similarly, a police officer in your community cannot charge you a weekly fee to patrol your neighborhood if your neighborhood is already part of the same beat.

Where a person is promised a benefit not to do that which he is already disallowed from doing, there is no consideration due to preexisting duty. David is sixteen years old; his uncle promises him $50 if he will refrain from smoking. The promise is not enforceable: legally, David already must refrain from smoking, so he has promised to give up nothing to which he had a legal right. This promise therefore lacked **legal sufficiency**.

CASE 7.3

Denney v. Reppert, 432 S.W.2d 647 (Ky. 1968)

R. L. MYRE, Sr., Special Commissioner.

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

On June 12th or 13th, 1963, three armed men entered the First State Bank, Eubank, Kentucky, and with a display of arms and threats robbed the bank of over $30,000 [about $302,000 in 2024 dollars]. Later in the day they were apprehended by State Policemen Garret Godby, Johnny Simms and Tilford Reppert, placed under arrest, and the entire loot was recovered. Later all of the prisoners were convicted and Garret Godby, Johnny Simms and Tilford Reppert appeared as witnesses at the trial.

The First State Bank of Eubank was a member of the Kentucky Bankers Association which provided and advertised a reward of $500.00 for the arrest and conviction of each bank robber. Hence the outstanding reward for the three bank robbers was $1,500.00 [about $15,000 in 2024 dollars]. Many became claimants for the reward and the Kentucky State Bankers Association being unable to determine the merits of the claims for the reward asked the circuit court to determine the merits of the various claims and to adjudge who was entitled to receive the reward or share in it. All of the claimants were made defendants in the action.

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

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

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

employees and public officials who are acting within the scope of their employment or official duties. * * *'.…

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

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

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

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

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

It is manifest from the record that Tilford Reppert is the only claimant qualified and eligible to receive the reward. Therefore, it is the judgment of the circuit court that he is entitled to receive payment of the $1,500.00 reward now deposited with the Clerk of this Court.

The judgment is affirmed.

Case questions

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

Past consideration is not sufficient to support a promise as it lacks legal sufficiency. The problem of past consideration arises when one party promises to pay or provide something in exchange for something that the other party has already done in the past. In other words, the promise is based on an act that has already been performed outside of any contractual agreement and cannot be exchanged for anything in the future.

For example, imagine that John mows his neighbor's lawn every week for a month without any agreement of payment. At the end of the month, the neighbor promises to pay John $100 for his work. However, the neighbor cannot enforce the promise because John's work was already performed before the promise was made. This means that John's legal detriment was in the past – it cannot serve as consideration in a contract entered today. The lawn mowing was an act of past consideration and cannot be exchanged for something in the future.

An **illusory promise** is a statement that appears to be a promise, but in reality, it does not actually impose any obligation on the person making the statement and, therefore, lacks legal sufficiency. In the context of contract law, an illusory promise is not considered to be valid consideration. Not every promise is a pledge to do something.

For example, if Lydia says "I promise to sell you my car if I feel like it," that statement is an illusory promise because it does not create a binding commitment to sell the car. By doing nothing Lydia still falls within the literal wording of her promise. Since the promise has no certain legal detriment, it cannot be considered valid consideration for a contract because it is not a true commitment.

The doctrine that such bargains are void is sometimes referred to as the rule of **mutuality of obligation**: if one party to a contract has not made a binding obligation, neither is the other party bound. Thus, if A contracts to hire B for a year at $6,000 a month, reserving the right to dismiss B at any time (an "option to cancel" clause), and B agrees to work for a year, A has not really promised anything; A is not bound to the agreement, and neither is B.

A promise to refrain from suing someone in return for the settlement of a legal dispute is called a **covenant not to sue**. The **legal value** in such a covenant is **forbearance** – giving up the legal right to sue for redress in the Courts, in exchange for the agreed upon settlement of a dispute. Ordinarily, these agreements will have legal sufficiency and **adequacy of consideration**. It is possible, however, for a situation to arise in which this would not represent a fair bargain, such as where there is coercion to sign such an agreement. In that case, there would still be legal sufficiency, but the agreement would lack of adequacy of consideration as it was not the product of a fair bargain.

ACCORD AND SATISFACTION GENERALLY

Sometimes, the parties to an ongoing contract may dispute the meaning of its terms and conditions, especially the amount of money actually due. When the dispute is genuine (and not the unjustified attempt of one party to avoid paying a sum clearly due), it can be settled by the parties' agreement on a fixed sum as the amount due. This second agreement, which substitutes for the disputed original agreement, is called an accord, and when the payment or other term is discharged, the accord is said to be satisfied. Therefore, this process is known as **accord and satisfaction**.

Lilac owes $1,000 to Juniper for services provided. Lilac is unable to pay the full amount owed. If

Juniper agrees to accept $750 as full payment in return for Lilac paying that amount today, this is an accord. When Lilac pays the $750 today, the accord is satisfied, and the original contract is discharged. Juniper's agreement to accept less than the original contract required for payment is a detriment of forbearance. Lilac's promise to make payment earlier than would have been required under the original contract is also a legal detriment. Both promises, therefore, have **legal sufficiency**.

It's important to note that an accord and satisfaction must be made in good faith, meaning that both parties must enter into the agreement voluntarily and with a genuine intent to settle the debt or dispute. If either party feels pressured or coerced into the agreement, it may not be considered valid.

The dispute that gives rise to the parties' agreement to settle by an accord and satisfaction may come up in several typical ways: where there is an unliquidated debt; a disputed debt; an "in-full-payment check" for less than what the creditor claims is due; unforeseen difficulties that give rise to a contract modification, or a **novation**; or a composition among creditors. But no obligation ever arises—and no real legal dispute can arise—where a person promises a benefit if someone will do that which he has a preexisting obligation to, or where a person promises a benefit to someone not to do that which the promisee is already disallowed from doing, or where one makes an **illusory promise**.

SETTLING AN UNLIQUIDATED DEBT

An unliquidated debt is one that is uncertain in amount. Such debts frequently occur when people consult professionals in whose offices precise fees are rarely discussed, or where one party agrees, expressly or by implication, to pay the customary or reasonable fees of the other without fixing the exact amount. It is certain that a debt is owed, but it is not certain how much.

Assume a patient goes to the hospital for a gallbladder operation. The cost of the operation has not been discussed beforehand in detail, although the cost in the metropolitan area is normally around $8,000. After the operation, the patient and the surgeon agree on a bill of $6,000. The patient pays the bill; a month later the surgeon sues for another $2,000. The patient will not have to pay the additional $2,000 as the original unliquidated debt was settled with the bill of $6,000. The agreement liquidating the debt (i.e. converting the uncertain debt to a fixed amount) is an accord and is enforceable. If instead the patient and the surgeon had agreed on an $8,000 fee before the operation, and if the patient arbitrarily refused to pay this liquidated debt unless the surgeon agreed to cut her fee in half, then the surgeon would be entitled to recover the other half in a lawsuit, because the patient would have given no consideration—given up nothing, "suffered no detriment"—for the surgeon's subsequent agreement to cut the fee.

SETTLING A DISPUTED DEBT

A disputed debt arises where the parties did agree on (liquidated) the price or fee but subsequently get into a dispute about its fairness, and then settle. When this dispute is settled, the parties have given consideration to an agreement to accept a fixed sum as payment for the amount due. Assume that in the gallbladder case the patient agrees in advance to pay $8,000. Eight months after the operation and as a result of nausea and vomiting spells, the patient must undergo a second operation; the surgeons discover a surgical sponge embedded in the patient's intestine. The patient refuses to pay the full sum of the original surgeon's bill; they settle on $6,000, which the patient pays. This is a binding agreement

because subsequent facts arose to make legitimate the patient's quarrel over his obligation to pay the full bill. As long as the dispute is based in fact and is not trumped up, as long as the promisee is acting in good faith, then consideration is present when a disputed debt is settled.

THE "IN-FULL-PAYMENT" CHECK SITUATION

To discharge his liquidated debt for $8,000 to the surgeon, the patient sends a check for $6,000 marked "payment in full." The surgeon cashes it and there is no dispute about the amount owed. In this case, the surgeon is still entitled to the remaining $2,000. At first glance, it may appear that the surgeon is agreeing to take the reduced amount by cashing the check. However, there is no **legal sufficiency** here. Because the surgeon is owed more than the face amount of the check, the surgeon causes the patient no legal detriment by accepting the check.

The key to the enforceability of a "payment in full" legend on the check is the character of the debt. If unliquidated, or if there is a dispute, then "payment in full" can serve as **accord and satisfaction** when written on a check that is accepted for payment by a creditor. But if the debt is liquidated and undisputed, there is no **consideration** when the check is for a lesser amount.

UNFORESEEN DIFFICULTIES

An **unforeseen difficulty** arising after a contract is made may be resolved by an **accord and satisfaction**, too. Difficulties that no one could foresee can sometimes serve as catalyst for a further promise that may appear to be without **consideration** but that the courts will enforce nevertheless. Suppose Peter contracts to build Jerry a house for $390,000. While excavating, Peter unexpectedly discovers quicksand, the removal of which will cost an additional $10,000. To ensure that Peter does not delay, Jerry promises to pay Peter $10,000 more than originally agreed. But when the house is completed, Jerry reneges on his promise. In such a situation, most courts would allow Peter to recover on the theory that the original contract was terminated, or modified, either by mutual agreement or by an implied condition that the original contract would be discharged if unforeseen difficulties developed. In short, the courts will enforce the parties' own mutual recognition that the unforeseen conditions had made the old contract unfair. The parties either have modified their original contract (which requires consideration at common law) or have given up their original contract and made a new one (a **novation**).

It is a question of fact whether the new circumstance is new and difficult enough to make a preexisting obligation into an unforeseen difficulty. Obviously, if Peter encounters only a small pocket of quicksand—say two gallons' worth—he would have to deal with it as part of his already-agreed-to job. If he encounters as much quicksand as would fill an Olympic-sized swimming pool, that's clearly new and unforeseen, and he should get extra to deal with it. Someplace between the two quantities of quicksand there is enough difficulty that Peter's duty to remove it is outside the original agreement and new consideration would be needed in exchange for its removal.

CREDITORS' COMPOSITION

A creditors' composition may give rise to debt settlement by an **accord and satisfaction**. This is an agreement whereby two or more creditors of a debtor consent to the debtor paying them pro rata shares of the debt due in full satisfaction of their claims. A composition agreement can be critically

important to a business in trouble; through it, the business might manage to stave off **bankruptcy**. Even though the share accepted is less than the full amount due and is payable after the due date so that **consideration** appears to be lacking, courts routinely enforce these agreements. The promise of each creditor to accept a lesser share than that owed in return for getting something is taken as consideration to support the promises of the others. A debtor has $3,000 on hand. He owes $3,000 each to A, B, and C. A, B, and C agree to accept $1,000 each and discharge the debtor. Each creditor has given up $2,000 but in return has at least received something, the $1,000. Without the composition, one might have received the entire amount owed her, but the others would have received nothing.

EXCLUSIVE DEALING AGREEMENT

In an exclusive dealing agreement, one party (the franchisor) promises to deal solely with the other party (the franchisee)—for example, a franchisor-designer agrees to sell all of her specially designed clothes to a particular department store (the franchisee). In return, the store promises to pay a certain percentage of the sales to the designer. On closer inspection, it may appear that the store's promise is **illusory**: it pays the designer only if it manages to sell dresses, but it may sell none. The franchisor-designer may therefore attempt to back out of the deal by arguing that because the franchisee is not obligated to do anything, there was no **consideration** for her promise to deal exclusively with the store.

Courts, however, have upheld exclusive dealing contracts on the theory that the franchisee has an obligation to use reasonable efforts to promote and sell the product or services.

The UCC follows the same rule. In the absence of language specifically delineating the seller's or buyer's duties, an exclusive dealing contract under Section 2-306(2) imposes "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."

OUTPUTS CONTRACTS AND NEEDS CONTRACTS

An **output contract** and a **needs contract** are two types of contracts that are commonly used in business transactions. When analyzing these types of contracts, it is important to read into them a requirement of reasonableness so that they have **legal sufficiency**.

An output contract is a contract in which one party agrees to sell all of the goods or services that they produce to the other party. The quantity of goods or services is not predetermined or fixed, but rather depends on the seller's output. The buyer agrees to purchase all of the seller's output, and the seller agrees to sell all of their output to the buyer. Output contracts are commonly used in industries where the output of one party is critical to the operations of the other party, such as in manufacturing or agriculture.

For example, a farmer may enter into an output contract with a food processing company, in which the farmer agrees to sell all of their wheat crop to the processing company, and the processing company agrees to buy all of the wheat that the farmer produces.

A needs contract is a contract in which one party agrees to purchase all of their goods or services from the other party. The quantity of goods or services is not predetermined or fixed, but rather depends on the buyer's needs. The seller agrees to provide all of the goods or services that the buyer requires,

and the buyer agrees to purchase all of their goods or services from the seller. Needs contracts are commonly used in industries where the buyer has a continuous need for a particular product or service, such as in healthcare or utilities.

For example, a hospital may enter into a needs contract with a medical supply company, in which the hospital agrees to purchase all of their medical supplies from the supply company, and the supply company agrees to provide all of the medical supplies that the hospital requires.

7.3 PROMISES ENFORCEABLE WITHOUT CONSIDERATION

For a variety of policy reasons, courts will enforce certain types of promises even though **consideration** may be absent. Some of these are governed by the UCC; others are part of the established common law and promote public policy.

PROMISE REVIVED AFTER STATUTE OF LIMITATIONS HAS PASSED

A **statute of limitations** is a law which sets the maximum period of time which one can wait before filing a lawsuit. In many states a contract claim must be brought within six years; if the plaintiff waits longer than that, the claim will be dismissed regardless of its merits. When the time period set forth in the statute of limitations has lapsed, the statute is said to have "run." If a person renews a promise to pay or acknowledges a debt after the running of a statute of limitations, then under the common law the new promise to pay is binding, although there is no **consideration** in the usual sense. In many states, this new promise or acknowledgment must be in writing and signed by the person with the debt. Some courts have determined that if a person makes a partial payment after the statute has run, a promise to pay or acknowledgment of a debt has been implied.

VOIDABLE DUTIES

Some promises that might otherwise serve as **consideration** are voidable by the promisor for a variety of reasons, including infancy, fraud, duress, or mistake. But a **voidable contract** does not automatically become void, and if the promisor has not avoided the contract but instead thereafter renews his promise, it is binding. For example, Mr. Melvin sells his bicycle to Seth, who is age thirteen and legally an infant. Seth promises to pay Mr. Melvin one hundred dollars. Seth may disaffirm the contract until he reaches the age of majority, but he does not. When Seth turns eighteen, he renews his promise to pay the one hundred dollars to Mr. Melvin. This promise is binding.

CHARITABLE CONTRIBUTIONS

A charitable contribution is a promise to donate money to a charity. Recognizing the necessity to charitable institutions of such pledges, the courts have also been mindful that a mere pledge of money to the general funds of a hospital, university, or similar institution does not usually induce substantial action but rather a promise without **consideration**. Generally, these promises are enforceable even if they lack consideration. As a matter of public policy, enforcing these contracts without consideration promotes the charitable purpose of the promise, and assures that a charity that has relied on the promise of a donation can receive that benefit without exchanging a detriment in return. In about one-quarter of the states, another doctrine is available for cases involving simple pledges: the "mutual

promises" theory, whereby the pledges of many individuals are taken as consideration for each other and are binding against each promisor.

PROMISSORY ESTOPPEL

Promissory estoppel is a legal principle that allows a party to enforce a promise, even if the promise was made without **consideration**, provided that certain conditions are met. In essence, promissory estoppel prevents one party from going back on their promise, even if no actual contract was created.

The doctrine of promissory estoppel is invoked in the interests of justice when three conditions are met:

1. the promise is one that the promisor should reasonably expect to induce the promisee to take action or forbear from taking action of a definite and substantial character
2. the action or forbearance is taken in reliance on the promise to a detriment
3. the only way to avoid injustice is to enforce the promise

For example, let's say that John promises to give Sally a car as a gift, but then changes his mind and refuses to give her the car. If Sally can show that she relied on John's promise to her detriment, such as by selling her old car in anticipation of receiving the new one, she may be able to enforce the promise through the doctrine of promissory estoppel, even though there was no actual contract created.

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

PROMISES ENFORCEABLE WITHOUT CONSIDERATION BY STATUTE

We have touched on several common-law exceptions to the consideration requirement. Some also are provided by statute.

UNDER THE UCC

Under the UCC, a contract must generally have **consideration** to be enforceable, but there are some exceptions that allow promises to be enforceable without consideration.

The UCC permits one party to discharge, without consideration, a claim or right arising out of an alleged **breach** of contract by the other party. This is accomplished by delivering to the other party a signed written **waiver** or renunciation. This provision applies to any contract governed by the UCC and is not limited to the sales provisions of Article 2.

The UCC also permits a party to discharge the other side without consideration when there is no

breach, and it permits parties to modify their Article 2 contract without consideration so long as the modification is made in good faith. For example, Seller agrees to deliver a ton of coal within seven days. Buyer needs the coal sooner and asks Seller to deliver within four days. Seller agrees. This promise is binding even though Seller received no additional consideration beyond the purchase price for the additional duty agreed to (the duty to get the coal to Buyer sooner than originally agreed).

The UCC allows a merchant's firm offer, signed, in writing, to bind the merchant to keep the offer to buy or sell open without consideration. This is the UCC's equivalent of a common-law option, which, as you recall, does require consideration.

Section 1-207 of the UCC allows a party a reservation of rights while performing a contract. This section raises a difficult question when a debtor issues an in-full-payment check in payment of a disputed debt. As noted earlier in this chapter, because under the common law the creditor's acceptance of an in-full-payment check in payment of a disputed debt constitutes an **accord and satisfaction**, the creditor cannot collect an amount beyond the check. But what if the creditor, in cashing the check, reserves the right (under Section 1-207) to sue for an amount beyond what the debtor is offering? The courts are split on this issue: regarding the sale of goods governed by the UCC, some courts allow the creditor to sue for the unpaid debt notwithstanding the check being marked "paid in full," while others do not.

BANKRUPTCY

Bankruptcy is federal statutory law. Like the situation described above where it was possible to revive an obligation after the statute of limitations had run, traditionally a promise to repay debts after a bankruptcy court has discharged them makes the debtor liable once again. The federal Bankruptcy Act includes certain procedural protections to ensure that the debtor knowingly enters into a reaffirmation of his debt. Among its provisions, the law requires the debtor to have reaffirmed the debt before the debtor is discharged in bankruptcy; he then has sixty days to rescind his reaffirmation. If the bankrupt party is an individual, the law also requires that a court hearing be held at which the consequences of his reaffirmation must be explained, and reaffirmation of certain consumer debts is subject to court approval if the debtor is not represented by an attorney.

INTERNATIONAL CONTRACTS

Contracts governed by the Convention on Contracts for the International Sale of Goods do not require **consideration** to be binding.

ACTIVITY 7B

What's Your Verdict?

The doctrine of consideration calls into question the age-old notion of a "handshake" agreement. That is, if the agreement which is the handshake does not have consideration, then no contract emerges, even if the parties shook on their promise. Is consideration a thing of the past? Should the good faith handshake

between parties control whether an agreement is enforceable as a contract? What are the values that requiring consideration in contracts promotes today? Explain your position using the information discussed in this Chapter.

End of Chapter Exercises

1. Hornbuckle purchased equipment from Continental Gin (CG) for $6,300. However, after some of the equipment proved defective, Hornbuckle sent CG a check for $4,000 marked "by endorsement this check is accepted in full payment," and CG endorsed and deposited the check. May CG force Hornbuckle to pay the remaining $2,300? Why?
2. Joseph Hoffman alleged that Red Owl Stores promised him that it would build a store building in Chilton, Wisconsin, and stock it with merchandise for Hoffman to operate in return for Hoffman's investment of $18,000. The size, cost, design, and layout of the store building was not discussed, nor were the terms of the lease as to rent, maintenance, and purchase options. Nevertheless, in reliance on Red Owl's promise, the Hoffmans sold their bakery and grocery store business, purchased the building site in Chilton, and rented a residence there for the family. The deal was never consummated: a dispute arose, Red Owl did not build the store, and it denied liability to Hoffman on the basis that its promise to him was too indefinite with respect to all details for a contract to have resulted. Is Hoffman entitled to some relief? On what theory?
3. Raquel contracted to deliver one hundred widgets to Sam on December 15, for which he would pay $4,000. On November 25, Sam called her and asked if she could deliver the widgets on December 5. Raquel said she could, and she promised delivery on that day. Is her promise binding? Why?
4. Richard promised to have Darlene's deck awning constructed by July 10. On June 20, Darlene called him and asked if he could get the job done by July 3, in time for Independence Day. Richard said he could, but he failed to do so, and Darlene had to rent two canopies at some expense. Darlene claims that because Richard breached his promise, he is liable for the cost of awning rental. Is she correct—was his promise binding? Why?
5. Seller agreed to deliver gasoline to Buyer at $3.15 per gallon over a period of one year. By the sixth month, gasoline had increased in price by more than a dollar a gallon. Although Seller had gasoline available for sale, he told Buyer the price would have to increase by that much or he would be unable to deliver. Buyer agreed to the increase, but when billed, refused to pay the additional amount. Is Buyer bound by the promise? Explain.
6. Montbanks's son, Charles, was seeking an account executive position with Dobbs, Smith & Fogarty, Inc., a large brokerage firm. Charles was independent and wished no interference by his well-known father. The firm, after several weeks' deliberation, decided to hire Charles. They made him an offer on April 12, 2010, and Charles accepted. Montbanks, unaware that his son had been hired and concerned that he might not be, mailed a letter to Dobbs on April 13 in which he promised to give the brokerage firm $150,000 in commission business if the firm would hire his son. The letter was received by Dobbs, and the firm wishes to enforce it against Montbanks. May Dobbs enforce the promise? Why?

7. In 1869, William E. Story promised his nephew, William E. Story II (then sixteen years old), $5,000 (about $120,000 in today's money) if "Willie" would abstain from drinking alcohol, smoking, swearing, and playing cards or billiards for money until the nephew reached twenty-one years of age. All of these were legally permissible activities for the teenager at that time in New York State. Willie accepted his uncle's promise and did refrain from the prohibited acts until he turned twenty-one. When the young man asked for the money, his uncle wrote to him that he would honor the promise but would rather wait until Willie was older before delivering the money, with interest added on. Willie agreed. Subsequently, Willie assigned the right to receive the money to one Hamer (Willie wanted the money sooner), and Story I died without making any payment. The estate, administered by Franklin Sidway, refused to pay, asserting there was no binding contract due to lack of consideration: the boy suffered no "detriment," and the uncle got no benefit. The trial court agreed with the estate, and the plaintiff appealed. Should the court on appeal affirm or reverse? Explain.
8. Harold Pearsall and Joe Alexander were friends for over twenty-five years. About twice a week, they bought what they called a package: a half-pint of vodka, orange juice, two cups, and two lottery tickets. They went to Alexander's house to watch TV, drink screwdrivers, and scratch the lottery tickets. The two had been sharing tickets and screwdrivers since the Washington, DC, lottery began. On the evening at issue, Pearsall bought the package and asked Alexander, "Are you in on it?" Alexander said yes. Pearsall asked for his half of the purchase price, but Alexander had no money. A few hours later, Alexander, having come by some funds of his own, bought another package. He handed one ticket to Pearsall, and they both scratched the tickets; Alexander's was a $20,000 winner. When Pearsall asked for his share, Alexander refused to give him anything. Are the necessary elements of offer, acceptance, and consideration present here so as to support Pearsall's assertion the parties had a contract?
9. Defendant, Lee Taylor, had assaulted his wife, who took refuge in the house of Plaintiff, Harrington. The next day, Taylor gained access to the house and began another assault upon his wife. Mrs. Taylor knocked him down with an axe and was on the point of cutting his head open or decapitating him while he was lying on the floor when Plaintiff intervened and caught the axe as it was descending. The blow intended for Defendant fell upon Harrington's hand, mutilating it badly, but saving Defendant's life. Subsequently, Defendant orally promised to pay Plaintiff her damages but, after paying a small sum, failed to pay anything more. Is Harrington entitled to enforce Taylor's entire promise?
10. White Sands Forest Products (Defendant) purchased logging equipment from Clark Corporation (Plaintiff) under an installment contract that gave Plaintiff the right to repossess and resell the equipment if Defendant defaulted on the contract. Defendant did default and agreed to deliver the equipment to Plaintiff if Plaintiff would then discharge Defendant from further obligation. Plaintiff accepted delivery and resold the equipment, but the sale left a deficiency (there was still money owed by Defendant). Plaintiff then sued for the deficiency, and Defendant set up as a defense the accord and satisfaction. Is the defense good?

REFERENCES

Estate of Timko v. Oral Roberts Evangelistic Assn., 215 N.W.2d 750 (Mich. App. 1974).

Lon L. Fuller, "Consideration and Form," *Columbia Law Review 41* (1941): 799.

Richard A. Posner, *Economic Analysis of Law* (New York: Aspen, 1973), 46.

Restatement (Second) of Contracts, Section 87(b).

Uniform Commercial Code, Section 1-107.

Uniform Commercial Code, Sections 2-209(4) and 2-209(1).

Uniform Commercial Code, Section 2-205.

CHAPTER 8 - CAPACITY

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the element of contractual capacity.
2. Identify when a contract is voidable or void due to lack of capacity.
3. Apply the sword and shield doctrine.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=56#h5p-6

8.1 GENERAL PERSPECTIVES ON CAPACITY

Contractual **capacity** refers to the legal ability of an individual or entity to enter into a binding contract and be held legally responsible for their actions and obligations under that contract. It is an important principle in contract law as it ensures that contracts are entered into voluntarily and that all parties involved are capable of understanding and fulfilling their contractual obligations. **Capacity** is necessary for a legally binding contract.

Most people who enter contracts have capacity. Because of that, and to avoid having to prove one's capacity every single time they wish to enter a contract, capacity is presumed unless there is something about the person or the transaction that calls capacity into question. In instances where capacity is questioned, it is possible to have either limited capacity (also called **limited competency**), or be incapable of contracting at all due to a lack of capacity, or **incompetency**.

The rule of contractual capacity is important because it helps to protect individuals who may be vulnerable or not fully capable of making informed decisions. **Minors**, people with mental disabilities, and individuals who are under the influence of drugs or alcohol may not have the capacity to fully understand the terms of a contract or the consequences of entering into it. By requiring that parties have the legal capacity to enter into a contract, the law seeks to prevent unfair contracts where one party may take advantage of the other party's lack of understanding of the legal consequences of an agreement. Further, requiring capacity to enter a contract helps to ensure that the terms of the

contract are understood and agreed upon by both parties. Since a contract is a meeting of the minds, if someone lacks mental capacity to understand what they are agreeing to, it is unreasonable to hold that person to the consequences of the contract. At common law there are various classes of people who are presumed to lack the requisite capacity to fully understand the consequences of a contract. These include **infants** (**minors**), the mentally ill, and the intoxicated. This Chapter will review each of these in turn.

8.2 MINORS (OR "INFANTS")

THE GENERAL RULE

Minors – persons younger than eighteen years of age in most states – may only enter into **voidable contracts**. This is because minors do not have full legal capacity to enter into contracts. Minors can enter into most contracts, but they can **avoid** their contracts, up to and within a reasonable time after reaching majority, while the other contracting party with full contractual capacity cannot. The idea is that minors do not stand on an equal footing with adults, and it is unfair to require them to abide by contracts made when they have immature judgment.

For example, suppose a 16-year-old enters into a contract to purchase a new phone from a mobile phone company. Since the 16-year-old is a minor and not yet legally capable of entering into a contract, the contract is voidable. This means that the 16-year-old has the option to either affirm the contract or void it. If the 16-year-old decides to go ahead with the purchase, the contract will be binding on the mobile phone company. However, if the 16-year-old chooses to avoid the contract, they will be released from any obligations or liabilities that may have arisen from the contract, and they will be entitled to a refund if they have already made any payments. This is called disaffirming a contract. To **disaffirm** a contract means to repudiate or reject a contract that has been previously entered into.

Most people will recognize the 16-year-old in the above example as a **minor**. But legal term **infant** is also used to describe the 16-year-old contracting party above. The words minor and infant are mostly synonymous, but there are some differences between the terms. Historically speaking, in a state where the legal age to drink alcohol is twenty-one, a twenty-year-old would be a minor, but not an infant, because infancy is under eighteen. A seventeen-year-old may avoid contracts (usually), but an eighteen-year-old, while legally bound to his contracts, cannot legally drink alcohol. This is why some states use the term infant for one who may avoid his contracts even though, of course, in everyday terms we think of an infant as a baby.

In nearly all U.S. states, an 18-year-old may assent to a binding contract, but there may still be some exceptions associated with age. For those under twenty-one, there may also be legal impediments to holding certain kinds of jobs, and agreeing to certain kinds of contracts, marrying, leaving home, and drinking alcohol. There is no uniform set of rules since each state can make their own laws in these areas. Because of these ambiguities, contracting adults like landlords or creditors may still require parents to co-sign contracts for a young adult over the age of 18. This is lawful, but is often unnecessary.

The exact day of "majority" – the day on which the limitations on contracting as a minor or infant

vanish – can also vary. The old common-law rule put it on the day before the twenty-first birthday. Many states have changed this rule so that majority commences on the day of the eighteenth birthday. For the most part, the remainder of this Chapter will use the word minor to describe a contracting party under the age of 18. This is consistent with the law in New Jersey, where by statute an individual under the age of 18 is defined as an infant, and therefore lacks the legal capacity to contract.

Even though a minor lacks the legal capacity to contract, the minor's contract is not automatically invalid. Instead, the minor has the right to choose to either affirm the contract or void it which makes the minor's contract voidable. This means that despite having limited competence minors can enter contracts, but most of those contracts can be avoided, or disaffirmed, without any reason for doing so other than the party is a minor. If a lawsuit about the contract was filed, the minor would claim the defense of infancy, and this defense would be sufficient unless there are other reasons why the contract could not be disaffirmed. Should the adult wish to get out of the contract, they cannot make the same claim. The adult cannot seek to disaffirm the contract; only the minor can.

When a minor disaffirms a contract, the minor has the legal right of a minor to walk away from a contract and be released from any obligations or liabilities arising from it. In addition, the minor is restored to their original position, meaning that they would be entitled to the return of any consideration, without the responsibility of being liable for damages under the contract. A minor need only return whatever part of the consideration in the contract that they still have. So, if the 16-year-old in our example above opts to disaffirm their purchase of the new phone one month after entering the contract, the minor may disaffirm. The minor would be entitled to the return of any down payment or other fees paid for the phone. The minor will return the phone but would not be liable for any damage done to the phone while it was in the minor's possession, even if the phone was broken. This is called the general rule of law pertaining to contracts entered into by minors. This means that the majority of states, but not all, follow this rule.

EXCEPTIONS TO THE MINOR'S RIGHT TO DISAFFIRM

There are several exceptions and limitations to the minor's right to disaffirm. These are discussed below.

Duty to Return Consideration Received

As we explored under the general rule, when a minor disaffirms a contract their own obligation would be to return an item of consideration if that item is still in the minor's possession. For instance, the minor would have to return the untouched groceries in a contract with a grocery store. Under the general rule, if some of the groceries were already eaten, there would be nothing to return and thus the minor would not be liable for the value of the groceries that were consumed. Some courts, however, have required more from the minor when necessary to avoid injustice to the adult. Suppose that our 16-year-old minor that purchased the cell phone decided to disaffirm their purchase after dropping and breaking the phone. There are some courts that would limit what the minor could receive in disaffirming the contract. For example, a court could determine that the minor should not receive full value back for the phone, but instead receive only that value associated with the (wrecked) phone at the time of the disaffirmance. Since this is contrary to the general rule, it is called the "**minority rule**" of law, where minority here means that less than half of the states follow this rule. On this area of law,

New Jersey is in the minority, typically requiring that a minor return all of the consideration (or the value of that consideration) that was received in order to **disaffirm**.

Necessaries

A **necessary** is a basic need of life such as food, clothing, shelter and basic medical services. This has historically been the definition at common law. In recent years, however, the courts have expanded the concept so that in many states today, necessities include property and services that will enable a person to earn a living and to provide for those dependent on them.

When a contract with a minor is for an item that is a necessary, an exception to the general rule that minors can disaffirm their contracts is that minors are generally liable for the reasonable cost of necessities. The reason behind this change from the general rule that minors may disaffirm without further obligation is that denying minors a full right of contract for necessaries would actually harm minors, not protect them. The minor will not be obligated to perform the contract so technically the minor can still disaffirm. However, the minor will be responsible to the other party for the reasonable value of the contracted necessary. For example, suppose a minor enters into a contract with a grocery store to purchase food items where the food qualifies as a necessary. If the minor later disaffirms the contract, they will not be liable for the contract price of the food items if they have not been consumed or used by the minor. Those items can be returned, which is required under the general rule. However, if the minor has already consumed or used the food items, and those food items are necessaries, the minor is responsible for the reasonable cost of the food items. The requirement that the minor be liable for the reasonable value of the necessary is rooted in the theory of **quasi contract**, which was explored in an earlier Chapter.

So, how does this rule protect minors? Since the rule provides protection to the seller of the necessary, in this case the food, that seller will want to sell to minors that need food for nourishment, because the seller does not risk the harsh consequences of the general rule.

Nonvoidable Contracts

There are some contracts that are considered **nonvoidable**. The contracts that are nonvoidable can vary by state, and can include contracts such as insurance, education or medical care, bonding agreements, stocks, or bank accounts, and child support agreements. The rationale behind making these contract nonvoidable is this: if a contract is voidable it is a disincentive to an adult party to contract with a minor (or other party that lacks capacity) since there is a risk that the minor will disaffirm the contract in the future. Many sellers simply will not take that risk and instead refuse to contract with minors completely. There are certain types of contracts, though, that we want to be available to minors and so making those contracts nonvoidable encourages these types of contracts with minors. For example, it is beneficial both to a minor and to society that the minor receive an education. Education can be expensive, and so to help assure that education loans are available to minors, the right of the minor to disaffirm that loan in the future is limited or eliminated.

Misrepresentation of Age

A minor that misrepresents their age in order to enter a contract may be limited in their ability to later disaffirm that contract. Typically, an adult that simply thought that the minor was over the age of 18 could not raise that as a defense to the minor's attempt to disaffirm the contract. This is true even if

the adult's belief that the minor was older was reasonable. Importantly, the minor must affirmatively misrepresent their age. Even so, this limitation on disaffirmance will depend on the state. A Michigan statute, for instance, prohibits an infant from disaffirming if he has signed a "separate instrument containing only the statement of age, date of signing and the signature." And some states estop him from claiming to be an infant even if he less expressly falsely represented himself as an adult. **Estoppel** is a refusal by the courts on equitable grounds to allow a person to escape liability on an otherwise valid defense; unless the infant can return the consideration, the contract will be enforced. It is a question of fact how far a non-express (an implied) misrepresentation will be allowed to go before it is considered so clearly misleading as to stray into the prohibited area. Some states hold the infant liable for damages for the tort of misrepresentation, but others do not. As William Prosser, the noted torts scholar, said of cases paying no attention to an infant's lying about his age, "The effect of the decisions refusing to recognize tort liability for misrepresentation is to create a privileged class of liars who are a great trouble to the business world."

Tort Connected with a Contract

Although the lack of contractual capacity can protect a minor from a contract by permitting the minor to disaffirm, this same rule does not extend to other areas of the law. Recall that minors can be liable for their torts (e.g., assault, trespass, nuisance, negligence). So, if there is also a tort claim connected with a contract involving a minor, the minor can be liable for the tort unless the tort suit is only an indirect method of enforcing the contract. For example, Tandy, who is 16, agrees to mow the neighbor's lawn for $50. The neighbor pays Tandy up front. Tandy can disaffirm this contract because Tandy is a minor. If Tandy doesn't mow the lawn, the neighbor could not sue for fraud because that would be an indirect attempt to enforce the contract. However, let's say that while mowing the lawn, Tandy accidentally damages the neighbor's flower bed with the lawnmower. The neighbor could then sue Tandy for the tort of negligence, which is a civil wrong resulting from a failure to exercise reasonable care.

RATIFICATION

When a **minor** becomes an adult (i.e., reaches the age of majority when the "disability" that rendered the party of limited contractual capacity has been lifted) there are two options for an existing contract. The party to the contract can disaffirm that contract up to a reasonable period of time after reaching the age of majority, where what is reasonable will depend on the circumstances. Or, the contract can be ratified. **Ratification** takes place upon accepting or confirming a contract that was originally voidable because a party lacked contractual capacity.

For example, suppose a minor signs a contract to buy a car, but the contract is voidable due to the minor's age. Once the minor reaches the age of majority, they may ratify the contract, thereby making it legally binding. They may ratify the contract by sending a letter to the seller of the car letting them know they intend to ratify the contract. This is **express ratification**. Or, they may ratify the contract by doing nothing to disaffirm it while continuing to drive the car. This is **implied ratification**. Express ratification occurs when a party explicitly confirms or approves the previously voidable contract. Implied ratification, on the other hand, occurs when a party behaves in a manner consistent with accepting a contract, or in a manner inconsistent with disaffirming the contract. Both express and implied ratification have the effect of making the previously voidable contract legally binding.

ACTIVITY 8A

You be the Judge

In the case of *Hojnowski v. Vans Skate Park*, the New Jersey Supreme Court heard a dispute involving the enforceability of a liability waiver signed by a parent on behalf of their minor child. The plaintiffs were the parents of a 12-year-old child who was injured at Vans Skate Park that had signed an extensive liability waiver and exculpatory clause when enrolling their child in a skateboarding program. This waiver was signed prior to the Plaintiffs having any access to the Skate Park.

While skating at the park on a later date, the child suffered a broken femur allegedly due to the conduct of a much more aggressive skater, of whose conduct the parents had already complained. Under the waiver the parents agreed that neither they, nor the child, would hold Vans Skate Park liable in case of an injury. In addition, the parents agreed that if there were a dispute between the parties that it would be submitted to arbitration, and not heard through the court system. The child did not sign the waiver.

Parents sued the Skate Park on their own behalf and for their child, alleging various tort claims, and the Skate Park defended the lawsuit stating that the parental waiver was an agreement between the parties that (1) limited the Skate Park's liability, and (2) required the arbitration of any disputes between the parties. The case made its way to the New Jersey Supreme Court which ruled in favor of the plaintiffs in part stating that parental waivers of a child's future claims for injuries in recreational activities are unenforceable. The Court held that parents cannot bind their children to contractual provisions that waive the child's rights to sue for injuries caused by the negligence of others. The decision in this case established an important precedent in New Jersey, indicating that liability waivers signed by parents on behalf of their minor children in recreational activities are generally unenforceable. However, the Court did find that the agreement to arbitrate claims was enforceable so that the Hojnowskis must use arbitration to pursue their claims.

Question: Would having the child sign the waiver themselves change the outcome of this case? Why or why not?

Question: Even though the Court found that the parental waiver in this case was unenforceable, it still found that the parent could bind the child to use arbitration for the resolution of the dispute. Why do you think these matters were treated differently?

Read about this case on Google Scholar.

8.3 PERSONS WHO ARE MENTALLY INCAPACITATED

Mental incapacity can result from mental illness, physical illness, or deficiency, and may have the effect of causing full **incompetence**, **limited competence**, or have no impact on **contractual capacity** at all. As an initial determination, the impact of the illness or deficiency on the ability of the party to understand the legal consequences of entering into a contract should be reviewed. A person who has an illness or deficiency that does not impact the ability to understand the legal consequences of a contract would not qualify for mental incapacity, and therefore could enter a valid contract.

When a person is suffering from an illness or deficiency that prevents them from understanding the

legal consequences of entering a contract, a contract entered during this time period is **voidable** due to limited competence. The time period to **avoid** the contract would be during the contract or when capacity is restored. For this limitation on competency, it is more likely that avoiding a contract will occur once the deficiency is lifted, restoring mental understanding. A disaffirmance may also take place by a **guardian**, if a court appoints a guardian and a voidable contract exists at that time of appointment.

When a person that is suffering from an illness or deficiency is adjudicated to be fully **incompetent** in a court proceeding, any further efforts of that person to enter a contract will result in a **void contract**. In this situation, a guardian will be appointed to proceed with contracting for the incompetent party in the future.

For example, suppose a seller diagnosed with a mental illness agrees to sell their property to a buyer. Even though the seller has a diagnosis, this contract will be valid unless the mental illness has impacted the seller's ability to understand the legal consequences of the contract. If the seller, due to their mental illness, cannot understand the legal consequences of the contract, the contract may be considered voidable. The seller would be able to disaffirm the contract. Similarly, the buyer may not be able to enforce the contract and may have to return any money or property received from the seller. If the seller has been adjudicated incompetent in a Court proceeding, the contract would be void. This means that the guardian responsible for making decisions on the seller's behalf could avoid the contract.

As in the situation with a minor, if the contract was for a necessity, the other party may have a valid claim against the estate of the one who is mentally incapacitated in order to prevent unjust enrichment. In any case, when a contract is disaffirmed, the mentally incapacitated person must return any property in their possession to the other contracting party. If the contract was fair and the other party had no knowledge of the mental illness, the court has the power to order other relief.

ACTIVITY 8B

Case Debate: Protection or Oppression? #FreeBritney

Britney Spears, a well-known pop singer, was placed under a conservatorship (or guardianship) in 2008. This is a legal arrangement where a guardian (conservator) is appointed to manage the personal and financial affairs of an individual (conservatee) who is deemed to lack the contractual capacity to make such decisions and enter contracts.

The conservatorship was established following a series of highly publicized personal and legal challenges in Britney Spears' life. The conservatorship was implemented due to concerns about Britney Spears' contractual capacity. It brought into question whether she had the legal capacity to enter into contracts and fully understand the implications and consequences of her agreements. Under the conservatorship, her father, Jamie Spears, initially served as the conservator, with control over her finances, career decisions, and personal life. A professional conservator, Jodi Montgomery, was later appointed as a temporary replacement for Jamie Spears to handle Britney's personal affairs.

Despite being under a conservatorship, Britney Spears had a successful show in residency in Las Vegas from December 2013 to December 2017. Widely regarded as a successful venture for Britney Spears both artistically and commercially, Britney demonstrated her talent, professionalism, and ability to deliver captivating performances on stage.

The conservatorship remained in place for many years, even while Britney Spears sought review of the conservatorship expressing her desire to end the conservatorship and regain control over her life and finances. At various times while the conservatorship was in place, Britney Spears' fans and the media questioned the conservatorship and its impact on her life. In 2019, the "#FreeBritney" movement gained momentum, with supporters advocating for an end to the conservatorship and greater transparency about Spears' well-being.

In June 2021, Britney Spears made a statement during a court hearing, expressing her desire to terminate the conservatorship. She revealed details about the restrictive nature of the arrangement, claiming that she had been subjected to abuse, forced medication, and denial of personal freedoms. Eventually the conservatorship was dissolved and currently Britney Spears has regained full contractual capacity.

Question: Contractual capacity is intended to provide legal protections to those that do not understand the legal consequences of their contracts and to safeguard individuals from the consequences of contracting with unscrupulous adults. With such a safeguard available for those with limited capacity, why isn't this enough protection for incompetent adults. In other words, what is the purpose of having a separate action where a Court could find a party incompetent and completely remove their right to contract and appoint a guardian?

Question: One of the justifications for continuing a guardianship is that the guardianship is working. When this is the perception, it can be very difficult for the party adjudicated incompetent to show that they can handle their own affairs. So, a guardianship that is working perpetuates the guardianship itself. When should a guardianship or conservatorship end? When should it have ended in the Britney Spears case?

Question: Should there be limits on guardianships as they pertain to contractual rights and obligations? What is the best way to balance the right to contract with the well-being of the individual subject to limitations imposed by a Court?

Debate the Case: Find and review two resources dealing with the #FreeBritney movement. Do you think that the Britney Spears conservatorship was a necessary safeguard or an infringement on the right to contract?

8.4 PERSONS WHO ARE INTOXICATED

People who are intoxicated at the time of entering a contract may have **limited competency** if the nature of their intoxication rendered the person unable to understand the nature and consequences of a contract. Intoxication could be the effect of alcohol, drugs, or other intoxicating substances, and could be voluntary or involuntary.

If a person is so drunk that he has little awareness of his acts, and if the other person knows this, any contract that results is voidable. Should the intoxicated person disaffirm the contract when regaining competency, he is obligated to refund the consideration to the other party unless he dissipated it

during his drunkenness. If the other person is reasonably unaware of his intoxicated state, however, an offer or acceptance of fair terms would be upheld by most courts.

If a person is only partially inebriated and has some (but not a full) understanding of his actions, courts will review factors in determining whether the transaction would be voidable or valid, for example, whether the other party induced the drunkenness, the adequacy of the consideration exchanged, and whether the transaction is one which a reasonably competent person might have made.

A person who was intoxicated at the time he made the contract may nevertheless subsequently **ratify** it. Thus, where a party, several times involuntarily committed for alcoholism, executed a promissory note in an alcoholic stupor but later, while sober, paid the interest on the past-due note, he was denied the defense of intoxication; the court said he had ratified his contract. In any event, intoxication is a disfavored defense on public policy grounds.

CASE 8.1

Cameron v. Power Co., 50 S.E. 695 (N.C. 1905)

WALKER, J.

This action was brought to recover damages for the breach of a contract whereby the plaintiff agreed to sell and the defendant to buy a Corliss engine. … The defendant in its

answer [to the complaint] admitted that its president had signed a contract, and pleaded specially that at the time of signing it he was so drunk that he did not have sufficient mental capacity to contract with the plaintiff for the engine. The court, without objection, submitted only one issue to the jury, which is as follows: "What damage, if any, is the plaintiff entitled to recover of the defendant?" The jury answered "Nothing." Judgment was entered accordingly.

The question presented for our consideration arises upon an exception to the charge of the court regarding the drunkenness of the plaintiff's agent and its sufficiency to avoid the contract.

…

We have examined the charge of the court with care and cannot find that his Honor said anything not in strict accordance with the law, as we now declare it to be. He charged the jury as follows: "The mere fact that the defendant's president was drinking was not sufficient, but the jury must find that he was so intoxicated that he could not understand the nature and scope of what he was doing. If the jury find from the greater weight of the testimony that the agent was drinking, it would not be sufficient to invalidate the contract, but if the jury find that the defendant's president, at the time he signed the contract or order for the engine, was so drunk as to be incapable of knowing the effect of what he was doing, then the contract or order would not be binding upon the defendant. Whether or not he was so intoxicated as to render him incompetent to contract is a question for the jury upon all the evidence." We think this was a clear and sufficient exposition of the law applicable to the facts of the case. What the judge said in his reference to the nature of the transaction in which the agent was engaged and its importance or magnitude … was evidently intended to point what he had already said as to the true test of mental capacity, and to impress upon them,

as an essential condition of the validity of the contract, that the agent of the defendant at the time he signed the paper must have been sober enough to understand the nature of the transaction and

the effect or consequence of his act, and not that he must have been able to act with wisdom or discretion.

No error.

Case Questions

1. The Court notes that the question of competency in this case is one for the jury to consider based on the evidence in the case. What type of evidence would you expect to see in a case where capacity is being challenged?
2. If the Court found that the Plaintiff's agents were too intoxicated to understand the legal consequences of the transaction, what would happen to the underlying contract in the case? Would there be damages?
3. In this case, the intoxication was voluntary. Do you think that the case would have turned out differently if the intoxication was involuntary? Why or why not?

8.5 THE SWORD AND SHIELD DOCTRINE

Throughout the Chapter, we've explored ways a person with **limited competency** can seek to **avoid** unwanted contracts. As stated previously, the purpose of allowing disaffirmance in these cases is to protect people with limited competency from being taken advantage of, much like a "shield."

The **sword and shield doctrine** is a legal principle that pertains to the use of a contract's terms as both a sword to enforce the contract and a shield to defend against claims under the contract. The "sword" aspect of the doctrine refers to the use of a contract's terms by a party seeking to enforce the contract. This means that a party can use the terms of the contract to compel the other party to perform their obligations under the contract. The "shield" aspect of the doctrine, on the other hand, refers to the use of a contract's terms as a defense against claims under the contract. This means that a party can use the terms of the contract to defend against claims made by the other party under the contract.

In cases of **capacity**, the sword and shield doctrine can be used to protect the interests of parties who lack contractual capacity, such as **minors** or individuals with mental disabilities.

The shield aspect of the doctrine can be used to defend against claims under a contract made by a party who lacks contractual capacity. For example, if a minor enters into a contract to purchase a car and the car is defective, the minor can use the shield aspect of the doctrine to defend against the

seller's claim for payment by arguing that they lacked contractual capacity to enter into the contract and are therefore not bound by its terms. This is possible even if the minor would seek to keep the car if it were not defective, thus minority is a shield.

The sword aspect of the doctrine can also be used by a party who lacks contractual capacity to enforce the terms of a contract that are beneficial to them. For example, if a minor enters into a contract to sell their artwork, and the buyer fails to make payment as required by the contract, the minor can use the sword aspect of the doctrine to compel the buyer to make payment as required by the contract.

At the same time, a sword has two sides, and some courts have reviewed attempts to disaffirm contracts through this doctrine, finding in some cases that the person with limited competency is using their right to disaffirm to achieve an unfair advantage over a competent adult in a contract. For example, suppose a 16-year-old minor signs a contract with an adult to buy a car. The minor then decides to disaffirm the contract having already driven the car for several months and causing damage to it. The adult may ask the court to review the circumstance of the disaffirmance to see if the minor is unfairly using this right to avoid paying for the damages they caused to the car while they were using it.

In such cases, the court may review the circumstances surrounding the disaffirmance to determine if the minor is attempting to take advantage of the adult (using disaffirmance as a sword) or if they have a legitimate reason to avoid the contract (a shield). If the court finds that the person with limited competence is unfairly using the ability to disaffirm, the court could rule in favor of the adult and hold the minor responsible for any damages they caused under the contract.

In general, the sword and shield doctrine is meant to balance the interests of parties in contractual dealings and ensure that both parties are held to the same standard of performance. However, in cases where one party lacks contractual capacity, the doctrine must be applied in a way that considers the particular circumstances of that party and their intentions in disaffirming a contract.

ACTIVITY 8C

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=56#h5p-5

ACTIVITY 8D

What's your Verdict?

Video games are popular, as are in-app purchases within them. Should minors be able to disaffirm in-app video game purchases? Does it matter if the funding for the purchase originated from the minor's own money, or from the parent? Explain your position using the information discussed in this Chapter.

End of Chapter Exercises

1. Langstraat was seventeen when he purchased a motorcycle. When applying for insurance, he signed a "Notice of Rejection," declining to purchase uninsured motorist coverage. He was involved in an accident with an uninsured motorist and sought to disaffirm his rejection of the uninsured motorist coverage on the basis of infancy. May he do so?
2. Ivar, an infant, bought a used car—not a necessity—for $9,500. Seller took advantage of Ivar's infancy: the car was really worth only $5,500. Can Ivar keep the car but disclaim liability for the $4,000 difference?
3. If Ivar bought the car and it was a necessity, could he disclaim liability for the $4,000?
4. If Ivar bought the car, and subsequently drove the car while it was having mechanical difficulties, resulting in blowing out the engine, can Ivar disaffirm the car? If so, will he have any liability in doing so? Under what theory?
5. Alice Ace found her adult son's Christmas stocking; Mrs. Ace herself had made it fifty years before. It was considerably deteriorated. Isabel, sixteen, handy with knitting, agreed to reknit it for $100, which Mrs. Ace paid in advance. Isabel, regrettably, lost the stocking. She returned the $100 to Mrs. Ace, who was very upset. May Mrs. Ace now sue Isabel for the loss of the stocking (conversion) and emotional distress?

REFERENCES

Dodson v. Shrader, 824 S.W.2d 545 (Tenn. 1992).

First State Bank of Sinai v. Hyland, 399 N.W.2d 894 (S.D. 1987).

Gastonia Personnel Corp. v. Rogers, 172 S.E.2d 19 (N.C. 1970).

Hojnowski v. Vans Skate Park, 187 N.J. 323, 901 A.2d 381 (2006)

N.J.S.A. 9:17B-1

Albert, Clark, Guide to New Jersey Contract Law, NJICLE

William L. Prosser, Handbook of the Law of Torts, 4th ed. (St. Paul, MN: West, 1971), 999.

Restatement (Second) of Contracts, Section 13.

Restatement (Second) of Contracts, Section 16(b).

CHAPTER 9 - LEGALITY

Learning Objectives

After studying this chapter, you should be able to:

1. Identify the types of contracts that are illegal.
2. Explain the various types of bargains made illegal by statute.
3. Explain the various types of bargains made illegal by public policy.
4. Describe courts deal with disputes concerning illegal contracts.
5. Analyze whether the element of Legality is present in an attempt to contract.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=211#h5p-8

9.1 GENERAL PERSPECTIVES ON ILLEGALITY

Our study now turns to the **legality** of the underlying bargain of a contract. The basic rule is that parties can enter a contract for any lawful purpose, and therefore courts will not enforce an illegal bargain. But why should the courts refuse to honor contracts made privately by people who presumably know what they are doing—for example, a wager on the World Series or a championship fight? Two reasons are usually given. One is that refusal to enforce such an agreement helps discourage unlawful behavior; the other is that honoring such contracts would demean the judiciary. It is unclear whether such limitations discourage parties from entering unlawful agreements. For instance, aman hired to commit a murder is not in the least deterred by the fact that the courts are not open to him to collect his fee. So, the protection of the good name of the judicial institution must provide the principal reason for denial of a remedy to one who has made an illegal bargain. Implementing this rule means that a promisee who has already performed under an illegal contract can neither obtain performance of the act for which he bargained nor recover the money he paid or the value of the performance he made. The court will simply leave the parties where it finds them, meaning that one of the parties will have received an uncompensated benefit, and the other will have no lawful remedy.

Following this notion, the courts have created several exceptions to the general rule. Not surprisingly, the severity of the rule against enforcement has led courts to seek ways to moderate its impact, chiefly by modifying it according to the principle ofrestitution. In general, restitution requires that one who has conferred a benefit or suffered a loss should not unfairly be denied compensation. Thus, a party who is excusably ignorant that his promise violates public policy and a party who is not equally in the wrong may recover restitution. Likewise, when a party "would otherwise suffer a forfeiture that is disproportionate in relation to the contravention of public policy involved," restitution will be allowed. Other exceptions exist when the party seeking restitution withdraws from the transaction contemplated in the contract before the illegal purpose has been carried out and when "allowing the claim would put an end to a continuing situation that is contrary to the public interest." An example of the latter situation occurs when two bettors place money in the hands of a stakeholder. If the wager is unlawful, the loser of the bet has the right to recover his money from the stakeholder before it is paid out to the winner.

Though by and large courts enforce contracts without considering the worth or merits of the bargain they incorporate, freedom of contract can conflict with other public policies. Tensions arise between the desire to let people pursue their own ends and the belief that certain kinds of conduct should not be encouraged. Thus, a patient may agree to be treated by an herbalist, but state laws prohibit medical care except by licensed physicians. Law and public policies against **usury**, **gambling**, obstructing justice, bribery, corrupt influence, perjury, restraint of trade, impairment of domestic relations, and fraud all significantly affect the authority and willingness of courts to enforce contracts.

In this chapter, we will consider two types of **illegality**: (1) that which results from a bargain that violates a statute and (2) that which the courts deem contrary to public policy, even though not expressly set forth in statutes.

9.2 AGREEMENTS IN VIOLATION OF STATUTE

Any bargain that violates the criminal law—including statutes that govern extortion, robbery, embezzlement, forgery, some **gambling**, licensing, and consumer credit transactions—is illegal. Thus, determining whether contracts are unlawful may seem to be an easy enough task. Clearly, whenever the statute itself explicitly forbids the making of the contract or the performance agreed upon, the bargain (such as a contract to sell drugs) is unlawful. But when the statute does not expressly prohibit the making of the contract to engage in an unlawful act, courts examine a number of factors.

It is important to remember that statutes can vary from jurisdiction to jurisdiction, and, thus, what might be unlawful conduct in one state might be lawful in another – making a contract valid in one state yet void in another.

GAMBLING CONTRACTS

A **gambling contract** is an agreement between two or more parties to wager or bet on the outcome of a future event or contest over which the bettors have no control and which typically involves chance. These contracts are generally considered illegal due to a variety of legal and public policy concerns. Some of the concerns about these contracts include gambling addiction, financial hardship, the potential for fraud, and other social problems like potentially attracting criminal elements who are

lured by the prospect of making easy money. That said, many states do have some kinds of gambling that have been legalized and regulated, including state-sponsored lotteries.

Because the outcome is contingent on events that lie outside the power of the parties to control does not transform a bargain into a gambling contract. For example, if a parent says to his daughter, "I'll bet you can't get an A in organic chemistry. If you do, I'll give you $50," this is not a gambling contract, but a unilateral contract, the consideration to the father being the daughter's achieving a good grade.

Despite the general rule against enforcing wagers, there are exceptions, most statutory but some rooted in the common law. The common law permits the sale or purchase of securities: Sally invests $6,000 in stock in Acme Company, hoping the stock will increase in value, though she has no control over the firm's management. It is not called gambling; it is considered respectable risk-taking in the capitalist system, or "entrepreneurialism." Insurance contracts are also speculative, but unless one party has no insurable interest (a concern for the person or thing insured) in the insured, the contract is not considered a wager.

ACTIVITY 9A

You be the judge

Article IV, Section VII, paragraph 2 of the New Jersey Constitution deals with gambling in our state. Read this section of the New Jersey Constitution. You can find the entire document located here: https://www.njleg.state.nj.us/constitution Based on what you know of gambling in New Jersey, is this what you'd expect our gambling laws to say? Is a gambling contract unlawful in New Jersey? Why or why not?

SUNDAY CONTRACTS

At common law, contracts entered into on Sundays, as well as other commercial activities, are valid and enforceable. However, there are some state statutes or local ordinances that regulate or restrict certain activities, including entering into contracts, on Sundays or other specific days of the week, often due to religious or historical reasons. These laws vary significantly from one jurisdiction to another, but they often address matters such as retail sales, alcohol consumption, and recreational activities.

These laws trace to the Second Commandment which frowns on work performed on "the Lord's Day." In 1781, a New Haven city ordinance banning Sunday work was printed on blue paper, and since that time such laws have been known as '**blue laws**.' The first statewide blue law was enacted in the United States in 1788; it prohibited travel, work, sports and amusements, and the carrying on of any business or occupation on Sundays. The only exceptions in most states throughout most of the nineteenth century were mutual promises to marry and contracts of necessity or charity. As the Puritan fervor wore off and citizens were, more and more, importuned to consider themselves "consumers" in a capitalistic economic system, the laws have faded in importance and have mostly repealed or unenforced. That said, New Jersey still has many Blue laws within the state and in specific

municipalities. For instance, in the Borough of Paramus New Jersey, local ordinance code §391-2 provides:

> Sunday activities restricted.
>
> No worldly employment or business, except works of necessity and charity, shall be performed or practiced by any person within the Borough on the first day of the week, commonly called and hereinafter designated as "Sunday."

Thus, many businesses located in the Borough of Paramus, including the Paramus Park Mall are closed on Sundays.

USURY

A **usury** statute is one that sets the maximum allowable interest that may be charged on a loan; usury is charging illegal interest rates. Formerly, such statutes were a matter of real importance because the penalty levied on the lender—ranging from forfeiture of the interest, or of both the principal and the interest, or of some part of the principal—was significant. But usury laws, like Sunday contract laws, have been relaxed to accommodate an ever-more-frenzied consumer society. There are a number of transactions to which the laws do not apply, varying by state: small consumer loans, pawn shop loans, payday loans, and corporate loans. In *Marquette v. First Omaha Service Corp.*, the Supreme Court ruled that a national bank could charge the highest interest rate allowed in its home state to customers living anywhere in the United States, including states with restrictive interest caps. Thus it was that in 1980m Citibank moved its credit card headquarters from cosmopolitan New York City to the somewhat less cosmopolitan Sioux Falls, South Dakota. South Dakota had recently abolished its usury laws, and so, as far as credit-card interest rates, the sky was the limit. That appealed to Citibank and a number of other financial institutions, and to the state of South Dakota because it became a major player in the U.S. financial industry, creating many jobs in the state.

LICENSING STATUTES

To practice most professions and carry on the trade of an increasing number of occupations, states require that providers of services possess licenses—hairdressers, doctors, plumbers, real estate brokers, anglers, egg inspectors, and, yes, lawyers are among those on a long list. As sometimes happens, though, a person may contract for the services of one who is unlicensed, either because (1) they are unqualified and conducting business without a license or (2) because for technical reasons (e.g., forgetting to mail in the license renewal application) they do not possess a license at the moment. To better understand the impact of a license or its lack, suppose that Robin calls Paul to provide legal services in drafting a contract. Paul, who does not have a license to practice law, drafts a contract for Robin's purpose. Robin then discovers that Paul does not have a law license, and refuses to pay Paul for the contract. Is Paul entitled to collect the fee?

The answer to this question requires a three-step analysis. First, some occupations may be performed without a license (e.g., lawn mowing). Other occupations may be performed with or without certain credentials, the difference lying in what the professional may tell the public. For instance, an accountant need not be a certified public accountant to carry out most accounting functions. Still, some occupations require a license as a minimum requirement to perform a specific type of work. It

is safe to assume that in the example above, Paul is required to hold a valid license to practice law to perform legal work for Robin.

The second step is to determine whether the licensing statute explicitly bars recovery by someone who has performed work while unlicensed. Reading the statute would be required to determine this, but many statutes do not contain a specific provision on the point. Statutes that do bar recovery would end our analysis, but let's assume that the statute in this scenario is silent on the practice of law without a license.

When a statute is silent, the third step of the analysis is to distinguish between "regulatory" and "revenue" licenses. A **regulatory license** is intended to protect the public health, safety, and welfare. To obtain these licenses, the practitioner of the art must generally demonstrate his or her abilities by taking some sort of examination, like the bar exam for lawyers or the medical boards for doctors. A **revenue license** generally requires no such examination and is imposed for the sake of raising revenue and to ensure that practitioners register their address so they can be found if a disgruntled client wants to serve them legal papers for a lawsuit. Some revenue licenses, in addition to requiring registration, require practitioners to demonstrate that they have insurance. A license to tend bar, available to anyone 21 or older who applies and pays the required fee, would be an example of a revenue license. In our example, a lawyer's license is a regulatory license.

If a state requires a professional license, it is necessary to determine whether the license is regulatory or revenue raising. Generally speaking, failure to hold a regulatory license bars recovery and such a contract would be void as illegal, but the absence of a revenue license does not bar recovery — the person may obtain the license and then move to recover.

CASE 9.1

Venturi & Company v. Pacific Malibu Development Corp., 172 Cal.App.4th 1417 (Calif. Ct. App. 2009)

RUBIN, J.

In June 2003, plaintiff Venturi & Company LLC and defendant Pacific Malibu Development Corp. entered into a contract involving development of a high-end resort on undeveloped property on the Bahamian island of Little Exuma. Under the contract, plaintiff agreed to serve as a financial advisor and find financing for the Little Exuma project.…[P]laintiff was entitled to some payment under the contract even if plaintiff did not secure financing for the project [called a success fee].

After signing the contract, plaintiff contacted more than 60 potential sources of financing for the project.…[I]n the end, defendants did not receive financing from any source that plaintiff had identified.

Defendants terminated the contract in January 2005. Two months earlier, however, defendants had signed a [financing agreement] with the Talisker Group. Plaintiff was not involved in defendants' negotiations with the Talisker Group.…Nevertheless, plaintiff claimed the contract's provision for a success fee entitled plaintiff to compensation following the [agreement]. When defendants refused to pay plaintiff's fee, plaintiff sued defendants for the fee and for the reasonable value of plaintiff's services.

Defendants moved for summary judgment. They argued plaintiff had provided the services of a real estate broker by soliciting financing for the Little Exuma project yet did not have a broker's license. Thus, defendants asserted…the Business and Professions Code barred plaintiff from receiving any compensation as an unlicensed broker.…Plaintiff opposed summary judgment. It argued that one of its managing principals, Jane Venturi, had a real estate sales license and was employed by a real estate broker (whom plaintiff did not identify) when defendants had signed their term sheet with the Talisker Group, the document that triggered plaintiff's right to a fee.

The court entered summary judgment for defendants. The court found plaintiff had acted as a real estate broker when working on the Little Exuma project. The court pointed, however, to plaintiff's lack of evidence that Jane Venturi's unnamed broker had employed or authorized her to work on the project.…[Summary judgment was issued in favor of defendants, denying plaintiff any recovery.] This appeal followed.

The court correctly ruled plaintiff could not receive compensation for providing real estate broker services to defendants because plaintiff was not a licensed broker. (Section 11136 [broker's license required to collect compensation for broker services].) But decisions such as Lindenstadt [Citation] establish that the court erred in denying plaintiff compensation to the extent plaintiff's services were not those of a real estate broker. In Lindenstadt, the parties entered into 25 to 30 written agreements in which the plaintiff promised to help the defendant find businesses for possible acquisition. After the plaintiff found a number of such businesses, the defendant refused to compensate the plaintiff. The defendant cited the plaintiff's performance of broker's services without a license as justifying its refusal to pay. On appeal, the appellate court rejected the defendant's sweeping contention that the plaintiff's unlicensed services forsome business opportunities meant the plaintiff could not receive compensation for any business opportunity. Rather, the appellate court directed the trial court to examine individually each business opportunity to determine whether the plaintiff acted as an unlicensed broker for that transaction or instead provided only services for which it did not need a broker's license.

Likewise here, the contract called for plaintiff to provide a range of services, some apparently requiring a broker's license, others seemingly not. Moreover, and more to the point, plaintiff denied having been involved in arranging, let alone negotiating, defendants' placement of Securities with the Talisker Group for which plaintiff claimed a "success fee" under the contract's provision awarding it a fee even if it had no role in procuring the financing. Thus, triable issues existed involving the extent to which plaintiff provided either unlicensed broker services or, alternatively, non-broker services for which it did not need a license. (Accord: [Citation] [severability allowed partial enforcement of personal manager employment contract when license required for some, but not all, services rendered under the contract].)

[T]he contract here…envisioned plaintiff directing its efforts toward many potential sources of financing. As to some of those sources, plaintiff may have crossed the line into performing broker services. But for other sources, plaintiff may have provided only financial and marketing advice for which it did not need a broker's license. (See, e.g. [Citation] [statute barring unlicensed contractor from receiving fees for some services did not prohibit recovery for work not within scope of licensing statute].) And finally, as to the Talisker Group, plaintiff may have provided even less assistance than financial and marketing advice, given that plaintiff denied involvement with the group. Whether plaintiff crossed the line into providing broker services is thus a triable issue of fact that we cannot resolve on summary judgment.

…Plaintiff…did not have a broker's license, and therefore was not entitled to compensation for broker's services. Plaintiff contends it was properly licensed because one of its managers, Jane Venturi, obtained a

real estate sales license in February 2004. Thus, she, and plaintiff claims by extension itself, were licensed when defendants purportedly breached the contract by refusing to pay plaintiff months later for the Talisker Group placement. Jane Venturi's sales license was not, however, sufficient; only a licensed broker may provide broker services. A sales license does not permit its holder to represent another unless the salesperson acts under a broker's authority.

The judgment for defendants is vacated, and the trial court is directed to enter a new order denying defendants' motion for summary judgment.…

Case Questions

1. Why did the plaintiff think it should be entitled to full recovery under the contract, including for services rendered as a real estate broker? Why did the court deny that?
2. Even if the plaintiff were not a real estate broker, why would that mean it could not recover for real estate services provided to the defendant?
3. The appeals court remanded the case; what did it suggest the plaintiff should recover on retrial?

Debate the case – Illegal (or Not) Contracts

Some contracts are unlawful because a statute makes that contract unlawful. Yet, in another state, that contract might be completely legal. This inconsistency between jurisdictions creates a legal and policy issue resulting in inconsistent treatment of the same type of contract depending on what state the parties are in. Should statutes that make conduct illegal be consistent across all jurisdictions, or should jurisdictions have the autonomy to establish their own differing statutes, even when it comes to illegality? Do some research and find at least one source that informs on the advantages and disadvantages of jurisdictional consistency and illustrates at least one common situation where this inconsistency is seen. Then decide which position you agree with and why.

9.3 BARGAINS MADE ILLEGAL BY COMMON LAW

Unsurprisingly, courts do not want to enforce contracts that violate established societal norms, laws, or public interests. When a contract is deemed to be against public policy, a court will typically refuse to enforce it, rendering it void. In determining whether to enforce a contract where there is no statute, courts must ordinarily balance the interests at stake. To strike the proper balance, courts must weigh the parties' expectations, the forfeitures that would result from denial of enforcement, and the public interest favoring enforcement against these factors: the strength of the policy; whether

denying enforcement will further the policy; the seriousness and deliberateness of the violation; and how direct the connection is between the misconduct and the contractual term to be enforced. After weighing these factors, if a court determines that a contract is against public policy, the bargain would be rendered unlawful under common law.

CASE 9.2

Bovard v. American Horse Enterprises, 247 Cal. Rptr. 340 (Calif. 1988)

[Bovard sued Ralph and American Horse Enterprises (a corporation) to recover on promissory notes that were signed when Ralph purchased the corporation, ostensibly a jewelry-making business. The trial court dismissed Bovard's complaint.]

PUGLIA, J.

The court found that the corporation predominantly produced paraphernalia used to smoke marijuana [roach clips and bongs] and was not engaged significantly in jewelry production, and that Bovard had recovered the corporate machinery through self-help [i.e., he had repossessed it]. The parties do not challenge these findings. The court acknowledged that the manufacture of drug paraphernalia was not itself illegal in 1978 when Bovard and Ralph contracted for the sale of American Horse Enterprises, Inc. However, the court concluded a public policy against the manufacture of drug paraphernalia was implicit in the statute making the possession, use and transfer of marijuana unlawful. The trial court held the consideration for the contract was contrary to the policy of express law, and the contract was therefore illegal and void. Finally, the court found the parties were in pari delicto [equally at fault] and thus with respect to their contractual dispute should be left as the court found them.

The trial court concluded the consideration for the contract was contrary to the policy of the law as expressed in the statute prohibiting the possession, use and transfer of marijuana. Whether a contract is contrary to public policy is a question of law to be determined from the circumstances of the particular case. Here, the critical facts are not in dispute. Whenever a court becomes aware that a contract is illegal, it has a duty to refrain from entertaining an action to enforce the contract. Furthermore the court will not permit the parties to maintain an action to settle or compromise a claim based on an illegal contract.…

[There are several] factors to consider in analyzing whether a contract violates public policy: "Before labeling a contract as being contrary to public policy, courts must carefully inquire into the nature of the conduct, the extent of public harm which may be involved, and the moral quality of the conduct of the parties in light of the prevailing standards of the community [Citations]"

These factors are more comprehensively set out in the Restatement Second of Contracts section 178:

1. 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.
2. In weighing the interest in the enforcement of a term, account is taken of

(a) the parties' justified expectations,

(b) any forfeiture that would result if enforcement were denied, and

(c) any special public interest in the enforcement of the particular term.

3. In weighing a public policy against enforcement of a term, account is taken of

(a) the strength of that policy as manifested by legislation or judicial decisions,

(b) the likelihood that a refusal to enforce the term will further that policy,

(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and

(d) the directness of the connection between that misconduct and the term.

Applying the Restatement test to the present circumstances, we conclude the interest in enforcing this contract is very tenuous. Neither party was reasonably justified in expecting the government would not eventually act to geld American Horse Enterprises, a business harnessed to the production of paraphernalia used to facilitate the use of an illegal drug. Moreover, although voidance of the contract imposed a forfeiture on Bovard, he did recover the corporate machinery, the only assets of the business which could be used for lawful purposes, i.e., to manufacture jewelry. Thus, the forfeiture was significantly mitigated if not negligible. Finally, there is no special public interest in the enforcement of this contract, only the general interest in preventing a party to a contract from avoiding a debt.

On the other hand, the Restatement factors favoring a public policy against enforcement of this contract are very strong. As we have explained, the public policy against manufacturing paraphernalia to facilitate the use of marijuana is strongly implied in the statutory prohibition against the possession, use, etc., of marijuana, a prohibition which dates back at least to 1929.…Obviously, refusal to enforce the instant contract will further that public policy not only in the present circumstances but by serving notice on manufacturers of drug paraphernalia that they may not resort to the judicial system to protect or advance their business interests. Moreover, it is immaterial that the business conducted by American Horse Enterprises was not expressly prohibited by law when Bovard and Ralph made their agreement since both parties knew that the corporation's products would be used primarily for purposes which were expressly illegal. We conclude the trial court correctly declared the contract contrary to the policy of express law and therefore illegal and void.

Case questions

1. Why did the court think it was significant that Bovard had repossessed the jewelry-making equipment?
2. What did Bovard want in this case?
3. If it was not illegal to make bongs and roach clips, why did the court determine that this contract should not be enforced?

COMMON-LAW RESTRAINT OF TRADE

One of the oldest public policies evolved by courts is the common-law prohibition against **restraint of trade**. A contract in restraint of trade is an agreement in which one party agrees to limit its ability to engage in a certain trade, profession, or business activity, usually for a specific time period and within a specific geographic area. Evolving from early contracts that fixed prices or agreed not to exclusive sales territories, today these contracts are typically concerned with promises not to compete in sales of businesses and employment contracts.

Not all restraints on trade are unlawful; only unreasonable ones are. As the Restatement puts it, "Every promise that relates to business dealings or to a professional or other gainful occupation operates as a restraint in the sense that it restricts the promisor's future activity. Such a promise is not, however, unenforceable, unless the restraint that it imposes is unreasonably detrimental to the smooth operation of a freely competitive private economy." An agreement that restrains trade will be construed as unreasonable unless it is **ancillary** to a legitimate business interest and is not more restrictive than is necessary to protect the legitimate interest. Restraint-of-trade cases usually arise in two settings: (1) the sale of a business and an attendant agreement not to compete with the purchasers and (2) an employee's agreement not to compete with the employer should the employee leave for any reason.

Sale of a Business

A first common area where a restraint-of-trade issue may arise is with the sale of a business. Regina sells her lingerie store to Victoria and promises not to establish a competing store in town for one year. Since Victoria is purchasing Regina's goodwill (the fact that customers are used to shopping at her store), as well as her building and inventory, there is clearly a property interest to be protected. And the geographical limitation ("in town") is reasonable if that is where the store does business. But if Regina had agreed not to engage in any business in town, or to wait ten years before opening up a new store, or not to open up a new store anywhere within one hundred miles of town, she could void the noncompetition terms of the contract because the restraint in each case (nature, duration, and geographic area of restraint) would have been broader than necessary to protect Victoria's interest.

Employment Noncompete Agreements

A second common restraint-of-trade issue arises with regard to **noncompete agreements** in employment contracts. As a condition of employment by the research division of a market research firm, Bruce, a product analyst, is required to sign an agreement in which he promises, for a period of one year after leaving the company, not to "engage, directly or indirectly, in any business competing with the company and located within fifty miles of the company's main offices." The principal reason recited in the agreement for this covenant not to compete is that by virtue of the employment, Bruce will come to learn a variety of internal secrets, including client lists, trade or business secrets, reports, confidential business discussions, ongoing research, publications, computer programs, and related papers. Is this agreement a lawful **restraint of trade**?

Here both the property interest of the employer and the extent of the restraint are issues. Certainly, an

employer has an important competitive interest in seeing that company information not walk out the door with former employees. Nevertheless, a promise by an employee not to compete with his or her former employer is scrutinized carefully by the courts as it restricts the employee from future work opportunities. Moreover, these types of contracts often arise from a take it or leave it negotiation with the employer where the employee is in a weak bargaining position. For these reasons, many courts are not enthusiastic about employment noncompete agreements, and in some states courts refuse to enforce such agreements. Other states view them more favorably as long as they are reasonable.

If a covenant not to compete is ruled unlawful, the courts can refuse to enforce the entire covenant, freeing the employee to compete thenceforth. Or, the court could delete from the agreement only that part that is unreasonable and enforce the remainder of the agreement, or even rewrite the objectionable clause themselves. If a court decides to enforce a **noncompete agreement**, it could issue an injunction to assure that the past employee does not violate the agreement.

ACTIVITY 9B

Debate the Case

In the 2022-2023 legislative session, the New Jersey legislature is considering enacting a statute (NJ Bill A3715) that would change the application of non-compete agreements in the state. https://www.njleg.state.nj.us/bill-search/2022/A3715/bill-text?f=A4000&n=3715_I1

Review the proposed Bill and find and read at least one internet source discussing the proposed legislation. Then answer the following questions:

1. How would the Bill, if it became law, change the way the general common lawdeals with non-compete agreements?
2. Which of these (the common law, or the new Bill) is better for employers, and why?
3. Debate the Case – if you were a member of the New Jersey legislature, would you vote in favor of the Bill or oppose the Bill? Support your position.

UNCONSCIONABLE CONTRACTS

Courts may refuse to enforce **unconscionable contracts**, those that are very one-sided, unfair, the product of unequal bargaining power, or oppressive; a court may find the contract divisible and enforce only the parts that are not unconscionable.

The common-law rule is reflected in the Restatement: "If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result."

And the **Uniform Commercial Code (UCC)** provides a similar rule in Section 2-302(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."

Unconscionable is not defined in the Restatement or the UCC, but cases have given gloss to the meaning, as in Williams v. Walker-Thomas Furniture Co.*, a well-known early interpretation of the section by the D.C. Court of Appeals.*

CASE 9.3

Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Ct. App. 1965)

WRIGHT, J.

Appellee, Walker-Thomas Furniture Company, operates a retail furniture store in the District of Columbia. During the period from 1957 to 1962 each appellant in these cases purchased a number of household items from Walker-Thomas, for which payment was to be made in installments. The terms of each purchase were contained in a printed form contract which set forth the value of the purchased item and purported to lease the item to appellant for a stipulated monthly rent payment. The contract then provided, in substance, that title would remain in Walker-Thomas until the total of all the monthly payments made equaled the stated value of the item, at which time appellants could take title. In the event of a default in the payment of any monthly installment, Walker-Thomas could repossess the item.

The contract further provided that 'the amount of each periodical installment payment to be made by (purchaser) to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by (purchaser) under such prior leases, bills or accounts; and all payments now and hereafter made by (purchaser) shall be credited pro rata on all outstanding leases, bills and accounts due the Company by (purchaser) at the time each such payment is made.' The effect of this rather obscure provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

On May 12, 1962, appellant Thorne purchased an item described as a daveno, three tables, and two lamps, having total stated value of $391.11 [about $2,800 in 2011 dollars]. Shortly thereafter, he defaulted on his monthly payments and appellee sought to replevy [repossess] all the items purchased since the first transaction in 1958. Similarly, on April 17, 1962, appellant Williams bought a stereo set of stated value of $514.95 [about $3,600 in 2011 dollars]. She too defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December, 1957. The Court of General Sessions granted judgment for appellee. The District of Columbia Court of Appeals affirmed, and we granted appellants' motion for leave to appeal to this court.

Appellants' principal contention, rejected by both the trial and the appellate courts below, is that these contracts, or at least some of them, are unconscionable and, hence, not enforceable. [In its opinion the lower court said:]

The record reveals that prior to the last purchase appellant had reduced the balance in her account to $164. The last purchase, a stereo set, raised the balance due to $678. Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her $218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a $514 stereo set.

We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business dealings. A review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose, however, no ground upon which this court can declare the contracts in question contrary to public policy. We note that were the Maryland Retail Installment Sales Act…or its equivalent, in force in the District of Columbia, we could grant appellant appropriate relief. We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar.

We do not agree that the court lacked the power to refuse enforcement to contracts found to be unconscionable. In other jurisdictions, it has been held as a matter of common law that unconscionable contracts are not enforceable. While no decision of this court so holding has been found, the notion that an unconscionable bargain should not be given full enforcement is by no means novel.…

Since we have never adopted or rejected such a rule, the question here presented is actually one of first impression.…[W]e hold that where the element of unconscionability is present at the time a contract is made, the contract should not be enforced.

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.…

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered 'in the light of the general commercial background and the commercial needs of the particular trade or case.' Corbin suggests the test as being whether the terms are 'so extreme as to appear unconscionable according to the mores and business practices of the time and place.' We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract. So ordered.

DAJAHER, J. (dissenting):

[The lower] court…made no finding that there had actually been sharp practice. Rather the appellant seems to have known precisely where she stood.

There are many aspects of public policy here involved. What is a luxury to some may seem an outright necessity to others. Is public oversight to be required of the expenditures of relief funds? A washing machine, e.g., in the hands of a relief client might become a fruitful source of income. Many relief clients may well need credit, and certain business establishments will take long chances on the sale of items, expecting their pricing policies will afford a degree of protection commensurate with the risk. Perhaps a remedy when necessary will be found within the provisions of the D.C. "Loan Shark" law, [Citation].

I mention such matters only to emphasize the desirability of a cautious approach to any such problem, particularly since the law for so long has allowed parties such great latitude in making their own contracts. I dare say there must annually be thousands upon thousands of installment credit transactions in this jurisdiction, and one can only speculate as to the effect the decision in these cases will have.

Case questions

1. Did the court here say that cross-collateral contracts are necessarily unconscionable?
2. Why is it relevant that the plaintiff had seven children and was on welfare?
3. Why did the defendant have a cross-collateral clause in the contract? What would happen if no such clauses were allowed?
4. What are the elements of unconscionability that the court articulates?

Unconscionability may arise procedurally or substantively. A term is procedurally unconscionable if it is imposed upon the "weaker" party because of fine or inconspicuous print, unexpected placement in the contract, lack of opportunity to read the term, lack of education or sophistication that precludes understanding, or lack of equality of bargaining power. Substantive unconscionability arises where the affected terms are oppressive and harsh, where the term deprives a party of any real remedy for breach. Most often—but not always—courts find unconscionable contracts in the context of consumer transactions rather than commercial transactions. In the latter case, the assumption is that the parties tend to be sophisticated businesspeople able to look out for their own contract interests.

EXCULPATORY CLAUSES

The courts have long held that public policy disfavors attempts to contract out of tort liability. **Exculpatory clauses** that exempt one party from tort liability for harm to the other caused intentionally or recklessly are unenforceable without exception. A contract provision that exempts a party from tort liability for negligence is void under two general circumstances: (1) when it "exempts an employer from liability to an employee for injury in the course of his employment" or (2) when it exempts one charged with a duty of public service and who is receiving compensation from liability to

one to whom the duty is owed. Contract terms with offensive exculpatory clauses may be considered somewhat akin to **unconscionability**.

To be enforced, exculpatory clauses must be reasonable. Exculpatory clauses will generally be held valid if (1) the agreement does not involve a business generally thought suitable for public regulation (a twenty-kilometer bicycle race, for example, is probably not one thought generally suitable for public regulation, whereas a bus line is); (2) the party seeking exculpation is not performing a business of great importance to the public or of practical necessity for some members of the public; (3) the party does not purport to be performing the service to just anybody who comes along (unlike the bus line); (4) the parties are dealing at arms' length, able to bargain about the contract; (5) the person or property of the purchaser is not placed under control of the seller, subject to his or his agent's carelessness; or (6) the clause is conspicuous and clear.

OBSTRUCTING THE ADMINISTRATION OF JUSTICE OR VIOLATING A PUBLIC DUTY

It is well established under common law that contracts that would interfere with the administration of justice or that call upon a public official to violate a public duty are void. Examples of such contracts are numerous: to conceal or compound a crime; to pay for the testimony of a witness in court contingent on the court's ruling; to suppress evidence by paying a witness to leave the state; or to destroy documents. Thus, in a case in Arkansas, a gambler sued a circuit court judge to recover $1,675 allegedly paid to the judge as protection money, and the Arkansas Supreme Court affirmed the dismissal of the suit, holding, "The law will not aid either party to the alleged illegal and void contract…'but will leave them where it finds them, if they have been equally cognizant of the illegality.'" Also in this category are bribes, agreements to obstruct or delay justice (jury tampering, abuse of the legal process), and the like.

FAMILY RELATIONS

Another broad area in which public policy intrudes on private contractual arrangements is that of undertakings between couples, either prior to or during marriage. Marriage is a relationship defined by statutory law, and individuals have limited ability to change its scope through legally enforceable contracts. Moreover, marriage is an institution that public policy favors, and agreements that unreasonably restrain marriage are void. Thus, a father's promise to pay his twenty-one-year-old daughter $100,000 if she refrains from marrying for ten years would be unenforceable. However, a promise in a postnuptial (after marriage) agreement that he will provide his wife with a fixed income for as long as she remains unmarried after his death if he predeceases her is valid because the offer of support is related to the need. Property settlements before, during, or upon the breakup of a marriage are generally enforceable since property is not considered to be an essential incident of marriage. But agreements in the form of property arrangements that tend to be detrimental to marriage are void—for example, a prenuptial (premarital) contract in which the wife-to-be agrees to leave the marriage on demand of the husband-to-be and to renounce any claims upon the husband-to-be at any time in the future in return for which he will pay her $100,000. Separation agreements are not considered detrimental to marriage as long as they are entered after or in contemplation of immediate separation; but a separation agreement must be "fair" under the circumstances, and judges may review them upon challenge. Similarly, child custody agreements are not left to the whim of the

parents but must be consistent with the best interest of the child, and the courts retain the power to examine this question.

The types of contracts or bargains that might be found illegal are innumerable, limited only by the ingenuity of those who seek to overreach.

ACTIVITY 9C

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=211#h5p-7

9.4 EXCEPTIONS TO ILLEGALITY

As stated in the outset of this Chapter, the general rule is that courts will not enforce illegal bargains. The parties are left where the court found them, and no relief is granted: it's a hands-off policy. The illegal agreement is classified as void, and that a wrongdoer has benefited to the other's detriment does not matter. For example, suppose a specialty contractor, statutorily required to have a license, constructs a waterslide for Plaintiff, when the contractor knew or should have known he was unlicensed. Plaintiff discovers the contractor is unlicensed and refuses to pay the contractor $80,000 remaining on the deal. Under the general rule of non-enforcement, the contractor will not get paid.

As always in the law, there are exceptions, and this is true even when discussing illegal contracts. There are limited instances where a court might permit one party to recover, but those instances do exist, and are discussed below.

PARTY WITHDRAWING BEFORE PERFORMANCE

A party that has withdrawn from a contract prior to performance in an illegal bargain may be entitled to seek restitution. For example, Samantha and Carlene agree to bet on a soccer game and deliver their wagers to the stakeholder. Subsequently, but before the game, Carlene discovers the wager is unlawful and decides she no longer wants the bet. She notifies Samantha and the stakeholder. In this case, a court may permit her to get her money back from the stakeholder.

PARTY PROTECTED BY STATUTE

When a party is protected by a statute, it can have a significant impact on the legality or enforceability of a contract. In contract law, statutes and regulations can override or modify the terms of a contract and may provide protections to one or both parties. For example, securities laws forbid the sale or purchase of unregistered offerings—such a contract is illegal. Yet even with the illegality, the statute

allows the purchaser of the unregistered offerings the right of rescission (return of the money paid), so there is still a contract remedy.

PARTY NOT EQUALLY AT FAULT

When both parties to a contract are equally responsible for the illegal conduct, called '*in pari delecto*', the court is more likely to refuse to enforce the contract for both parties. Neither party is favored since both have "unclean hands." However, there are situations where one party is less culpable or less involved in the illegal conduct than the other party. In such cases, the court may be more lenient toward the party with lesser fault. If one party induces another to make an illegal contract by undue influence, fraud, or duress; the party with lesser fault in the illegality can recover their consideration.

EXCUSABLE IGNORANCE

Excusable ignorance occurs when one party to the contract was genuinely unaware of the contract's illegal nature. This ignorance may arise due to a lack of knowledge about specific laws or regulations, misrepresentation by the other party, or other reasonable factors that prevented the party from recognizing the illegality. For example, a laborer is hired to move sealed crates, which contain illegal drugs. Although it is unlawful to sell and ship these drugs, the laborer can still be payed for services due to excusable ignorance.

PARTIAL ILLEGALITY

Partial illegality in contracts refers to a situation where only a portion of a contract is illegal, while the remainder of the contract is lawful and enforceable. In cases of partial illegality, the court may choose to sever or remove the illegal portion while upholding the valid portions of the contract, provided that the legal and illegal aspects are distinct and separable. For example, a six-page employment contract contains two paragraphs of an illegal noncompete agreement. The illegal part is thrown out, but the legal parts are enforceable.

End of Chapter Exercises

1. Henrioulle was an unemployed widower with two children who received public assistance from the Marin County (California) Department of Social Services. There was a shortage of housing for low-income residents in Marin County. He entered into a lease agreement on a printed form by which the landlord disclaimed any liability for any injury sustained by the tenants anywhere on the property. Henrioulle fractured his wrist when he tripped on a rock on the common stairs in the apartment building. The landlord had been having a hard time keeping the area clean. Is the disclaimer valid? Explain.
2. Albert Bennett, an amateur cyclist, entered a bicycle race sponsored by the United States Cycling Federation. He signed a release exculpating the federation for liability: "I further understand that serious accidents occasionally occur during bicycle racing and that participants in bicycle racing occasionally sustain mortal or serious personal injuries, and/or property damage, as a consequence thereof. Knowing the risks of bicycle racing, nevertheless I hereby

agree to assume those risks and to release and hold harmless all the persons or entities mentioned above who (through negligence or carelessness) might otherwise be liable to me (or my heirs or assigns) for damages." During the race, Bennett was hit by an automobile that had been allowed on the otherwise blocked-off street by agents of the defendant. Bennett sued; the trial court dismissed the case on summary judgment. Bennett appealed. What was the decision on appeal?

3. Ramses owned an industrial supply business. He contracted to sell the business to Tut. Clause VI of their Agreement of Sale provided as follows: "In further consideration for the purchase, Ramses agrees that he shall not compete, either directly or indirectly, in the same business as is conducted by the corporation in its established territory." Two months after the sale, Ramses opened a competing business across the street from the business now owned by Tut, who brought suit, asking the court to close Ramses's business on the basis of Clause VI. What should the court decide? Why?
4. After taking a business law class at State U, Elke entered into a contract to sell her business law book to a classmate, Matthew, for $45. As part of the same contract, she agreed to prepare a will for Matthew's mother for an additional $110. Elke prepared the will and sent the book to Matthew, but he refused to pay her. Is she entitled to any payment? Explain.
5. Elmo, a door-to-door salesman, entered into a contract to sell the Wilson family $320 worth of household products on credit. The Wilsons later learned that Elmo had failed to purchase a city license to make door-to-door sales and refused to pay him. May Elmo collect from the Wilsons? Why?
6. Blubaugh leased a large farm combine from John Deere Leasing by signing an agreement printed on very lightweight paper. The back side of the form was "written in such fine, light print as to be nearly illegible.…The court was required to use a magnifying glass." And the wording was "unreasonably complex," but it contained terms much in John Deere's favor. When Blubaugh defaulted, John Deere repossessed the combine, sold it for more than he had paid, and sued him for additional sums in accordance with the default clauses on the back side of the lease. Blubaugh defended by asserting the clauses were unconscionable. Is this a case of procedural, substantive, or no unconscionability? Decide.
7. Sara Hohe, a fifteen-year-old junior at Mission Bay High School in San Diego, was injured during a campus hypnotism show sponsored by the PTSA as a fund-raiser for the senior class. Hypnotism shows had been held annually since 1980, and Sara had seen the previous year's show. She was selected at random from a group of many volunteers. Her participation in the "Magic of the Mind Show" was conditioned on signing two release forms. Hohe's father signed a form entitled "Mission Bay High School PTSA Presents Dr. Karl Santo." Hohe and her father both signed a form titled "Karl Santo Hypnotist," releasing Santo and the school district from all liability. During the course of the show, while apparently hypnotized, Hohe slid from her chair and also fell to the floor about six times and was injured. She, through her father, then sued the school district. The Hohes claimed the release was contrary to public policy; the trial court dismissed the suit on summary judgment. Was the release contrary to public policy? Decide.
8. In 1963 the Southern Railway Company was disturbed by an order issued by the Interstate Commerce Commission, a federal agency, which would adversely affect the firm's profit by some $13 million [about $90 million in 2011 dollars]. Southern hired a lawyer, Robert Troutman, who was a friend of President John F. Kennedy, to lobby the president that the latter

might convince the attorney general, Robert Kennedy, to back Southern's position in a lawsuit against the ICC. It worked; Southern won. Southern then refused to pay Troutman's bill in the amount of $200,000 [about $14 million in 2011 dollars] and moved for summary judgment dismissing Troutman's claim, asserting—among other things—that contracts whereby one person is hired to use his influence with a public official are illegal bargains. Should summary judgment be issued? Decide.

REFERENCES

Article IV, Section VII, paragraph 2 of the New Jersey

California Business and Professions Code, Section 16600.

Harold C. Havighurst, review of *Corbin on Contracts*, by Arthur L. Corbin, *Yale Law Journal*61 (1952): 1143, 1144–45.

Henrioulle v. Marin Ventures, Inc., 573 P.2d 465 (Calif. 1978).

Marquette v. First Omaha Service Corp., 439 U.S. 299 (1978).

Pacific Custom Pools, Inc. v. Turner Construction, 94 Cal. Rptr. 2d 756 (Calif. 2000).

Raimondo v. Van Vlerah, 325 N.E.2d 544 (Ohio 1975).

Ransburg v. Haase, 586 N.E. 2d 1295 (Ill. Ct. App. 1992).

Thomas M. Reardon, "T. M. Reardon's first-hand account of Citibank's move to South Dakota," *NorthWestern Financial Review*, September 15, 2004.

Restatement (Second) of Contracts, Section 178.

Restatement (Second) of Contracts, Section 186(a).

Restatement (Second) of Contracts, Section 195.

Restatement (Second) of Contracts, Section 197(b).

Womack v. Maner, 301 S.W.2d 438 (Ark. 1957).

Paramus Park Mall Hours, https://www.paramuspark.com/en/visit.html

CHAPTER 10 - REAL ASSENT

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the difference between undue influence and duress.
2. Explain the difference between the different types of misrepresentation
3. Explain the different between mutual and unilateral mistakes

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=212#h5p-15

10.1 INTRODUCTION TO THE REQUIREMENT OF REAL ASSENT

In contract law, "**real assent**" refers to the genuine and voluntary agreement of all parties involved in a contract to its terms and conditions. For a contract to be legally valid, it's essential that all parties enter into it with a clear understanding of the contract's terms and freely give their consent to be bound by those terms. In other words, in addition to manifestation of assent through the application of the concepts in prior Chapters, a party's assent must be real as he or she must consent to the contract freely. Real assent ensures that the parties have a meeting of the minds, meaning they understand and agree to the same thing. If the assent to contract is not 'real', the resulting contract is typically voidable. Real assent can be compromised or invalidated if any of the following are present:

Duress: If one party is forced, threatened, or coerced into entering into the contract against their will, and thus their consent is not genuine.

Undue Influence: If one party exercises excessive influence or control over the other party, such that the weaker party cannot make an independent decision.

Misrepresentation: If one party makes a false statement or representation that induces the other party to enter into the contract, and the false statement is **material** to the contract.

Mistake: If one or both parties make a material mistake about a fundamental aspect of the contract such as the subject matter, price, or terms.

Each of these will be discussed in detail in this Chapter.

10.2 DURESS

The defense of **duress** typically involves one party making a threat toward the other party to induce that person to enter a contract. This threat can take various forms, such as physical harm, economic harm, damage to reputation, or even blackmail. The key is that the threat or pressure is wrongful and improper. Contracts require the genuine and voluntary consent of all parties involved. When a party is forced or pressured into the contract against their will, their consent is not genuine, and the contract is ordinarily considered **voidable**. A contract induced by physical violence is **void**.

Physical Duress

If a person is forced into entering a contract on threat of physical bodily harm, he or she is the victim of physical duress. This is defined by the **Restatement** in Section 174: "If conduct that appears to be a manifestation of assent by a party who does not intend to engage in that conduct is physically compelled by duress, the conduct is not effective as a manifestation of assent." In addition, comment (a) to Section 174 provides in part, "This Section involves an application of that principle to those *relatively rare situations in which actual physical force* has been used to compel a party to appear to assent to a contract.…The essence of this type of duress is that a party is compelled by physical force to do an act that he has no intention of doing. He is, it is sometimes said, 'a mere mechanical instrument.' The result is that there is no contract at all, or a 'void contract' as distinguished from a voidable one" (emphasis added).

Duress by Threat

A second kind of duress is *duress by threat*, which is more common than physical duress. Here the perpetrator threatens the victim, who feels there is no reasonable alternative but to assent to the contract. Duress by threat renders the contract voidable. For a threat to rise to the level of duress, the threat must be improper and there must be no reasonable alternative other than entering a contract. As an example, if a supplier threatens to hold up shipment of necessary goods unless the buyer agrees to pay more than the contract price, this would not be duress if the buyer could purchase identical supplies from someone else. It is also notable that the standard for evaluating the threat is subjective. It does not matter if the person threatened is unusually timid or that a reasonable person would not have felt threatened. The question is whether the threat in fact induced assent by the victim.

There are many types of improper threats that might induce a party to enter into a contract: threats to commit a crime or a tort (e.g., bodily harm or taking of property), to instigate criminal prosecution, to instigate civil proceedings when a threat is made in bad faith, to breach a "duty of good faith and fair dealing under a contract with the recipient," or to disclose embarrassing details about a person's private life.

As an example of a contract procured through duress by threat, suppose that Jack buys a car from a local used-car salesman, Mr. Olson. The day after the sale, Jack recognizes he bought a lemon. He threatens to break windows in Olson's showroom if Olson does not buy the car back for $2,150,

the purchase price. Mr. Olson agrees. The agreement is voidable if Olson feels he has no reasonable alternative and is frightened into agreeing. Suppose Jack knows that Olson has been tampering with his cars' odometers, a federal offense, and threatens to have Olson prosecuted if he will not repurchase the car. Even though Olson may be guilty of breaking the federal law, this threat is made to have the car repurchased, and that misuse of the information for personal ends of power is what rises to duress. Suppose instead that Jack then tells Olson if he isn't made whole on the car, "I'm going to haul you into court and sue your pants off." As long as Jack means that he intends to sue for his purchase price, this is not an improper threat, because everyone has the right to use the courts to gain what they think is rightfully theirs.

A threat to breach a contract that induces the victim to sign a new contract may also be improper. Suppose that as part of the original purchase price, Olson agrees to make all necessary repairs and replace all failed parts for the first ninety days. At the end of one month, the transmission dies, and Jack demands a replacement. Olson refuses to repair the car unless Jack signs a contract agreeing to buy his next car from Olson. Whether this threat is improper depends on whether Jack has a reasonable alternative; if a replacement transmission is readily available and Jack has the funds to pay for it, he might have an alternative in suing Olson in small claims court for the cost. But if Jack needs the car immediately and he is impecunious, then the threat would be improper and the contract voidable. A threat to breach a contract is not necessarily improper, however. It depends on whether the new contract is fair and equitable because of unanticipated circumstances. If, for example, Olson discovers that he must purchase a replacement transmission at three times the anticipated cost, his threat to hold up work unless Jack agrees to pay for it might be reasonable.

10.3 UNDUE INFLUENCE

The Restatement characterizes undue influence as "unfair persuasion." It is a milder form of **duress** than physical harm or threats. **Undue influence** is a defense that pertains to situations where one party exerts improper or unfair pressure on another party to manipulate them into entering into a contract or making a particular decision. This pressure can be subtle, psychological, or emotional in nature and often involves a relationship of trust and confidence between the parties. This can include relationships between family members, caregivers, attorneys, doctors, financial advisors, and their clients, among others. Undue influence undermines the voluntary nature of consent, making the contract or decision voidable.

The unfairness of undue influence does not lie in any **misrepresentation**; rather it is the improper use of trust or power to deprive a person of free will and substitute instead another's objective. Falling within this rule are situations where, for example, a child takes advantage of an infirm parent, a doctor takes advantage of an ill patient, or a lawyer takes advantage of an unknowledgeable client. If there has been undue influence, the contract is voidable by the party who has been unfairly persuaded. At the core of undue influence is the nature of the persuasion and the relationship. Whether the relationship is one of domination and the persuasion is unfair is a factual question. The answer hinges on a host of variables, including "the unfairness of the resulting bargain, the unavailability of independent advice, and the susceptibility of the person persuaded."

CASE 10.1

Hodge v. Shea, 168 S.E.2d 82 (S.C. 1969)

BRAILSFORD, J.

In this equitable action the circuit court decreed specific performance of a contract for the sale of land, and the defendant has appealed. The plaintiff is a physician, and the contract was prepared and executed in his medical office on August 19, 1965. The defendant had been plaintiff's patient for a number of years. On the contract date, he was seventy-five years of age, was an inebriate of long standing, and was afflicted by grievous chronic illnesses, including arteriosclerosis, cirrhosis of the liver, neuritises, arthritis of the spine and hip and varicose veins of the legs. These afflictions and others required constant medication and frequent medical attention, and rendered him infirm of body and mind, although not to the point of incompetency to contract.

During the period immediately before and after August 19, 1965, George A. Shea, the defendant, was suffering a great deal of pain in his back and hip and was having difficulty in voiding. He was attended professionally by the plaintiff, Dr. Joseph Hodge, either at the Shea home, at the doctor's office or in the hospital at least once each day from August 9 through August 26, 1965, except for August 17. The contract was signed during the morning of August 19. One of Dr. Hodge's frequent house calls was made on the afternoon of that day, and Mr. Shea was admitted to the hospital on August 21, where he remained until August 25.

Mr. Shea was separated from his wife and lived alone. He was dependent upon Dr. Hodge for house calls, which were needed from time to time. His relationship with his physician, who sometimes visited him as a friend and occasionally performed non-professional services for him, was closer than ordinarily arises from that of patient and physician.…

"Where a physician regularly treats a chronically ill person over a period of two years, a confidential relationship is established, raising a presumption that financial dealings between them are fraudulent." [Citation]

A 125 acre tract of land near Mr. Shea's home, adjacent to land which was being developed as residential property, was one of his most valuable and readily salable assets. In 1962, the developer of this contiguous land had expressed to Mr. Shea an interest in it at $1000.00 per acre. A firm offer of this amount was made in November, 1964, and was refused by Mr. Shea on the advice of his son-in-law that the property was worth at least $1500.00 per acre. Negotiations between the developer and Mr. Ransdell commenced at that time and were in progress when Mr. Shea, at the instance of Dr. Hodge and without consulting Mr. Ransdell or anyone else, signed the contract of August 19, 1965. Under this contract Dr. Hodge claims the right to purchase twenty choice acres of the 125 acre tract for a consideration calculated by the circuit court to be the equivalent of $361.72 per acre. The market value of the land on the contract date has been fixed by an unappealed finding of the master at $1200.00 per acre.…

The consideration was expressed in the contract between Dr. Hodge and Mr. Shea as follows:

The purchase price being (Cadillac Coupe DeVille 6600) & $4000.00 Dollars, on the following terms: Dr. Joseph Hodge to give to Mr. George Shea a new $6600 coupe DeVille Cadillac which is to be registered in

name of Mr. George A. Shea at absolutely no cost to him. In return, Mr. Shea will give to Dr. Joe Hodge his 1964 Cadillac coupe DeVille and shall transfer title of this vehicle to Dr. Hodge. Further, Dr. Joseph Hodge will pay to Mr. George A. Shea the balance of $4000.00 for the 20 acres of land described above subject to survey, title check, less taxes on purchase of vehicle.

Dr. Hodge was fully aware of Mr. Shea's financial troubles, the liens on his property and his son-in-law's efforts in his behalf. He was also aware of his patient's predilection for new Cadillacs. Although he was not obligated to do so until the property was cleared of liens, which was not accomplished until the following June, Dr. Hodge hastened to purchase a 1965 Cadillac Coupe DeVille and delivered it to Mr. Shea on the day after his discharge from the hospital on August 25, 1965. If he acted in haste in an effort to fortify what he must have realized was a dubious contract, he has so far succeeded.…

The case at hand is attended by gross inadequacy of consideration, serious impairment of the grantor's mentality from age, intemperance and disease, and a confidential relationship between the grantee and grantor. Has the strong presumption of vitiating unfairness arising from this combination of circumstances been overcome by the evidence? We must conclude that it has not. The record is devoid of any evidence suggesting a reason, compatible with fairness, for Mr. Shea's assent to so disadvantageous a bargain. Disadvantageous not only because of the gross disparity between consideration and value, but because of the possibility that the sale would impede the important negotiations in which Mr. Ransdell was engaged. Unless his memory failed him, Mr. Shea knew that his son-in-law expected to sell the 125 acre tract for about $1500.00 per acre as an important step toward raising sufficient funds to satisfy the tax and judgment liens against the Shea property. These circumstances furnish strong evidence that Mr. Shea's assent to the contract, without so much as notice to Mr. Ransdell, was not the product of a deliberate Exercise of an informed judgment.…

Finally, on this phase of the case, it would be naive not to recognize that the 1965 Cadillac was used to entice a highly susceptible old man into a hard trade. Mr. Shea was fatuously fond of new Cadillacs, but was apparently incapable of taking care of one. His own 1964 model (he had also had a 1963 model) had been badly abused. According to Dr. Hodge, it 'smelled like a toilet. * * * had several fenders bumped, bullet holes in the top and the car was just filthy * * *. It was a rather foul car.'…Knowing the condition of Mr. Shea's car, his financial predicament and the activities of his son-in-law in his behalf, Dr. Hodge used the new automobile as a means of influencing Mr. Shea to agree to sell. The means was calculated to becloud Mr. Shea's judgment, and, under the circumstances, its use was unfair.…

Reversed and remanded.

Case questions

1. Why is it relevant that Mr. Shea was separated from his wife and lived alone?
2. Why is it relevant that it was his doctor who convinced him to sell the real estate?
3. Why did the doctor offer the old man a Cadillac as part of the deal?
4. Generally speaking, if you agree to sell your real estate for less than its real value, that's just a unilateral mistake and the courts will grant no relief. What's different here?

Activity 10A

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=212#h5p-27

10.4 MISREPRESENTATION

Misrepresentation refers to a false statement or assertion made by one party to a contract during the negotiation or formation of a contract. When the other party in the contract relies on this false statement and enters into the contract based on the belief that the statement is true, it can lead to legal consequences. Misrepresentation can render the contract voidable, allowing the deceived party the option to rescind or void the contract and potentially seek damages. This section will focus on the following three main types of misrepresentation:

Fraudulent Misrepresentation (Fraud): Fraudulent misrepresentation, often referred to as fraud, occurs when a party intentionally and knowingly makes a false statement with the intent to deceive the other party and induce them into the contract. Fraud is the most serious form of misrepresentation and can lead to not only contract rescission but also potential liability for damages. Courts also distinguish between fraud in the execution and fraud in the inducement. Fraud in the execution is defined by the Restatement as follows: "If a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has reasonable opportunity to know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent."

Negligent Misrepresentation: Negligent misrepresentation happens when a false statement is made due to negligence, carelessness, or a lack of reasonable care in ascertaining its accuracy. To prove negligent misrepresentation, the deceived party must demonstrate that the misrepresenting party failed to exercise reasonable care in providing accurate information.

Innocent Misrepresentation: Innocent misrepresentation occurs when a false statement is made without any knowledge that it is false. In such cases, the person making the statement genuinely believes it to be true, but it turns out to be inaccurate. While innocent misrepresentation may not typically lead to damages, it can still result in the contract being voidable.

Fraudulent Misrepresentation

A fraudulent misrepresentation is a false statement or assertion of a **material** fact, made with the intent to deceive the other party, and induce the other party to enter into a contract. The deceived party enters the contract justifiably and reasonably relying on this false statement, which results in

harm or damages. Fraudulent misrepresentation may also appear as the tort of "fraud" or even as criminal conduct.

Misstatement of Fact

Generally a statement not in accord with the facts (a fact is something amenable to testing as true) is a **misrepresentation**. Falsity does not depend on the intent of the speaker or writer. A typist's unnoticed error in a letter (inadvertently omitting the word "not," for example, or transposing numbers) can amount to a misrepresentation on which the recipient may rely.

Concealment

Another type of **misrepresentation** is concealment. **Concealment** refers to the act of deliberately hiding **material** information during the negotiation or formation of a contract. While misrepresentation is often associated with making false statements, concealment is about keeping important facts hidden. It is hiding the truth. A common example is painting over defects in a building—by concealing the defects, the owner is misrepresenting the condition of the property. The act of concealment need not be direct; it may consist of sidetracking the other party from gaining necessary knowledge by, for example, convincing a third person who has knowledge of the defect not to speak. Concealment is always a misrepresentation.

Nondisclosure

A more passive type of **concealment** is **nondisclosure**. Although generally the law imposes no obligation on anyone to speak out, nondisclosure of a fact can operate as a misrepresentation under certain circumstances. This occurs, for example, whenever the other party has erroneous information, or, as *Reed v. King* shows, where the nondisclosure amounts to a failure to act in good faith, or where the party who conceals knows or should know that the other side cannot, with reasonable diligence, discover the truth.

CASE 10.2

Reed v. King, 193 Cal. Rptr. 130 (Calif. Ct. App. 1983)

BLEASE, J.

In the sale of a house, must the seller disclose it was the site of a multiple murder? Dorris Reed purchased a house from Robert King. Neither King nor his real estate agents (the other named defendants) told Reed that a woman and her four children were murdered there ten years earlier. However, it seems "truth will come to light; murder cannot be hid long." (Shakespeare, *Merchant of Venice*, Act II, Scene II.) Reed learned of the gruesome episode from a neighbor after the sale. She sues seeking rescission and damages. King and the real estate agent defendants successfully demurred to her first amended complaint for failure to state a cause of action. Reed appeals the ensuing judgment of dismissal. We will reverse the judgment.

Facts

We take all issuable facts pled in Reed's complaint as true. King and his real estate agent knew about the murders and knew the event materially affected the market value of the house when they listed it for sale. They represented to Reed the premises were in good condition and fit for an "elderly lady" living alone. They did not disclose the fact of the murders. At some point King asked a neighbor not to inform Reed of that event. Nonetheless, after Reed moved in neighbors informed her no one was interested in purchasing the house because of the stigma. Reed paid $76,000, but the house is only worth $65,000 because of its past.…

Discussion

Does Reed's pleading state a cause of action? Concealed within this question is the nettlesome problem of the duty of disclosure of blemishes on real property which are not physical defects or legal impairments to use.

Numerous cases have found non-disclosure of physical defects and legal impediments to use of real property are material. [Citation] However, to our knowledge, no prior real estate sale case has faced an issue of non-disclosure of the kind presented here. Should this variety of ill-repute be required to be disclosed? Is this a circumstance where "non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing [?]" (Rest.2d Contracts, § 161, subd. (b).)

The paramount argument against an affirmative conclusion is it permits the camel's nose of unrestrained irrationality admission to the tent. If such an "irrational" consideration is permitted as a basis of rescission the stability of all conveyances will be seriously undermined. Any fact that might disquiet the enjoyment of some segment of the buying public may be seized upon by a disgruntled purchaser to void a bargain. In our view, keeping this genie in the bottle is not as difficult a task as these arguments assume. We do not view a decision allowing Reed to survive a demurrer in these unusual circumstances as endorsing the materiality of facts predicating peripheral, insubstantial, or fancied harms.

The murder of innocents is highly unusual in its potential for so disturbing buyers they may be unable to reside in a home where it has occurred. This fact may foreseeably deprive a buyer of the intended use of the purchase. Murder is not such a common occurrence that buyers should be charged with anticipating and discovering this disquieting possibility. Accordingly, the fact is not one for which a duty of inquiry and discovery can sensibly be imposed upon the buyer.

Reed alleges the fact of the murders has a quantifiable effect on the market value of the premises. We cannot say this allegation is inherently wrong and, in the pleading posture of the case, we assume it to be true. If information known or accessible only to the seller has a significant and measureable effect on market value and, as is alleged here, the seller is aware of this effect, we see no principled basis for making the duty to disclose turn upon the character of the information. Physical usefulness is not and never has been the sole criterion of valuation. Stamp collections and gold speculation would be insane activities if utilitarian considerations were the sole measure of value.

Reputation and history can have a significant effect on the value of realty. "George Washington slept here" is worth something, however physically inconsequential that consideration may be. Ill-repute or "bad will" conversely may depress the value of property. Failure to disclose such a negative fact where it will have a foreseeably depressing effect on income expected to be generated by a business is tortuous. [Citation] Some cases have held that unreasonable fears of the potential buying public that a gas or oil pipeline may rupture may depress the market value of land and entitle the owner to incremental compensation in eminent domain.

Whether Reed will be able to prove her allegation the decade-old multiple murder has a significant effect on market value we cannot determine. If she is able to do so by competent evidence she is entitled to a favorable ruling on the issues of materiality and duty to disclose. Her demonstration of objective tangible harm would still the concern that permitting her to go forward will open the floodgates to rescission on subjective and idiosyncratic grounds.…

The judgment is reversed.

Case questions

1. Why is it relevant that the plaintiff was "an elderly lady living alone"?
2. How did Mrs. Reed find out about the gruesome fact here?
3. Why did the defendants conceal the facts?
4. What is the concern about opening "floodgates to rescission on subjective and idiosyncratic grounds"?
5. Why *did* George Washington sleep in so many places during the Revolutionary War?
6. Did Mrs. Reed get to rescind her contract and get out of the house as a result of this case?

Statement Made False by Subsequent Events

If a statement of fact is made false by later events, it must be disclosed as false. For example, in idle chatter one day, Alphonse tells Gaston that he owns thirty acres of land. In fact, Alphonse owns only twenty-seven, but he decided to exaggerate a little. He meant no harm by it, since the conversation had no import. A year later, Gaston offers to buy the "thirty acres" from Alphonse, who does not correct the impression that Gaston has. The failure to speak is a **nondisclosure**—presumably intentional, in this situation—that would allow Gaston to rescind a contract induced by his belief that he was purchasing thirty acres.

Statements of Opinion

An opinion, of course, is not a fact; neither is sales **puffery**. For example, the statements "In my opinion this apple is very tasty" and "These apples are the best in the county" are not facts; they are not expected to be taken as true. Reliance on opinion is hazardous and generally not considered justifiable. As the Restatement puts it: "The propensity of sellers and buyers to exaggerate the advantages to the other party of the bargains they promise is well recognized, and to some extent their assertions must be discounted." Vague statements of quality, such as that a product is "good," ought to suggest nothing other than that such is the personal judgment of the opinion holder.

Despite this general rule, there are certain exceptions that justify reliance on opinions and effectively make them into facts. Merely because someone is less astute than the one with whom she is bargaining

does not give rise to a claim of justifiable reliance on an unwarranted opinion. But if the person is inexperienced and susceptible or gullible to blandishments, the contract can be voided.

CASE 10.3

Vokes v. Arthur Murray, Inc., 212 S.2d. 906 (Fla. 1968)

PIERCE, J.

This is an appeal by Audrey E. Vokes, plaintiff below, from a final order dismissing with prejudice, for failure to state a cause of action, her fourth amended complaint, hereinafter referred to as plaintiff's complaint.

Defendant Arthur Murray, Inc., a corporation, authorizes the operation throughout the nation of dancing schools under the name of "Arthur Murray School of Dancing" through local franchised operators, one of whom was defendant J. P. Davenport whose dancing establishment was in Clearwater.

Plaintiff Mrs. Audrey E. Vokes, a widow of 51 years and without family, had a yen to be "an accomplished dancer" with the hopes of finding "new interest in life." So, on February 10, 1961, a dubious fate, with the assist of a motivated acquaintance, procured her to attend a "dance party" at Davenport's "School of Dancing" where she whiled away the pleasant hours, sometimes in a private room, absorbing his accomplished sales technique, during which her grace and poise were elaborated upon and her rosy future as "an excellent dancer" was painted for her in vivid and glowing colors. As an incident to this interlude, he sold her eight 1/2-hour dance lessons to be utilized within one calendar month therefrom, for the sum of $14.50 cash in hand paid, obviously a baited "come-on."

Thus she embarked upon an almost endless pursuit of the terpsichorean art during which, over a period of less than sixteen months, she was sold fourteen "dance courses" totaling in the aggregate 2302 hours of dancing lessons for a total cash outlay of $31,090.45 [about $320,000 in 2024 dollars] all at Davenport's dance emporium. All of these fourteen courses were evidenced by execution of a written "Enrollment Agreement-Arthur Murray's School of Dancing" with the addendum in heavy black print, "No one will be informed that you are taking dancing lessons. Your relations with us are held in strict confidence", setting forth the number of "dancing lessons" and the "lessons in rhythm sessions" currently sold to her from time to time, and always of course accompanied by payment of cash of the realm.

These dance lesson contracts and the monetary consideration therefore of over $31,000 were procured from her by means and methods of Davenport and his associates which went beyond the unsavory, yet legally permissible, perimeter of "sales puffing" and intruded well into the forbidden area of undue influence, the suggestion of falsehood, the suppression of truth, and the free Exercise of rational judgment, if what plaintiff alleged in her complaint was true. From the time of her first contact with the dancing school in February, 1961, she was influenced unwittingly by a constant and continuous barrage of flattery, false praise, excessive compliments, and panegyric encomiums, to such extent that it would be not only inequitable, but unconscionable, for a Court exercising inherent chancery power to allow such contracts to stand.

She was incessantly subjected to overreaching blandishment and cajolery. She was assured she had "grace and poise"; that she was "rapidly improving and developing in her dancing skill"; that the additional lessons

would “make her a beautiful dancer, capable of dancing with the most accomplished dancers”; that she was “rapidly progressing in the development of her dancing skill and gracefulness”, etc., etc. She was given “dance aptitude tests” for the ostensible purpose of “determining” the number of remaining hours of instructions needed by her from time to time.

At one point she was sold 545 additional hours of dancing lessons to be entitled to an award of the “Bronze Medal” signifying that she had reached “the Bronze Standard”, a supposed designation of dance achievement by students of Arthur Murray, Inc.…At another point, while she still had over 1,000 unused hours of instruction she was induced to buy 151 additional hours at a cost of $2,049.00 to be eligible for a “Student Trip to Trinidad”, at her own expense as she later learned.…

Finally, sandwiched in between other lesser sales promotions, she was influenced to buy an additional 481 hours of instruction at a cost of $6,523.81 in order to “be classified as a Gold Bar Member, the ultimate achievement of the dancing studio.”

All the foregoing sales promotions, illustrative of the entire fourteen separate contracts, were procured by defendant Davenport and Arthur Murray, Inc., by false representations to her that she was improving in her dancing ability, that she had excellent potential, that she was responding to instructions in dancing grace, and that they were developing her into a beautiful dancer, whereas in truth and in fact she did not develop in her dancing ability, she had no “dance aptitude,” and in fact had difficulty in “hearing that musical beat.” The complaint alleged that such representations to her “were in fact false and known by the defendant to be false and contrary to the plaintiff’s true ability, the truth of plaintiff’s ability being fully known to the defendants, but withheld from the plaintiff for the sole and specific intent to deceive and defraud the plaintiff and to induce her in the purchasing of additional hours of dance lessons.” It was averred that the lessons were sold to her “in total disregard to the true physical, rhythm, and mental ability of the plaintiff.” In other words, while she first exulted that she was entering the “spring of her life”, she finally was awakened to the fact there was “spring” neither in her life nor in her feet.

The complaint prayed that the Court decree the dance contracts to be null and void and to be cancelled, that an accounting be had, and judgment entered against, the defendants “for that portion of the $31,090.45 not charged against specific hours of instruction given to the plaintiff.” The Court held the complaint not to state a cause of action and dismissed it with prejudice. We disagree and reverse.

It is true that “generally a misrepresentation, to be actionable, must be one of fact rather than of opinion.” [Citations] But this rule has significant qualifications, applicable here. It does not apply where there is a fiduciary relationship between the parties, or where there has been some artifice or trick employed by the representor, or where the parties do not in general deal at “arm’s length” as we understand the phrase, or where the representee does not have equal opportunity to become apprised of the truth or falsity of the fact represented. [Citation] As stated by Judge Allen of this Court in [Citation]:

“* * * A statement of a party having * * * superior knowledge may be regarded as a statement of fact although it would be considered as opinion if the parties were dealing on equal terms.”…

In [Citation] it was said that “* * * what is plainly injurious to good faith ought to be considered as a fraud sufficient to impeach a contract.”… [Reversed.]

Case questions

1. What was the motivation of the "motivated acquaintance" in this case?
2. Why is it relevant that Mrs. Vokes was a "widow of 51 years and without family"?
3. How did the defendant J. P. Davenport entice her into spending a lot of money on dance lessons?
4. What was the defendants' defense as to why they should not be liable for misrepresentation, and why was that defense not good?
5. Would you say the court here is rather condescending to Mrs. Vokes, all things considered?

Misstatement of Law

Typically, incorrect assertions of law will not provide the basis for relief. For example, an assertion that "the city has repealed the sales tax" would not be actionable if false. An assertion of the legal consequences of a given set of facts is generally an opinion on which the recipient relies at his or her peril, especially if both parties know or assume the same facts. Thus, if there is a lien on a house, the seller's statement that "the courts will throw it out, you won't be bothered by it" is an opinion. A statement that "you can build a five-unit apartment on this property" is not actionable because, at common law, people are supposed to know what the local and state laws are, and nobody should rely on a layperson's statement about the law. However, if the statement of law is made by a lawyer or real estate broker, or some other person on whom a layperson may justifiably rely, then it may be taken as a fact and, if untrue, as the basis for a claim of misrepresentation. (Assertions about foreign laws are generally held to be statements of fact, not opinion.)

Assertions of Intention

Usually, assertions of intention are not considered facts. The law allows considerable leeway in the honesty of assertions of intention. The Restatement talks in terms of "a misrepresentation of intention…consistent with reasonable standards of fair dealing." The right to misstate intentions is useful chiefly in the acquisition of land; the cases permit buyers to misrepresent the purpose of the acquisition so as not to arouse the suspicion of the seller that the land is worth considerably more than his asking price. To be a misrepresentation that will permit rescission, an assertion of intention must be false at the time made; that is, the person asserting an intention must not then have intended it. That later he or she does not carry out the stated intention is not proof that there was no intention at the time asserted. Moreover, to render a contract voidable, the false assertion of intention must be harmful in some way to other interests of the recipient. Thus, in the common example, the buyer of land tells the seller that he intends to build a residence on the lot, but he actually intends to put up a factory and has lied because he knows that otherwise the seller will not part with it because her own home is on an adjacent lot. The contract is voidable by the seller. So a developer says, as regards the

picturesque old barn on the property, "I'll sure try to save it," but after he buys the land he realizes it would be very expensive (and in the way), so he does not try to save it. No misrepresentation.

Intentionally-made Misrepresentation

The second element necessary to prove fraud is that the misrepresentation was intentionally made. According to the Restatement, a **misrepresentation** is intentionally made "if the maker intends his assertion to induce a party to manifest his assent and the maker (a) knows or believes that the assertion is not in accord with the facts, or (b) does not have the confidence that he states or implies in the truth of the assertion, or (c) knows that he does not have the basis that he states or implies for the assertion."

The question of intent often has practical consequences in terms of the remedy available to the plaintiff. If the misrepresentation is fraudulent, the plaintiff may, as an alternative to avoiding the contract, recover damages. Some states would force the plaintiff to elect one of these two remedies, whereas other states would allow the plaintiff to pursue both remedies (although only one type of recovery would eventually be allowed). If the misrepresentation is not intentional, then the common law allows the plaintiff only the remedy of rescission. But the **Uniform Commercial Code (UCC)**, Section 2-721, allows both remedies in contracts for the sale of goods, whether the misrepresentation is fraudulent or not, and does not require election of remedies.

Reliance

The final element necessary to prove fraud is **reliance** by the victim. He or she must show that the **misrepresentation** induced assent—that is, he or she relied on it. The reliance need not be solely on the false assertion; the defendant cannot win the case by demonstrating that the plaintiff would have assented to the contract even without the misrepresentation. It is sufficient to **avoid** the contract if the plaintiff weighed the assertion as one of the important factors leading him to make the contract, and he believed it to be true. The person who asserts reliance to avoid a contract must have acted in good faith and reasonably in relying on the false assertion. Thus if the victim failed to read documents given to him that truly stated the facts, he cannot later complain that he relied on a contrary statement, as, for example, when the purchaser of a car dealership was told the inventory consisted of new cars, but the supporting papers, receipt of which he acknowledged, clearly stated how many miles each car had been driven. If Mr. Olson tells Jack that the car Jack is interested in is "a recognized classic," and if Jack doesn't care a whit about that but buys the car because he likes its tail fins, he will have no case against Mr. Olson when he finds out the car is not a classic: it didn't matter to him and he didn't rely on it.

Ordinarily, the person relying on a statement need not verify it independently. However, if verification is relatively easy, or if the statement is one that concerns matters peculiarly within the person's purview, he or she may not be held to have justifiably relied on the other party's false assertion. Moreover, usually the rule of reliance applies to statements about past events or existing facts, not about the occurrence of events in the future.

ACTIVITY 10B

You be the Judge

Commonly known as the "Ghostbusters" ruling, the case of *Stambovsky v. Ackley*, 169 A.D.2d 254 (N.Y. App. Div. 1991) is widely discussed for defining when a house is haunted as a matter of law. The homeowner advertised the house for tours, saying it was haunted by ghosts, and even writing about the haunting in Reader's Digest, yet said none of this when putting the home up for sale.

What should the seller of a home that they have previously suggested is haunted say when placing this home up for sale to avoid making a material misrepresentation? What should be the seller's obligations to avoid misrepresentation in such a case? What should be the buyer's obligations of discovery of material facts in such a case? Search the internet for a source of information on this case, and after reading that source, debate whether there was a misrepresentation in the case, and if there was, what type?

10.4 Nonfraudulent Misrepresentation

Nonfraudulent misrepresentation may also be grounds for some relief. There are two types: **negligent misrepresentation** and **innocent misrepresentation**.

Negligent Misrepresentation

Where representation is caused by carelessness, it is negligent misrepresentation. To prove it, a plaintiff must show a negligent misstatement of fact that is **material** and justifiably relied upon.

Negligent

As an element of misrepresentation, "negligent" here means that the party who makes the representation was careless. A potential buyer of rural real estate asks the broker if the neighborhood is quiet. The broker assures her it is. In fact, the neighbors down the road have a whole kennel of hunting hounds that bark a lot. The broker didn't know that; she just assumed the neighborhood was quiet. That is negligence: failure to use appropriate care.

Misstatement of Fact

Whether a thing is a fact may be subject to the same general analysis used in discussing fraudulent misrepresentation. (A person could negligently conceal a fact, or negligently give an opinion, as in legal malpractice.)

Materiality

A **material** misrepresentation is one that "would be likely to induce a reasonable person to manifest his assent" or that "the maker knows…would be likely to induce the recipient to do so." An honestly mistaken statement that the house for sale was built in 1922 rather than 1923 would not be the basis for avoiding the contract because it is not material unless the seller knew that the buyer had sentimental or other reasons for purchasing a house built in 1922.

We did not mention materiality as an element of fraud; if the misrepresentation is fraudulent, the victim can avoid the contract, no matter the significance of the misrepresentation. So although materiality is not technically required for fraudulent misrepresentation, it is usually a crucial factor in determining whether the plaintiff did rely on the misstatement. Obviously, the more immaterial the false assertion, the less likely it is that the victim relied on it to his detriment. This is especially the case when the defendant knows that he does not have the basis that he states for an assertion but believes

that the particular point is unimportant and therefore immaterial. And of course it is usually not worth the plaintiff's efforts to sue over an immaterial fraudulent misrepresentation. Consequently, for practical purposes, materiality is an important consideration in most cases.

Justifiable Reliance

The issues regarding reliance for negligent misrepresentation are the same as those set out for fraudulent misrepresentation.

Negligent misrepresentation implies culpability and is usually treated the same as fraudulent misrepresentation; if the representation is not fraudulent, however, it cannot be the basis for rescission unless it is also material.

Innocent Misrepresentation

The elements necessary to prove innocent misrepresentation are, reasonably enough, based on what we've looked at so far, as follows: an innocent misstatement of fact that is material and justifiably relied upon. All issues with proofs are the same as with negligent misrepresentation, except now the misrepresentation is innocent. The plaintiffs purchased the defendants' eighteen-acre parcel on the defendants' representation that the land came with certain water rights for irrigation, which they believed was true. It was not true. The plaintiffs are entitled to rescission on the basis of innocent misrepresentation.

Remedies

Fraudulent misrepresentation has traditionally given the victim the right to rescind the contract promptly (return the parties to the before-contract status) *or* affirm it and bring an action for damages caused by the fraud, but not both. The UCC (Section 2-721) has rejected the "election of remedies" doctrine; it allows cumulative damages, such that the victim can both return the goods and sue for damages. This is the modern trend for fraudulent misrepresentation: victims may first seek damages, and if that does not make them whole, they may seek rescission. In egregious cases of fraud where the defendant has undertaken a pattern of such deceit, the rare civil remedy of punitive damages may be awarded against the defendant.

One further note: the burden of proof for fraudulent misrepresentation is that it must be proved not just "by a preponderance of the evidence," as in the typical civil case, but rather "by clear, cogent, and convincing evidence"; the fact finder must believe the claim of fraud is very probably true.

10.5 MISTAKE

In discussing fraud, we have considered the ways in which trickery by the other party makes a contract void or voidable. We now examine the ways in which the parties might "trick" themselves by making assumptions that lead them mistakenly to believe that they have agreed to something they have not. A **mistake** is "a belief about a fact that is not in accord with the truth."

Unilateral Mistake

Where one party makes a mistake, it is a **unilateral mistake**. Ordinarily if there is a unilateral mistake a contract is **valid**. This is because the law has to balance the interests of both parties. A rule

permitting a party making a unilateral mistake to void a contract would be subject to opportunistic behavior on the part of the person seeking to avoid the contract. That party could simply make-up a mistake to void a contract. This is why the law requires more in order to avoid a contract.

Exceptions

If one side *knows or should know* that the other has made a mistake, he or she may not take advantage of it. A person who makes the mistake of not reading a written document will usually get no relief, nor will relief be afforded to one whose mistake is caused by negligence (a contractor forgets to add in the cost of insulation) unless the negligent party would suffer unconscionable hardship if the mistake were not corrected. Courts will allow the correction of drafting errors in a contract ("reformation") in order to make the contract reflect the parties' intention.

Mutual Mistake

In the case of **mutual mistake**—both parties are wrong about the subject of the contract—relief may be granted. The Restatement sets out three requirements for successfully arguing mutual mistake. The party seeking to avoid the contract must prove that

- the mistake relates to a "basic assumption on which the contract was made,"
- the mistake has a material effect on the agreed exchange of performances, and
- the party seeking relief does not bear the risk of the mistake.

Basic assumption is probably clear enough but here is an example. In the famous "cow case," the defendant sold the plaintiff a cow—Rose of Abalone—believed by both to be barren and thus of less value than a fertile cow (a young dairy cow in 2021 would sell for around $2,000). Just before the plaintiff was to take Rose from the defendant's barn, the defendant discovered she was "large with calf"; he refused to go on with the contract. The court held this was a mutual mistake of fact—"a barren cow is substantially a different creature than a breeding one"—and ruled for the defendant. That she was infertile was "a basic assumption" of the contract.

CASE 10.4

Konic International Corporation v. Spokane Computer Services, Inc., 708 P.2d 932 (Idaho 1985)

The magistrate found the following facts. David Young, an employee of Spokane Computer, was instructed by his employer to investigate the possibility of purchasing a surge protector, a device which protects computers from damaging surges of electrical current. Young's investigation turned up several units priced from $50 to $200, none of which, however, were appropriate for his employer's needs. Young then contacted Konic. After discussing Spokane Computer's needs with a Konic engineer, Young was referred to one of Konic's salesmen. Later, after deciding on a certain unit, Young inquired as to the price of the selected item. The salesman responded, "fifty-six twenty." The salesman meant $5,620. Young in turn thought $56.20.

The salesman for Konic asked about Young's authority to order the equipment and was told that Young

would have to get approval from one of his superiors. Young in turn prepared a purchase order for $56.20 and had it approved by the appropriate authority. Young telephoned the order and purchase order number to Konic who then shipped the equipment to Spokane Computer. However, because of internal processing procedures of both parties the discrepancy in prices was not discovered immediately. Spokane Computer received the surge protector and installed it in its office. The receipt and installation of the equipment occurred while the president of Spokane Computer was on vacation. Although the president's father, who was also chairman of the board of Spokane Computer, knew of the installation, he only inquired as to what the item was and who had ordered it. The president came back from vacation the day after the surge protector had been installed and placed in operation and was told of the purchase. He immediately ordered that power to the equipment be turned off because he realized that the equipment contained parts which alone were worth more than $56 in value. Although the president then told Young to verify the price of the surge protector, Young failed to do so. Two weeks later, when Spokane Computer was processing its purchase order and Konic's invoice, the discrepancy between the amount on the invoice and the amount on the purchase order was discovered. The president of Spokane Computer then contacted Konic, told Konic that Young had no authority to order such equipment, that Spokane Computer did not want the equipment, and that Konic should remove it. Konic responded that Spokane Computer now owned the equipment and if the equipment was not paid for, Konic would sue for the price. Spokane Computer refused to pay and this litigation ensued.

Basically what is involved here is a failure of communication between the parties. A similar failure to communicate arose over 100 years ago in the celebrated case of *Raffles v. Wichelhaus*, [Citation] which has become better known as the case of the good ship "Peerless." In *Peerless*, the parties agreed on a sale of cotton which was to be delivered from Bombay by the ship "Peerless." In fact, there were two ships named "Peerless" and each party, in agreeing to the sale, was referring to a different ship. Because the sailing time of the two ships was materially different, neither party was willing to agree to shipment by the "other" Peerless. The court ruled that, because each party had a different ship in mind at the time of the contract, there was in fact no binding contract. The *Peerless* rule later was incorporated into section 71 of the Restatement of Contracts and has now evolved into section 20 of Restatement (Second) of Contracts (1981). Section 20 states in part:

(1) There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and

(a) neither knows or has reason to know the meaning attached by the other.

Comment (c) to Section 20 further explains that "even though the parties manifest mutual assent to the same words of agreement, there may be no contract because of a material difference of understanding as to the terms of the exchange." Another authority, Williston, discussing situations where a mistake will prevent formation of a contract, agrees that "where a phrase of contract…is reasonably capable of different interpretations…there is no contract." [Citation]

In the present case, both parties attributed different meanings to the same term, "fifty-six twenty." Thus, there was no meeting of the minds of the parties. With a hundred fold difference in the two prices, obviously price was a material term. Because the "fifty-six twenty" designation was a material term expressed in an ambiguous form to which two meanings were obviously applied, we conclude that no contract between the parties was ever formed. Accordingly, we do not reach the issue of whether Young had authority to order the equipment.

[Affirmed.]

Case questions

1. Why is it reasonable to say that no contract was made in this case?
2. A discrepancy in price of one hundred times is, of course, enormous. How could such an egregious mistake have occurred by both parties? In terms of running a sensible business, how could this kind of mistake be avoided before it resulted in expensive litigation?

Material Effect on the Agreed-to Exchange of Performance

Material effect on the agreed-to exchange of performance means that because of the mutual mistake, there is a significant difference between the value the parties thought they were exchanging compared with what they would exchange if the contract were performed, given the standing facts. Again, in the cow case, had the seller been required to go through with the deal, he would have given up a great deal more than he anticipated, and the buyer would have received an unagreed-to windfall.

Party Seeking Relief Does Not Bear the Risk of the Mistake

Assume a weekend browser sees a painting sitting on the floor of an antique shop. The owner says, "That old thing? You can have it for $100." The browser takes it home, dusts it off, and hangs it on the wall. A year later a visitor, an expert in art history, recognizes the hanging as a famous lost El Greco worth $1 million. The story is headlined; the antique dealer is chagrined and claims the contract for sale should be voided because both parties mistakenly thought they were dickering over an "old, worthless" painting. The contract is valid. The owner is said to bear the risk of mistake because he contracted with conscious awareness of his ignorance: he knew he didn't know what the painting's possible value might be, but he didn't feel it worthwhile to have it appraised. He gambled it wasn't worth much, and lost.

End of Chapter Exercises

1. Eulrich, an auto body mechanic who had never operated a business, entered into a Snap-On Tools franchise agreement. For $22,000 invested from his savings and the promise of another $22,000 from the sale of inventory, he was provided a truck full of tools. His job was to drive around his territory and sell them. The agreement allowed termination by either party; if Eulrich terminated, he was entitled to resell to Snap-On any new tools he had remaining. When he complained that his territory was not profitable, his supervisors told him to work it harder, that anybody could make money with Snap-On's marketing system. (In fact, the evidence showed that the system made money for the supervisors and little for dealers; dealers quickly

failed and were replaced by new recruits.) Within several months Eulrich was out of money and desperate. He tried to "check in" his truck to get money to pay his household bills and uninsured medical bills for his wife; the supervisors put him off for weeks. On the check-in day, the exhausted Eulrich's supervisors berated him for being a bad businessman, told him no check would be forthcoming until all the returned inventory was sold, and presented him with a number of papers to sign, including a "Termination Agreement" whereby he agreed to waive any claims against Snap-On; he was not aware that was what he had signed. He sued to rescind the contract and for damages. The defendants held up the waiver as a defense. Under what theory might Eulrich recover?

2. Chauncey, a college student, worked part-time in a restaurant. After he had worked for several months, the owner of the restaurant discovered that Chauncey had stolen $2,000 from the cash register. The owner called Chauncey's parents and told them that if they did not sign a note for $2,000, he would initiate criminal proceedings against Chauncey. The parents signed and delivered the note to the owner but later refused to pay. May the owner collect on the note? Why?
3. A restaurant advertised a steak dinner that included a "juicy, great-tasting steak, a fresh crisp salad, and a warm roll." After reading the ad, Clarence visited the restaurant and ordered the steak dinner. The steak was dry, the lettuce in the salad was old and limp with brown edges, and the roll was partly frozen. May Clarence recover from the restaurant on the basis of misrepresentation? Why?
4. Bert purchased Ernie's car. Before selling the car, Ernie had stated to Bert, "This car runs well and is reliable. Last week I drove the car all the way from Seattle to San Francisco to visit my mother and back again to Seattle." In fact, Ernie was not telling the truth: he had driven the car to San Francisco to visit his paramour, not his mother. Upon discovery of the truth, may Bert avoid the contract? Why?
5. Randolph enrolled in a business law class and purchased a new business law textbook from the local bookstore. He dropped the class during the first week and sold the book to his friend Scott. Before making the sale, Randolph told Scott that he had purchased the book new and had owned it for one week. Unknown to either Randolph or Scott, the book was in fact a used one. Scott later discovered some underlining in the middle of the book and attempted to avoid the contract. Randolph refused to refund the purchase price, claiming that he had not intentionally deceived his friend. May Scott avoid the contract? Why?
6. Waters was attracted to Midwest Supply by its advertisements for doing federal income taxes. The ads stated "guaranteed accurate tax preparation." Waters inquired about amending past returns to obtain refunds. Midwest induced him to apply for and receive improper refunds. When Waters was audited, he was required to pay more taxes, and the IRS put tax liens on his wages and bank accounts. In fact, Midwest hired people with no knowledge about taxes at all; if a customer inquired about employees' qualifications, Midwest's manual told the employees to say, "Midwest has been preparing taxes for twenty years." The manual also instructed office managers never to refer to any employee as a "specialist" or "tax expert," but never to correct any news reporters or commentators if they referred to employees as such. What cause of action has Waters, and for what remedies?
7. Mutschler Grain Company (later Jamestown Farmers Elevator) agreed to sell General Mills 30,000 bushels of barley at $1.22 per bushel. A dispute arose: Mutschler said that transportation

was to be by truck but that General Mills never ordered any trucks to pick up the grain; General Mills said the grain was to be shipped by rail (railcars were in short supply). Nine months later, after Mutschler had delivered only about one-tenth the contracted amount, the price of barley was over $3.00 per bushel. Mutschler defaulted on, and then repudiated, the contract. Fred Mutschler then received this telephone call from General Mills: "We're General Mills, and if you don't deliver this grain to us, why we'll have a battery of lawyers in there tomorrow morning to visit you, and then we are going to the North Dakota Public Service (Commission); we're going to the Minneapolis Grain Exchange and we're going to the people in Montana and there will be no more Mutschler Grain Company. We're going to take your license." Mutchsler then shipped 22,000 bushels of barley at the $1.22 rate and sued General Mills for the difference between that price and the market price of over $3.00. Summary judgment issued for General Mills. Upon what basis might Mutschler Grain appeal?

8. Duke decided to sell his car. The car's muffler had a large hole in it, and as a result, the car made a loud noise. Before showing the car to potential buyers, Duke patched the hole with muffler tape to quiet it. Perry bought the car after test-driving it. He later discovered the faulty muffler and sought to avoid the contract, claiming fraud. Duke argued that he had not committed fraud because Perry had not asked about the muffler and Duke had made no representation of fact concerning it. Is Duke correct? Decide and explain.
9. At the end of the term at college, Jose, talking in the library with his friend Leanne, said, "I'll sell you my business law notes for $25." Leanne agreed and paid him the money. Jose then realized he'd made a mistake in that he had offered his notes when he meant to offer his book. Leanne didn't want the book; she had a book. She wanted the notes. Would Leanne have a cause of action against Jose if he refused to deliver the notes? Decide and explain.

REFERENCES

Dairy Cows: How Long Do They Live and Milk Production Statistics / FFAC. (2021, November 30). Ffacoalition.org. https://ffacoalition.org/articles/dairy-cows/

Ehrman v. Mann, 979 So.2d 1011 (Fla. Ct. App. 2008).

Ikeda v. Curtis, 261 P.2d 684 (Wash. 1951).

Kirkham v. Smith, 23 P.3d 10 (Wash. Ct. App. 2001).

Lesher v. Strid, 996 P.2d 988 (Or. Ct. App. 2000).

Merritt v. Craig, 753 A.2d 2 (Md. Ct. App. 2000).

Restatement (Second) of Contracts, Section 151.

Restatement (Second) of Contracts, Section 162(1).

Restatement (Second) of Contracts, Section 162(2).

Restatement (Second) of Contracts, Section 163.

Restatement (Second) of Contracts, Section 168(d).

Restatement (Second) of Contracts, Section 171(1).

Restatement (Second) of Contracts, Section 177.

Sikora v. Vanderploeg, 212 S.W.3d 277 (Tenn. Ct. App. 2006).

Stambovsky v. Ackley, 169 A.D.2d 254 (N.Y. 1991).

CHAPTER 11 - FORM AND MEANING

Learning Objectives

After studying this chapter, you should be able to:

1. Identify the types of contracts that must be evidenced by some writing under the Statute of Frauds.
2. Explain the exceptions to the requirements of the various Statutes of Frauds.
3. Describe the various ways to satisfy the requirements when a contract must be written.
4. Analyze how a contract should be interpreted if its meaning is disputed.
5. Apply the parol evidence rule to fully integrated contracts.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=58#h5p-16

11.1 GENERAL PERSPECTIVES ON THE STATUTE OF FRAUDS

INTRODUCTION TO THE STATUTE OF FRAUDS

In prior chapters, we have focused on the question of whether the parties created a **valid contract** and have examined the requirements of agreement through **offer** and **acceptance**, **consideration**, **capacity** and **legality**. Assuming that these requirements have been met, we now turn to the form and meaning of the contract itself. This Chapter answers two important questions:

1. Does the contract have to be in a written form?
2. If the contract is in written form and there is a dispute, how do we know what the contract means?

Generally, a contract need not be in writing to be enforceable. However, over time and due to concerns about fraudulent contracting, several statutes were enacted that have the impact of requiring certain contracts to be written in order to be enforceable.

HISTORICAL PERSPECTIVE

Historically, an oral agreement to pay a high-fashion model $2 million to pose for photographs is as binding as if the language of the deal were printed on parchment and signed in the presence of twenty witnesses. For three centuries, however, a large exception grew up around what came to be known as the **Statute of Frauds**. The first Statute of Frauds was enacted in England in 1677 under the formal name "An Act for the Prevention of Frauds and Perjuries." The English statute's two sections dealing with contracts read as follows:

> [Sect. 4]…no action shall be brought

- whereby to charge any executor or administrator upon any special promise, to answer damages out of his own estate;
- or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person;
- or to charge any person upon any agreement made upon consideration of marriage;
- or upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them;
- or upon any agreement that is not to be performed within the space of one year from the making thereof;

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

As may be evident from the title of the act and the language used within it, the general purpose of the law is to provide evidence, in areas of some complexity and importance, that a contract was actually made. Succinctly, the purpose is to prevent fraud in certain types of contracts by requiring a written contract.

Notice, of course, that this is a *statute*; it is a legislative intrusion into the common law of contracts. In addition, the name given to this class of statutes can be somewhat confusing. These statutes do not deal with fraud as you might normally think of it. They are, instead, attempts to avoid fraud in contracting. The Statute of Frauds, therefore, tells us when a contract is required to be evidenced by a writing and signed by the party to be bound to that contract.

The Statute of Frauds has been enacted in form similar to the seventeenth-century act in every state except Maryland and New Mexico – where judicial decisions have given it legal effect – and

Louisiana. With minor exceptions in Minnesota, Wisconsin, North Carolina, and Pennsylvania, the laws all embrace the same categories of contracts that are required to be in writing. Early in the twentieth century, Section 17 was replaced by a section of the Uniform Sales Act, and this in turn has now been replaced by provisions in the **Uniform Commercial Code (UCC)**.

Figure 11.1 Contracts Required to Be in Writing

Statute of Frauds	UCC Sales of Contracts
1. Promises to Pay Debt of Another 2. Agreements of Executor or Administrator 3. Marriage Promises 4. Sale of Land 5. Contracts Not to be Performed Within One Year	1. Sale of Goods for $500 or More 2. Sale of Securities 3. Other Sales Exceedings $5000

However ancient, the Statute of Frauds is alive and well in the United States. Today it is used as a technical defense in many contract actions, often with unfair results: it can be used by a person to wriggle out of an otherwise perfectly fine oral contract (it is said then to be used "as a sword instead of a shield"). Consequently, courts interpret the law strictly and over the years have enunciated a host of exceptions—making what appears to be a simple law quite complex. Indeed, after more than half a century of serious scholarly criticism, the British Parliament repealed most of the statute in 1954. Even in New Jersey, in 1995 there was some rolling back of our home state requirements for the Statutes of Frauds. Yet, because business transactions regularly span across state lines, it is important to each common Statute of Frauds that is in place in the United States today.

11.2 CONTRACTS THAT MUST BE WRITTEN UNDER THE STATUTE OF FRAUDS

Five different areas of the **Statute of Frauds** appear in this section. For each statute, the general requirements are set forth, followed by exceptions to the general requirements.

CONTRACTS AFFECTING AN INTEREST IN LAND

Almost all contracts involving an **interest in land** are subject to the Statute of Frauds. For purposes of this statute, "land" is interpreted broadly to include such things as the actual land (e.g. ground and soil) and things attached to that land, such as trees or buildings. "Contracts that involve an interest in land" is also a broad description, which includes the sale, mortgage or lease of real property (including homes and buildings). This interest can also include profits from the land, the creation of easements on the land, and the establishment of other interests through restrictive covenants and agreements concerning the permissive use of the land.

While there are some exceptions to the writing requirement, such as a contract to sell crops grown on land, and short-term leases (usually for a term of one year or less), it is wise to put land-related contracts in writing when you are unsure if your land contract falls within the Statute of Frauds.

Exceptions to the Requirement to Place Contracts Affecting an Interest in Land in Writing

The **past performance doctrine** is one exception to the Statute of Frauds requirement for **interest in land**. While an oral contract to sell land is not normally binding, if the buyer has taken possession and made improvements on the property, courts will usually say the case is out of the statute, and the party claiming an oral contract can attempt to prove the existence of the oral contract.

Suppose that Seller agrees to sell a tract of land to Buyer for $100,000. There is no written agreement, but Buyer pays the purchase price to Seller and takes possession of the land. Buyer begins the process of making improvements to the land including erecting a fence. The actions of the seller, accepting the money, and the buyer, taking possession and making improvements, provide the confidence that this is not a fraudulent transaction. Courts can enforce this oral agreement using the exception of past performance.

THE **ONE-YEAR RULE**

An agreement that cannot be performed within one year from its making must be evidenced by some writing to be enforceable. Memories of an oral contract can fade over time, and so under this one-year rule requiring a written contract, a documentation of the agreement will be available in the case of a later dispute between the contracting parties, or their representatives. The critical time frame is how long it will take to complete the contract from the time the contract is made until performance is complete. Consider the following examples. Which of these must be written? Which can be oral?

1. Today, Bob agrees to work for Alice for a period of 13 months.
2. Today, Bob agrees to work for Alice for a period of 7 months. His employment will begin 6 months from now, and continue for 7 months thereafter until complete.
3. Today, Bob agrees to work for Alice for a period of 11 months.

Example 3 can be oral since this contract will certainly take less than one year. Example 1 must be written since this contract will certainly last more than one year. Example 2 must also be written. Even though the period of employment itself is only seven months, since that period does not begin until six months from now, the total length of the contract is 13 months. So, a written contract would be required to enforce the contract in Example 2.

Exceptions to the One-Year Rule

The **one-year rule** has been universally interpreted to mean a contract that is impossible to be fully performed within one year. Under the **possibility test**, if there is even the slightest chance of carrying out the agreement completely within a year, an oral contract is enforceable. For example, an oral agreement to pay a sum of money on a date 13 months from today is enforceable since it is possible that the payment could be made earlier, even tomorrow. Even for contracts where it would be unlikely to complete performance within a year, as long as it is possible to do so, the exception still applies. For example, a contract to construct a very large residential complex that would normally take around two years to complete would not need to be written under this Statute because, technically, if enough construction workers were employed, the complex could possibly be completed within a year. Unless there is a fixed term longer than a year, some courts have even found that a contract which involves

the performance of a person can be oral because any person may die within the year, and therefore their contract would not fall within the statute.

CASE 11.1

Iacono v. Lyons, 16 S.W.3d 92 (Texas Ct. App. 2000)

O'CONNOR, J.

Mary Iacono, the plaintiff below and appellant here, appeals from a take-nothing summary judgment rendered in favor of Carolyn Lyons, the defendant below and appellee here. We reverse and remand.

The plaintiff [Iacono] and defendant [Lyons] had been friends for almost 35 years. In late 1996, the defendant invited the plaintiff to join her on a trip to Las Vegas, Nevada. There is no dispute that the defendant paid all the expenses for the trip, including providing money for gambling.

The plaintiff contended she was invited to Las Vegas by the defendant because the defendant thought the plaintiff was lucky. Sometime before the trip, the plaintiff had a dream about winning on a Las Vegas slot machine. The plaintiff's dream convinced her to go to Las Vegas, and she accepted the defendant's offer to split "50-50" any gambling winnings.

In February 1997, the plaintiff and defendant went to Las Vegas. They started playing the slot machines at Caesar's Palace. The plaintiff contends that, after losing $47, the defendant wanted to leave to see a show. The plaintiff begged the defendant to stay, and the defendant agreed on the condition that she (the defendant) put the coins into the machines because doing so took the plaintiff too long. (The plaintiff, who suffers from advanced rheumatoid arthritis, was in a wheelchair.) The plaintiff agreed, and took the defendant to a dollar slot machine that looked like the machine in her dream. The machine did not pay on the first try. The plaintiff then said, "Just one more time," and the defendant looked at the plaintiff and said, "This one's for you, Puddin."

The slot machine paid $1,908,064. The defendant refused to share the winnings with the plaintiff, and denied they had an agreement to split any winnings. The defendant told Caesar's Palace she was the sole winner and to pay her all the winnings.

The plaintiff sued the defendant for breach of contract. The defendant moved for summary judgment on the grounds that any oral agreement was unenforceable under the statute of frauds or was voidable for lack of consideration. The trial court rendered summary judgment in favor of the defendant.…

[Regarding the "consideration" argument:] The defendant asserted the agreement, if any, was voidable because there was no consideration. The defendant contended the plaintiff's only contribution was the plaintiff's dream of success in Las Vegas and her "luck." The plaintiff asserted the defendant bargained with her to go to Las Vegas in return for intangibles that the defendant thought the plaintiff offered (good luck and the realization of the dream). The plaintiff said she gave up her right to remain in Houston in return for the agreement to split any winnings. The plaintiff also asserted the agreement was an exchange of promises.

…The plaintiff alleged she promised to share one-half of her winnings with the defendant in exchange for the defendant's promise to share one-half of her winnings with the plaintiff. These promises, if made, represent the respective benefits and detriments, or the bargained for exchange, necessary to satisfy the

consideration requirement. See [Citation] (when no other consideration is shown, mutual obligations by the parties to the agreement will furnish sufficient consideration to constitute a binding contract).…[Regarding the Statute of Frauds argument:] The defendant asserted the agreement, if any, was unenforceable under the statute of frauds because it could not be performed within one year. There is no dispute that the winnings were to be paid over a period of 20 years.…

[The statute] does not apply if the contract, from its terms, could possibly be performed within a year—however improbable performance within one year may be. [Citations] [It bars] only oral contracts that cannot be completed within one year. [Citation] (If the agreement, either by its terms or by the nature of the required acts, cannot be performed within one year, it falls within the statute of frauds and must be in writing).

To determine the applicability of the statute of frauds with indefinite contracts, this Court may use any reasonably clear method of ascertaining the intended length of performance. [Citation] The method is used to determine the parties' intentions at the time of contracting. The fact that the entire performance within one year is not required, or expected, will not bring an agreement within the statute. See [Citations].

Assuming without deciding that the parties agreed to share their gambling winnings, such an agreement possibly could have been performed within one year. For example, if the plaintiff and defendant had won $200, they probably would have received all the money in one pay-out and could have split the winnings immediately. Therefore, the defendant was not entitled to summary judgment based on her affirmative defense of the statute of frauds.

We reverse the trial court's judgment and remand for further proceedings.

Case questions

1. The defendant contended there was no consideration to support her alleged promise to split the winnings fifty-fifty. What consideration did the court find here?
2. The defendant contended that the Statute of Frauds' one-year rule prohibited the plaintiff from attempting to prove the existence of the alleged oral contract to split the winnings. What reasoning did the court give here as to why the statute did not apply?
3. After this case, the court remanded the matter to the lower court. What has to happen there before plaintiff gets her money?

ACTIVITY 11A

Debate: The Contract for Life

Generally, the employment relationship between an employer and an employee is considered to be "at will." This means that the relationship can be ended at any time, by either the employer or the employee. Thus, only a minority of employees work under employment contracts which set out a length of time for the relationship in the contract. Even fewer such employment contracts set out no specific end date, becoming what might be a contract for the life of the employee. In most states and in the federal government, judges have the promise of lifetime employment, commonly known as tenure. And speaking of tenure, this is a common practice in higher education, too.

We learned that the one-year rule requires that contracts which cannot be completed within a year must be written. On the other hand, a contract that has the possibility of being completed within a year can be oral. Regarding tenure, this might become a very long contract, and yet because the employee whose life it is based on could die within a year, it doesn't have to be written. Or does it?

Question: Regarding the one-year rule, what are the reasons why a contract for tenure should be required to be written?

Question: Using the same one-year rule, what are the reasons why a contract for tenure should be enforceable even it is not written?

Question: If you were a lawmaker considering a change to a Statute of Frauds dealing specifically with the issue of lifetime employment contracts, what would you want the statute to require?

Question: Does New Jersey have a one-year rule requiring contracts in excess of a year long to be written?

CONTRACTS IN CONSIDERATION OF MARRIAGE

An agreement that relies on the promise to marry as consideration for some other promise must be written under the Statute of Frauds. For instance, if Carter proposes marriage to Max, and Max agrees to marry Carter as long as Carter also gives Max a car, this agreement must be written. Mutual promises to marry, however are not within the rule. For instance, if Carter proposes marriage to Max, and Max agrees to marry Carter, there is no promise that is part of the marriage proposal. Therefore, this marriage proposal agreement need not be written.

In addition, the Statute of Frauds governs such promises where marriage is the consideration regardless of who makes the promise. Suppose Carter's father had said to Carter, "If you marry Max and settle down, I will give you $1 million." The father's promise to Carter is not enforceable unless written.

A common application of this area of the Statute of Frauds is used for **prenuptial agreements**. These are agreements that some people use prior to entering a marriage so that they can establish ownership rights in their own property and limit the ownership rights of the future spouse. Such agreements would be effective once the marriage takes place and could stipulate how assets will be treated upon divorce or death. This Statute of Frauds would also apply to postnuptial agreements where the consideration would be agreeing to continue with the marriage.

There are no specific exceptions for these types of agreements, but they are limited in application to people who use marriage as consideration and then get married. People who cohabitate are not covered by this area of the Statute of Frauds, although other areas might apply in those situations. It is

also important that when a prenuptial agreement is used, the voluntariness of the agreement is clear so that any future court reviewing the agreement would not be concerned about enforcing it. If the agreement is unclear, or appears involuntary at the time it is used, a court might decline to enforce it and instead make equitable adjustments of property of the marriage to avoid an injustice.

PROMISES TO PAY THE DEBT OF ANOTHER

A promise to pay the debt of another person if that person does not pay their own debt must be written under the Statute of Frauds. Such promises can be called a collateral promise or a secondary promise because the promise is ancillary to some other promise. For example, Alex wants to take out a loan for their first car. Alex has not yet established credit, and so due to their poor credit history, the lender asks for a guarantor who will agree to make the payments if Alex fails to pay. Alex asks their mother to guarantee the debt. The mother's agreement with the lender is the secondary promise, and must be written in order for the lender to enforce it if Alex defaults in the future. In this scenario, the mother is a **surety** or **guarantor** (the terms are essentially synonymous); someone who promises to perform upon the default of another.

This agreement distills down to the following: B agrees to pay C if A does not. B is making an agreement with C that is *collateral*—on the side—to the promise A is making to C.

This rule only applies to a collateral promise. For example if Alex's mother agrees to make half of the payments on Alex's car loan, this would not be a collateral but instead be a primary promise. Thus, under this rule, the Statute of Frauds would not require that the promise be reduced to writing. In other words, where A and B both agree to pay C this is a direct promise, not a collateral promise.

Moreover, under this rule the debt paid for someone else need not be money, but can be any contractual duty. For example, if Alex agrees to work off some car payments at the dealership car wash, Alex's mother can promise to show up and wash cars if Alex fails to do so. This, too, would be a secondary or collateral promise, and therefore it must be written to be enforceable.

Exception to Promises to Pay the Debt of Another

The main purpose doctrine is a major exception to the surety provision of the Statute of Frauds. Under this doctrine, the reason for agreeing to act as a surety is considered when determining if a written agreement is required. If the main purpose of this agreement was to secure an economic advantage for the surety, then the agreement is not bound by the Statute of Frauds writing requirement. Suppose, in the previous example, that Alex's mother is really the one who wants the car, but doesn't want to buy one herself. Instead she agrees to act as surety, knowing all along that she will be the one using the car to get back and forth to work and run daily errands. In such a situation, the agreement to pay Alex's debt, even when the agreement was oral, would be binding on Alex's mom since her main purpose in making this agreement was her own transportation needs, and not Alex's.

Normally, the main purpose rule comes into play when the surety desires a financial advantage to herself that cannot occur unless she provides some security. For example, the board chairman of a small company, who also owns all the voting stock, might guarantee a printer that if his company defaulted in paying the bill for desperately needed catalogs, he would personally pay the bill. If his main purpose in giving the guarantee was to get the catalogues printed in order to stave off

bankruptcy, and thus to preserve his own interest in the company, he would be bound by an oral agreement.

CASE 11.2

Wilson Floors Co. v. Sciota Park, Ltd., and Unit, Inc., 377 N.E.2d 514 (1978)

SWEENY, J.

In December of 1971, Wilson Floors Company (hereinafter "Wilson") entered into a contract with Unit, Inc. (hereinafter "Unit"), a Texas corporation to furnish and install flooring materials for "The Cliffs" project, a development consisting of new apartments and an office building to be located in Columbus, Ohio. Unit…was the general manager for the project. The Pittsburgh National Bank (hereinafter the bank), as the construction lender for the project, held mortgages on The Cliffs property security for construction loans which the bank had made to Unit.

As the work progressed on the project Unit fell behind in making payments to Wilson for its completed work in the spring of 1973. At that time, the project was approximately two-thirds completed, the first mortgage money of seven million dollars having been fully dispersed by the bank to Unit. Appellant [Wilson] thereupon stopped work in May of 1973 and informed Unit that it would not continue until payments were forthcoming. On May 15, 1973, the bank conducted a meeting with the subcontractors in The Cliffs project, including Wilson.

At the meeting, the bank sought to determine whether it would be beneficial at that stage of the project to lend more money to Unit, foreclose on the mortgage and hire a new contractor to complete the work, or do nothing. Subcontractors were requested to furnish the bank an itemized account of what Unit owed them, and a cost estimate of future services necessary to complete their job contracts. Having reviewed the alternatives, the bank determined that it would be in its best interest to provide additional financing for the project. The bank reasoned that to foreclose on the mortgage and hire a new contractor at this stage of construction would result in higher costs.

There is conflicting testimony in regard to whether the bank made assurances to Wilson at this meeting that it would be paid for all work to be rendered on the project. However, after the May meeting, Wilson, along with the other subcontractors, did return to work.

Payments from Unit again were not forthcoming, resulting in a second work stoppage. The bank then arranged another meeting to be conducted on June 28, 1973.

At this second meeting, there is conflicting testimony concerning the import of the statements made by the bank representative to the subcontractors. The bank representative who spoke at the meeting testified at trial that he had merely advised the subcontractors that adequate funds would be available to complete the job. However, two representatives of Wilson, also in attendance at the meeting, testified that the bank representative had assured Wilson that if it returned to work, it would be paid.

After the meeting, Wilson returned to work and continued to submit its progress billings to Unit for payment. Upon completion of its portion of The Cliffs project, Wilson submitted its final invoice of

$15,584.50 to Unit. This amount was adjusted downward to $15,443.06 upon agreement of Unit and Wilson. However, Wilson was not paid this amount.

As a result of nonpayment, Wilson filed suit…against Unit and the bank to recover the $15,443.06 [about $111,700 in 2024 dollars]. On September 26, 1975, Wilson and Unit stipulated that judgment for the sum of $15,365.84, plus interest, be entered against Unit. When Unit failed to satisfy the judgment, appellant proceeded with its action against the bank. [The trial court decided in favor of Wilson, but the intermediate appellate court reversed the trial court decision.]…[The Ohio statute of frauds provides]:

No action shall be brought whereby to charge the defendant, upon a special promise, to answer for the debt, default, or miscarriage of another person…unless the agreement…or some memorandum thereof, is in writing and signed by the party to be charged.…

In paragraph one of *Crawford v. Edison* [an 1887 Ohio case], however, this court stated:

When the leading object of the promisor is, not to answer for another, but to subserve some pecuniary or business purpose of his own, involving a benefit to himself…his promise is not within the statute of frauds, although it may be in form a promise to pay the debt of another and its performance may incidentally have the effect of extinguishing that liability.…

So long as the promisor undertakes to pay the subcontractor whatever his services are worth irrespective of what he may owe the general contractor and so long as the main purpose of the promisor is to further his own business or pecuniary interest, the promise is enforceable.…

The facts in the instant case reflect that the bank made its guarantee to Wilson to subserve its own business interest of reducing costs to complete the project. Clearly, the bank induced Wilson to remain on the job and rely on its credit for future payments. To apply the statute of frauds and hold that the bank had no contractual duty to Wilson despite its oral guarantees would not prevent the wrong which the statute's enactment was to prevent, but would in reality effectuate a wrong.

Therefore, this court affirms the finding of the Court of Common Pleas that the verbal agreement made by the bank is enforceable by Wilson, and reverses the judgment of the Court of Appeals.

Case questions

1. The exception to the Statute of Frauds in issue here is the main purpose doctrine. How does this doctrine relate to the concept of promissory estoppel?
2. What was the main purpose behind the bank's purported promise?

AGREEMENTS OF EXECUTOR OR ADMINISTRATOR

The promise by an executor or administrator of an estate to answer personally for the debt or other duty of the deceased is analogous to the surety provision—it must be evidenced by some writing if it is to be enforced. For an agreement to be covered by the statute, there must have been an obligation

before the decedent's death. Thus, if the executor arranges for a funeral and guarantees payment should the estate fail to pay the fee, an oral contract is binding, because there was no preexisting obligation. If, however, the decedent has made his own arrangements and signed a note obligating his estate to pay, the executor's promise to guarantee payment would be binding only if written. The main purpose exception to the surety provision applies to this section of the **Statute of Frauds** as well.

THE UNIFORM COMMERCIAL CODE

Contracts for the sale of goods in the amount of $500 or greater must be evidenced by some writing to be enforceable. Section 2-201 of the **UCC** states:

> [A] contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. 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.

Thus, to satisfy the requirement of the UCC, a contract for goods worth $500 or more must have the quantity of goods as well as the signature of the party against whom enforcement is sought. For example, if a buyer contracts with a seller to purchase 10,000 widgets for $1,000, the written contract for sale must include the quantity of widgets – 10,000 – and at least one signature. If the buyer wants to enforce the contract as against the seller, the buyer needs the seller's signature. Similarly, if the seller seeks to sue buyer for breach of contract, the seller needs the buyer's signature on the contract.

This UCC Code section has no impact on sales of goods below $500 so oral agreements for the sale of goods valued at less than $500 are fully enforceable without exception.

Exceptions under the UCC

There are four exceptions to the UCC's Statute of Frauds requirement that are relevant here.

The Ten-Day-Reply Doctrine

The UCC holds merchants to a higher standard of conduct than non-merchants. The ten-day-reply doctrine provides that in a contract between two merchants, if an oral agreement is reached and one party sends the other a written statement confirming it, the other party has ten days to object in writing or the agreement is enforceable.

"Specially Manufactured Goods"

This UCC provides an exception for a seller that has manufactured goods to the buyer's specifications or who has made "either a substantial beginning of their manufacture or commitments for their procurement." Assuming that the goods are unsuitable for sale to others, if the buyer repudiates the oral agreement, the seller will be able to seek remedies even if the agreement for the specially manufactured goods was oral.

The "Admission" Exception

This exception arises when the party against whom enforcement is sought admits in testimony or legal papers that a contract was in fact made. That said, the admission will not permit enforcement of all claimed terms of the contract; enforcement is limited to the quantity of goods admitted.

The "Payment or Delivery and Acceptance" Exception

Similar to the past performance exception for the sale of **interest in land**, the UCC provides that an oral contract for goods in excess of $500 will be upheld if payment has already been made and accepted, or if the goods have been received and accepted.

Other Writing Requirements

In addition to these requirements, the UCC provides that agreements for the sale of securities (e.g., most stocks and bonds) usually need to be evidenced by a writing, and agreements for property not included in the sales or securities articles of the UCC that exceed $5,000 in value need to be so evidenced. Included here would be intangible property such as rights to royalties and to mortgage payments, and other rights created by contract. And in many states, other statutes require a writing for several different kinds of contracts. These include agreements to pay commissions to real estate brokers, to make a will, to pay debts already discharged in bankruptcy, to arbitrate rather than litigate, to make loans, and to make installment contracts.

ACTIVITY 11B

Which is Which

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=58#h5p-29

11.3 SUFFICIENCY OF THE REQUIRED WRITING

Now that we've set out the types of agreements where the contractual intentions must be evidenced by a writing, it is time to understand what is required to provide enough evidence of the agreement such that it will be enforced in situation where a writing is required.

WRITING REQUIREMENT UNDER THE COMMON LAW

When asked to think about a contract, you might picture a student loan document you recently signed, or your insurance policy, or even the license agreement for your Apple Account. These are

all written documents that would satisfy the writing requirement under the common law, but much simpler documentation will also suffice in many cases. For example, written documents like a check, a receipt, a written notation on an envelop, and other simple documents also satisfy the requirement of a writing under the common law.

The writing need not contain every term, but it must recite the subject matter of the contract in a way that would be understandable in the context of the transaction. For example, a written agreement to buy a parcel of land is usually sufficiently definitive if it refers to the parcel in such a way that it could be mistaken for no other—for example, "seller's land in Allentown," assuming that the seller owned only one parcel there. Beyond the subject matter, the essential terms of promises to be performed must be written out; but all of the little details need not be. If an essential term is missing, it cannot be enforced, unless it can be inferred or imposed by rule of law. A written contract for the sale of land containing every term but the time for payment, which the parties orally agreed would be upon delivery of the deed, is sufficient. (A contract that omitted the selling price would not be.)

The parties must be named in the writing in a manner sufficient to identify them. Their whole names need not be given if initials or some other reference makes it inescapable that the writing does concern the actual parties. Reference to the agent of a party identifies the party. Possession of the writing may even be sufficient: if a seller gives a memorandum of an oral agreement for the sale of his land, stating all the terms, to the buyer, the latter may seek specific performance even though the writing omits to name or describe him or his agent.

In a few states, consideration for the promise must be stated in writing, even if the consideration has already been given. Consequently, written contracts frequently contain such language as "for value received." But in most states, failure to refer to consideration already given is unnecessary. The situation is different, however, when the consideration is a return promise yet to be performed. Usually the return promise is an essential term of the agreement, and failure to state it will vitiate the writing.

WRITING REQUIREMENT UNDER THE UCC

In contracts for the sale of goods, the writing must be signed by the party to be charged, and the parties must be sufficiently identified. The quantity of the items purchased must also be set forth in the writing. But consideration, including the selling price, need not be set forth for the memorandum to meet the requirements of the UCC, though obviously it makes sense to do so whenever possible. By contrast, UCC Sections 1-206 and 3-319 concerning intangible personal property and investment securities require "a defined or stated price."

ELECTRONIC COMMUNICATIONS

The Electronic Signatures in Global and National Commerce Act, S. 761, popularly referred to as ESign, pertains to documentation of agreements in electronic form. The primary impact of Esign is to make almost anything reasonably indicative of a signature good enough electronically. It provides the following:

> Notwithstanding any statute, regulation, or other rule of law [other than subsequent parts

> of this same statute], with respect to any transactions in or affecting interstate or foreign commerce—
>
> a signature, contract, or other record relating to such transaction may not be denied legal effect, validity or enforceability solely because it is in electronic form; and
>
> a contract relating to such transaction may not be denied legal effect, validity or enforceability solely because an electronic signature or electronic record was used in its formation.…

The term "transaction" means an action or set of actions relating to the conduct of a business, consumer or commercial affairs between two or more persons, including any of the following types of conduct—

- the sale, lease, exchange, or other disposition of [personal property and intangibles]
- the sale, lease, exchange or other disposition of any interest in real property, or any combination thereof.

The term "electronic signature" means an electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.

11.4 EXCEPTIONS; ORAL RESCISSION

The basic rule is that contracts governed by the **Statute of Frauds** are unenforceable if they are not sufficiently written down. If the agreement contains several promises, the unenforceability of one promise will generally render the other promises unenforceable also. Because this can lead to injustice in some situations, in addition to the specific exceptions discussed above there are some general exceptions to the Statute of Frauds as well.

FULL PERFORMANCE

If an oral contract has been performed fully by both sides, its unenforceability under the statute of frauds is moot. Having fulfilled its function (neither side having repudiated the contract), the agreement cannot be rescinded on the ground that it should have been, but was not, reduced to writing.

DETRIMENTAL RELIANCE

Some relief may be granted to one who has relied on an oral contract to her detriment. For a partially performed contract that is unenforceable under the Statute of Frauds, restitution may be available. Suppose George orally agrees to landscape Arthur's fifteen acres, in return for which George is to receive title to one acre at the far end of the lot. George is not entitled to the acre if Arthur defaults, but he may recover for the reasonable value of the services he has performed up to the time of repudiation. Somewhat related, if one side has reasonably and foreseeably relied upon a promise in such a way that injustice can only be avoided by enforcing it, some courts will use promissory estoppel to preclude the necessity of a writing, but the connection between the alleged oral contract and the detrimental reliance must be convincing.

ORAL RESCISSION

Most contracts required to be in writing may nonetheless be rescinded orally. The new (oral) agreement is treated in effect as a modification of the old one, and since a complete rescission will not usually trigger any action the statute requires to be in writing, the rescission becomes effective in the absence of any signed memorandum.

Some agreements, however, may not be rescinded orally. Those that by their terms preclude oral rescission are an obvious class. Under the UCC, certain agreements for the sale of goods may not be orally rescinded, depending on the circumstances. For instance, if title has already passed to the buyer under a written agreement that satisfies the statute, the contract can be rescinded only by a writing. Contracts for the sale of land are another class of agreements that generally may not be orally rescinded. If title has already been transferred, or if there has been a material change of position in reliance on the contract, oral agreements to rescind are unenforceable. But a contract that remains wholly executory, even though enforceable because in writing, may be rescinded orally in most states.

CONTRACT MODIFICATION

Contracts governed by the Statute of Frauds may be modified orally if the resulting contract, taken as a whole, falls outside the statute. The same rule applies under the UCC. For example, a written contract for the sale of a new bicycle worth $1,200 may be orally modified by substituting the sale of a used bicycle worth $450, but not by substituting the sale of a used bike worth $600. The modified contract effectively rescinds the original contract.

11.5 THE PAROL EVIDENCE RULE

THE PURPOSE OF THE PAROL EVIDENCE RULE

Written contracts, especially substantial ones, simply don't appear out of thin air. Negotiations, agreements and understanding necessarily precede the conclusion of a final deal. In a negotiation leading up to a contract parties write letters, talk by telephone, meet face-to-face, send e-mails, and exchange thoughts and views about what they want and how they will reciprocate. They might even make a few promises seeking to entice the other side to keep negotiating, knowing that they can or will not keep all of those promises in a final agreement. As this sort of negotiation winds down toward a tentative agreement, the parties must place their agreements into a written document that reflects what all of those negotiations finally led to.

Once the final version of the agreement is reduced to a written document that the parties sign, what should happen to the letters, phone calls, emails, and the promises that didn't make it to the written contract? The **parol evidence rule** answers this question.

PAROL EVIDENCE RULE AT COMMON-LAW

The rule at common law is this: a written contract intended to be the parties' complete understanding discharges all prior or contemporaneous promises, statements, or agreements that add to, vary, or conflict with it.

The parol evidence rule (*parol* means oral) is a substantive rule of law that operates to bar the

introduction of evidence intended to show that the parties had agreed to something different from what they finally arrived at and wrote down. It applies to prior written as well as oral discussions that don't make it into the final written agreement. Though its many apparent exceptions make the rule seem difficult to apply, its purposes are simple: to give freedom to the parties to negotiate without fear of being held to the consequences of asserting preliminary positions, and to give finality to the written contract that results.

For example, suppose that Seller and Buyer enter into a final written contract for the sale of a car after negotiations about the price and other features of the automobile. The written agreement states that Seller will sell the car to Buyer for $10,000, and that Buyer will pay the full amount in cash upon delivery. If Buyer later tries to introduce evidence at trial of a prior oral agreement in which Seller agreed to accept $9,000 for the car if Buyer instead picked up the car from the Seller, the court will apply the parol evidence rule and exclude this evidence. The court will enforce the terms of the written agreement, which state that the purchase price is $10,000 and that payment is due in cash upon delivery.

The rule applies to written contracts, whether or not the Statute of Frauds requires them to be in writing. The Statute of Frauds gets to whether there was a contract at all; the parol evidence rule says, granted there was a written contract, does it express the parties' understanding? But the rule is concerned only with events that transpired before the contract in dispute was signed. It has no bearing on agreements reached subsequently that may alter the terms of an existing contract.

EXEMPTIONS AND EXCEPTIONS TO THE PAROL EVIDENCE RULE

Despite its apparent stringency, the **parol evidence rule** does not negate all prior agreements or statements, nor preclude their use as evidence. A number of situations fall outside the scope of the rule and hence are not technically exceptions to it, so they are better phrased as exemptions (something not within the scope of a rule).

Not an Integrated Contract

If the parties never intended the written contract to be their full understanding—if they intended it to be partly oral—then the rule does not apply. If the document is fully integrated, no extrinsic evidence will be permitted to modify the terms of the agreement, even if the modification is in addition to the existing terms, rather than a contradiction of them. If the contract is partially integrated, prior consistent additional terms may be shown. It is the duty of the party who wants to exclude the parol evidence to show the contract was intended to be integrated. That is not always an easy task. To prevent a party later from introducing extrinsic evidence to show that there were prior agreements, the contract itself can recite that there were none. Here, for example, is the final clause in the National Basketball Association Uniform Player Contract: "This agreement contains the entire agreement between the parties and there are no oral or written inducements, promises or agreements except as contained herein." Such a clause is known as a **merger clause**.

Void or Voidable Contracts

Parol evidence is admissible to show the existence of grounds that would cause the contract to be void. Such grounds include illegality, fraud, duress, mistake, and lack of consideration. And parol evidence

is allowed to show evidence of lack of contractual capacity. Evidence of infancy, incompetency, and so on would not change the terms of the contract at all but would show it was voidable or void.

Contracts Subject to a Condition Precedent

When the parties orally agree that a written contract is contingent on the occurrence of an event or some other condition (a condition precedent), the contract is not integrated and the oral agreement may be introduced. The classic case is that of an inventor who sells in a written contract an interest in his invention. Orally, the inventor and the buyer agree that the contract is to take effect only if the buyer's engineer approves the invention. (The contract was signed in advance of approval so that the parties would not need to meet again.) The engineer did not approve it, and in a suit for performance, the court permitted the evidence of the oral agreement because it showed that in this case there was never an agreement at all. Note that the oral condition does not contradict a term of the written contract; it negates it. The parol evidence rule will not permit evidence of an oral agreement that is inconsistent with a written term, for as to that term the contract is integrated.

Untrue Recital or Errors

The parol evidence rule does not prevent a showing that a fact stated in a contract is untrue. The rule deals with prior agreements; it cannot serve to choke off inquiry into the facts. Thus the parol evidence rule will not bar a showing that one of the parties is a minor, even if the contract recites that each party is over eighteen. Nor will it prevent a showing that a figure in the contract had a typographical error—for example, a recital that the rate charged will be the plumber's "usual rate of $3 per hour" when both parties understood that the usual rate was in fact $30 per hour. A court would allow reformation (correction) of such errors.

Ambiguity

To enforce a contract, its terms must be understood, so parol evidence would be allowed, but a claim of ambiguity cannot be used to alter, vary, or change the contract's meaning.

Postcontract Modification

Ordinarily, an additional consistent oral term may be shown only if the contract was partially integrated. The parol evidence rule bars evidence of such a term if the contract was fully integrated. However, when there is additional consideration for the term orally agreed, it lies outside the scope of the **integrated contract** and may be introduced. In effect, the law treats each separate consideration as creating a new contract; the integrated written document does not undercut the separate oral agreement, as long as they are consistent. Buyer purchases Seller's business on a contract; as part of the agreement, Seller agrees to stay on for three weeks to help Buyer "learn the ropes." Buyer realizes she is not yet prepared to go on her own. She and Seller then agree that Seller will stay on as a salaried employee for five more weeks. Buyer cannot use the parol evidence rule to preclude evidence of the new agreement: it is a postcontract modification supported by new consideration. Similarly, parties could choose to rescind a previously made contract, and the parol evidence rule would not bar evidence of that.

The UCC Approach

Under Section 2-202 of the UCC, a course of dealing, a usage of trade, or a course of performance

can be introduced as evidence to explain or supplement any written contract for the sale of goods. A course of dealing is defined as "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." 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." A course of performance is the conduct of a party in response to a contract that calls for repeated action (e.g., a purchase agreement for a factory's monthly output, or an undertaking to wash a neighbor's car weekly).

CASE 11.3

Hampden Real Estate, Inc. v. Metropolitan Management Group, Inc., 142 Fed. Appx. 600 (Fed. Ct. App. Pa. 2005)

COWEN, J.

[The court has jurisdiction based on diversity of citizenship.]

Hampden Real Estate sold Metropolitan Management a residential property pursuant to an Agreement of Sale (the "Sale Agreement"). The Sale Agreement provided that the property would be sold for $3.7 million, that Metropolitan would assume Hampden's mortgage on the building, and that Hampden would receive a credit in the amount of $120,549.78—the amount being held in escrow pursuant to the mortgage (the "Escrow Account Credit").

Between the execution of the Sale Agreement and the closing, the parties negotiated certain adjustments to the purchase price to compensate for required repairs. During these negotiations, the parties reviewed a draft and final Settlement Statement (the "Settlement Statement"), prepared by the closing agent, which did not list the Escrow Account Credit among the various debits and credits. A few weeks after the closing, Hampden demanded payment of the Escrow Account Credit.

Following Metropolitan's refusal to pay the Escrow Account Credit, Hampden filed a complaint claiming breach of contract, unjust enrichment, and conversion. Metropolitan brought counterclaims for breach of contract, unjust enrichment, and fraudulent or negligent misrepresentation. Hampden brought a partial motion for summary judgment as to the breach of contract claim, which was granted and its unjust enrichment and conversion claims were dismissed as moot.…

The District Court correctly determined that the threshold issue is the role of the Settlement Statement, "based on both the intent of the parties and the custom and usage of the document." However, the Court refused to consider extrinsic or parol evidence to determine the intent of the parties, reasoning that the parol evidence rule precluded such consideration absent ambiguity in the written contract. We find that the District Court misapplied the rule. The parol evidence rule seeks to preserve the integrity of written agreements by precluding the introduction of contemporaneous or prior declarations to alter the meaning of written agreements. [Citation] The rule does not apply, however, where a party seeks to introduce evidence of subsequent oral modifications. See [Citation:] a "written agreement may be modified by a subsequent written or oral agreement and this modification may be shown by writings or by words or by conduct or by all three. In such a situation the parol evidence rule is inapplicable." Here, the parol evidence rule does not preclude testimony regarding the parties' intention to alter the final purchase price by

executing a Settlement Statement, after the execution of the Sale Agreement, which omitted the Escrow Account Credit.

The cases cited by Hampden are not to the contrary as each involved the admissibility of prior negotiations to demonstrate misrepresentations made in the inducement of the contract. As example, the court in [Citation], held that "[i]f a party contends that a writing is not an accurate expression of the agreement between the parties, and that certain provisions were omitted therefrom, the parol evidence rule does not apply." (Permitting the introduction of parol evidence to establish that the contract omitted provisions which appellees represented would be included in the writing).…

The District Court further held that the integration clause contained in the written contract supports the conclusion that the Settlement Statement, which mentioned neither the Escrow Account Credit nor that it was amending the Sale Agreement, is not a modification of the Sale Agreement. The Court explained that the outcome might be different if the Settlement Statement mentioned "the escrow credit but provided different details, but as the [Settlement Statement] in this case simply ignored the escrow credit, and both parties agree that there were no oral discussions regarding the escrow credit, the [Settlement Statement] cannot be said to modify the escrow credit provision in the Agreement of Sale." We disagree.

It is well-settled law in Pennsylvania that a "written contract which is not for the sale of goods may be modified orally, even when the contract provides that modifications may only be made in writing." [Citation] "The modification may be accomplished either by words or conduct," [Citation] demonstrating that the parties intended to waive the requirement that amendments be made in writing. [Citation] An oral modification of a written contract must be proven by "clear, precise and convincing evidence." [Citation] Viewing the evidence in the light most favorable to Metropolitan, we find that the District Court erred in concluding that there was insufficient evidence in the record to raise a genuine issue of material fact as to whether the parties intended to orally modify the Sale Agreement. Metropolitan introduced a Settlement Statement which omitted the Escrow Account Credit, while listing all other debits and credits and submitted an affidavit from its President who "reviewed the Draft Settlement Statement and understood that the Escrow Account Credit had been omitted as part of the ongoing negotiations between the parties concerning the amount of the credit to which Metropolitan was entitled" due to the poor condition of the property.

Accordingly, the District Court erred in granting summary judgment in favor of Hampden. At a minimum, there was a triable issue of fact concerning whether the Settlement Statement was intended to modify the prior written Sale Agreement and serve as the final and binding manifestation of the purchase price. Specifically, whether the parties intended to exclude the Escrow Account Credit from the purchase price as part of the negotiations to address Hampden's failure to maintain the property.

[Reversed and remanded.]

Case questions

1. The contract had an integration clause. Why didn't that bar admission of the subsequent oral modification to the contract?

2. What rule of law was the plaintiff relying on in support of its contention that the original agreement should stand?
3. What rule of law was the defendant relying on in support of its contention that the original agreement had been modified?
4. According to the defendant, how had the original agreement been modified, and why?

11.6 INTERPRETATION OF WRITTEN AGREEMENTS

Sometimes, the meaning of a word can depend on factors that are not specific to the word itself. For instance, the skill of the writer plays a role in the meaning, precision and consistency in use of words. The meaning of a word can also vary based on the context of its use. Words and phrases can be ambiguous, either when they stand alone or when they take on a different coloration from words and phrases near them Interpretation difficulties can arise for any of a number of reasons: a form contract might contain language that is inconsistent with provisions written in specific for the transaction; the parties might use jargon that is unclear; a necessary term may be inadvertently omitted; there may be assumptions about prior usage or performance that might color their understanding of the words they do use. Because ambiguities do arise, courts are frequently called on to give content to the words on paper.

THE BASIC RULE OF INTERPRETATION

Courts attempt to give meaning to the parties' understanding when they wrote the contract.

The intention of the parties governs, and if their purpose in making the contract is known or can be ascertained from all the circumstances, it will be given great weight in determining the meaning of an obscure, murky, or ambiguous provision or a pattern of conduct. A father tells the college bookstore that in consideration of its supplying his daughter, a freshman, with books for the coming year, he will guarantee payment of up to $350. His daughter purchases books totaling $400 the first semester, and he pays the bill. Midway through the second semester, the bookstore presents him with a bill for an additional $100, and he pays that. At the end of the year, he refuses to pay a third bill for $150. A court could construe his conduct as indicating a purpose to ensure that his daughter had whatever books she needed, regardless of cost, and interpret the contract to hold him liable for the final bill.

TOOLS OF INTERPRETATION

The policy of uncovering purpose has led to a number of tools of judicial interpretation:

- More specific terms or conduct are given more weight than general terms or unremarkable conduct. Thus, a clause that is separately negotiated and added to a contract will be counted as more significant than a standard term in a form contract.
- A writing is interpreted as a whole, without undue attention to one clause.
- Common words and terms are given common meaning; technical terms are given their technical meaning.
- In the range of language and conduct that helps in interpretation, the courts prefer the following items in the order listed: express terms, course of performance, course of dealing, and usage of trade.
- If an amount is given in words and figures that differ, the words control.
- Writing controls over typing; typing controls over printed forms.
- Ambiguities are construed against the party that wrote the contract.

In this chapter, we have considered a set of generally technical legal rules that spell out the consequences of contracts that are wholly or partially oral or that, if written, are ambiguous or do not contain every term agreed upon. These rules fall within three general headings: the **Statute of Frauds**, the **parol evidence rule**, and the rules of interpretation. Obviously, the more attention paid to the contract before it is formally agreed to, the fewer the unforeseen consequences. In general, the conclusion is inescapable that a written contract will avoid a host of problems. Writing down an agreement is not always sensible or practical, but it can probably be done more often than it is. Writing almost fifty years ago—and it is still true—a law professor studying business practices noted the following:

Businessmen often prefer to rely on "a man's word" in a brief letter, a handshake or "common honesty and decency"—even when the transaction involves exposure to serious risks. Seven lawyers from law firms with business practices were interviewed. Five thought that businessmen often entered contracts with only a minimal degree of advanced planning. They complained that businessmen desire to "keep it simple and avoid red tape" even where large amounts of money and significant risks are involved.…Another said that businessmen when bargaining often talk only in pleasant generalities, think they have a contract, but fail to reach agreement on any of the hard, unpleasant questions until forced to do so by a lawyer.

Written contracts do not, to be sure, guarantee escape from disputes and litigation. Sometimes ambiguities are not seen; sometimes they are necessary if the parties are to reach an agreement at all. Rather than back out of the deal, it may be worth the risk to one or both parties deliberately to go along with an ambiguous provision and hope that it never arises to be tested in a dispute that winds up in court.

Nevertheless, it is generally true that a written contract has at least three benefits over oral ones, even those that by law are not required to be in writing. (1) The written contract usually avoids ambiguity. (2) It can serve both as a communications device and as a device for the allocation of power, especially within large companies. By alerting various divisions to its formal requirements, the contract requires the sales, design, quality-control, and financial departments to work together. By

setting forth requirements that the company must meet, it can place the power to take certain actions in the hands of one division or another. (3) Finally, should a dispute later arise, the written contract can immeasurably add to proof both of the fact that a contract was agreed to and of what its terms were.

ACTIVITY 11C

What's Your Verdict?

Considering the benefits of written contracts, and also the frequency with which we enter contracts in our own lives, has the statute of frauds achieved the right balance between written and oral contracts? Should we have greater requirements for contracts to be written? Should we permit more oral contracts? Explain your position using the concepts from the Chapter.

End of Chapter Exercises

1. Plaintiff's and Defendant's cars crashed. Plaintiff hired an attorney, who negotiated with Defendant's insurance adjuster. Plaintiff's attorney claimed he and the adjuster reached an oral settlement, but the insurance company refused to honor it and filed for summary judgment, raising the Statute of Frauds' suretyship provision as a defense: a promise by one person (the insurance company here) to pay the debts of another (the insured) must be evidenced by some writing, and there was no writing. Is the defense good? Explain.
2. Plaintiff Irma Kozlowski cohabited with Defendant Thaddeus Kozlowski for fifteen years without marriage. She repeatedly asked him specifically about her financial situation should he predecease her, and he assured her—she said—that he would arrange to provide for her for the rest of her life. She had provided the necessary household services and emotional support to permit him to successfully pursue his business career; she had performed housekeeping, cleaning, and shopping services and had run the household and raised the children, her own as well as his. When they separated and she was "literally forced out of the house," she was sixty-three years old and had no means or wherewithal for survival. When she sued, he raised the Statute of Frauds' one-year rule as a defense. Is the defense good?
3. Carlson purchased a parcel of real estate that was landlocked. Carlson called his neighbor, Peterson, and asked if he could use an abandoned drive on Peterson's property to travel to his (Carlson's) property from the highway. Peterson said, "Sure, anytime." Later the two became engaged in a dispute, and Peterson blocked the drive. May Carlson enforce Peterson's promise that he could use the drive "anytime"? Why?
4. Silverman, who was elderly and somewhat disabled, lived alone on a farm. Silverman called Burch and said, "Burch, if you will move in with me and help me take care of the farm, it will be yours when I die." Burch did as Silverman requested and on Silverman's death two years later, claimed the farm on the basis of their oral agreement, but the estate resisted. Is Burch entitled

to the farm? Why?

5. On February 12, Sally was hired to manage a company for a period of one year. She reported for work on February 26 but was fired two weeks later. She sued the owner of the company for breach of their one-year oral contract. May she recover? Why?
6. Baker entered into an oral contract to sell her car to Clyde for $8,600. She delivered the car to Clyde; Clyde inspected it, found no problems, kept it for three days, but then refused to pay and now wants to return the car. Is the contract enforceable? Why?
7. Wayne, a building contractor, built a new house and offered it for sale. A young couple accepted the offer, and the parties entered into an oral agreement covering all the terms of sale. The couple later tried to back out of the agreement. Wayne filed suit, and during the trial, the couple admitted making the contract. Is the contract enforceable? Why?
8. Plaintiff leased commercial space from Defendant for a florist shop. After the lease was signed, Plaintiff learned that the county code allowed only one freestanding sign on the property, and one was already up, advertising Defendant's business. Plaintiff claimed Defendant breached the lease by not providing them space for a sign; Defendant pointed to the lease, paragraph 16 of which provided that "Tenant shall not erect or install any sign…without written consent of the Landlord." But Plaintiff claimed Defendant said during negotiations he could have a sign, evidence Defendant objected to based on the parol evidence rule. Defendant admitted that during negotiations he told Plaintiff that despite paragraph 16, he could have a sign (but not freestanding); that despite language in the lease requiring renovation plans to be in writing, they did not have to be. Defendant also testified that the written form lease he used was not drafted specifically for this property, and that although the lease required attachments of exhibits, there were no attachments. Is Plaintiff barred by the parolevidence rule from showing that Defendant said he could have a freestanding sign?
9. On March 1, 2010, Milton talked to Harriet and, as Harriet claimed, said, "I will hire you as sales manager for one year at a salary of $57,000. You start next Monday, March 8." Harriet agreed. Four months later Milton discharged Harriet and she sued, claiming breach of employment contract. Is the alleged contract enforceable?
10. Al Booth's Inc. sued Boyd-Scarp (a contractor) and James Rathmann for nonpayment following delivery of various appliances to Rathmann's new home being built by Boyd-Scarp. Booth's was aware that Boyd-Scarp was having financial problems and allegedly contacted Rathmann prior to delivery, asking him to guarantee payment. Evidence was adduced that Rathmann orally promised to pay in the event the builder did not and that the goods were then delivered. Rathmann denied any such promise, raising the Statute of Frauds, and Al Booth's sued. Will Al Booth's prevail?

REFERENCES

Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 96, 106th Congress (2000).

In re Marriage of Rada, 402, 869 P.2d 254 (Mont. 1994).

Kozlowski v. Kozlowski, 395 A.2d 913 (N.J. 1978).

Pym v. Campbell, 119 Eng. Rep. 903 (Q.B. 1856).

Restatement (Second) of Contracts, Chapter 5, statutory note.

Restatement (Second) of Contracts, Section 125.

Restatement (Second) of Contracts, Section 207(f).

Restatement (Second) of Contracts, Section 207(h).

Stewart Macaulay, "Non-contractual Relations in Business: A Preliminary Study," *American Sociological Review* 28, no. 1 (1963): 58–59.

Stuart Studio, Inc. v. National School of Heavy Equipment, Inc., 214 S.E.2d 192 (N.C. 1975).

Towne v. Eisner, 245 U.S. 418, 425 (1917).

Uniform Commercial Code, Section 8-319

Uniform Commercial Code, Section 1-206.

Uniform Commercial Code, Section 2-201

Uniform Commercial Code, Section 2-209(3).

Uniform Commercial Code, Section 2-210(1)

CHAPTER 12 - THIRD-PARTY RIGHTS

Learning Objectives

After studying this chapter, you should be able to:

1. Explain how an assignment of contract rights is made and how it operates.
2. Explain how a delegation of duties is made and how it operates.
3. Compare and contrast Intended and Incidental Third-Party Beneficiary Agreements.
4. Analyze the rights and remedies available to third parties in contracts.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=248#h5p-17

12.1 GENERAL PERSPECTIVES ON THIRD-PARTY RIGHTS

Ordinarily only the parties to a contract have the **right** to enforce that contract. To this point in our studies, we have focused on the rights and duties of the two parties to a contract. The laws surrounding **third-party rights** govern the ability of third parties or outsiders to enforce contractual rights or to be bound by contractual obligations even though they are not a party to a contract. This allows individuals or entities that are not directly involved in a contract to benefit from or be bound by the contract's terms.

There are several reasons why third-party rights in contracts exists. One reason is to ensure fairness and equity in contractual relationships. In many cases, outsiders may have a legitimate interest in the performance of a contract, and allowing them to enforce their rights or obligations under the contract can prevent injustice and promote the overall fairness of the legal system. Another is to promote efficiency and convenience in contractual relationships. By allowing outsiders to enforce their rights or obligations under a contract, parties to a contract can avoid the need for multiple contracts or legal actions, which can save time and resources. Finally, third-party rights can be used to facilitate economic transactions. In many industries, such as construction and real estate, contracts often involve multiple parties with different interests and responsibilities. Allowing outsiders to enforce rights or obligations under a contract can help ensure that everyone involved in a transaction is

held accountable and that the transaction proceeds smoothly. This Chapter explores contracts where outsiders acquire rights or duties or both by considering:

Assignees (outsiders who acquire rights after the contract is made)

Delegatees (outsiders who acquire duties after the contract is made)

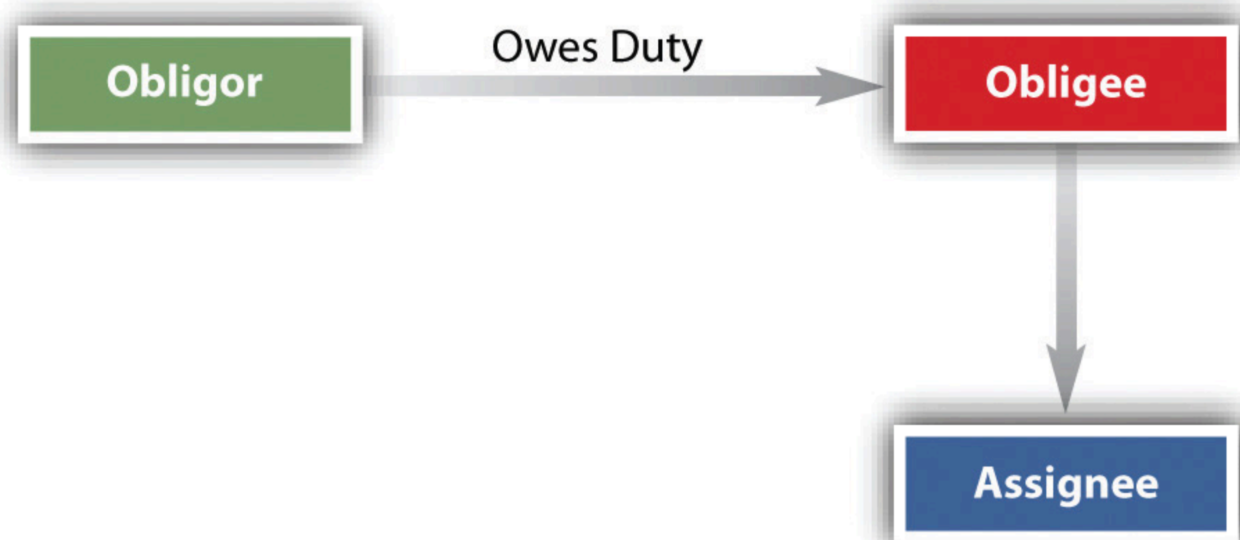
Third-party beneficiaries (outsiders who acquire rights when the original contract is made)

12.2 ASSIGNMENT OF CONTRACT RIGHTS

Contracts create rights and obligations between contracting parties. An **assignment** is the transfer of rights under a contract from one party (the **assignor**) to another party (the **assignee**). When a party assigns their rights under a contract, they are essentially transferring their ability to receive benefits or enforce terms of the contract to someone else. Stated another way, an assignment occurs when an **obligee** (one who has the right to receive a contract benefit) transfers a right to receive a contract benefit owed by the **obligor** (the one who has a **duty** to perform) to a third person (assignee); the obligee then becomes an assignor (one who makes an assignment). So, the party that makes the assignment is both an obligee and an assignor. The assignee acquires the right to receive the contractual obligations of the promisor, who is referred to as the obligor.

Generally, the assignor may assign any right unless (1) doing so would materially change the obligation of the obligor, materially burden him, increase his risk, or otherwise diminish the value to him of the original contract; (2) statute or public policy forbids the assignment; or (3) the contract itself precludes assignment. The common law of contracts and Articles 2 and 9 of the Uniform Commercial Code (UCC) govern assignments. Assignments are a common occurrence in business, legal, and financial transactions.

Figure 12.1 Assignment of Rights



METHOD OF ASSIGNMENT

Manifesting Assent

To effect an **assignment**, the assignor must make known his intention to transfer the rights to the third person. This intention must take place in the present – it cannot be a future intention. The assignor's intention must be that the assignment is effective without need of any further action or any further manifestation of intention to make the assignment. Under the UCC, any assignments of rights in excess of $5,000 must be in writing, but otherwise, assignments can be oral and consideration is not required: the assignor could assign the right to the assignee for no exchange of money or any other consideration. For example, Mrs. Franklin has the right to receive $750 a month from the sale of a house she formerly owned; she assigns the right to receive the money to her son Jason, as a gift. The assignment is good, and need not be written.

Acceptance and Revocation

For the assignment to become effective, the assignee must manifest his acceptance under most circumstances. This is done automatically when, as is usually the case, the assignee has given consideration for the assignment (i.e., there is a contract between the assignor and the assignee in which the assignment is the assignor's consideration), and then the assignment is not revocable without the assignee's consent. Problems of acceptance normally arise only when the assignor intends the assignment as a gift. Then, for the assignment to be irrevocable, either the assignee must manifest his acceptance or the assignor must notify the assignee in writing of the assignment. Thus, if Mrs. Franklin assigns the $750 a month from the sale of her house to her son Jason as a gift, this assignment is valid, but revocable.

Notice

Notice to the obligor is not required, but an obligor who renders performance to the assignor without notice of the assignment (that performance of the contract is to be rendered now to the assignee) is discharged from their obligation within the contract. Obviously, the assignor cannot then keep the consideration he has received; he owes it to the assignee. But if notice is given to the obligor and she performs to the assignor anyway, the assignee can recover from either the obligor or the assignee, so the obligor could have to perform twice. Of course, an obligor who receives notice of the assignment from the assignee will want to be sure the assignment has really occurred. After all, anybody could waltz up to the obligor and say, "I'm the assignee of your contract with the bank. From now on, pay me the $500 a month, not the bank." The obligor is entitled to verification of the assignment.

EFFECT OF ASSIGNMENT

An **assignment** of rights effectively makes the assignee stand in the shoes of the assignor. He gains all the rights against the obligor that the assignor had, but no more. An obligor who could avoid the assignor's attempt to enforce the rights could avoid a similar attempt by the assignee. Suppose Dealer sells a car to Buyer on a contract where Buyer is to pay $300 per month and the car is warranted for 50,000 miles. If the car goes on the fritz before then and Dealer won't fix it, Buyer could fix it for, say, $250 and deduct that $250 from the amount owed Dealer on the next installment. Now, if Dealer

assigns the contract to Assignee, Assignee stands in Dealer's shoes, and Buyer could likewise deduct the $250 from payment to Assignee.

Exceptions

The "shoe rule" does not apply to two types of assignments. First, it is inapplicable to the sale of a negotiable instrument to a holder in due course. Second, the rule may be waived: under the UCC and at common law, the obligor may agree in the original contract not to raise defenses against the assignee that could have been raised against the assignor. While awaiver of defenses makes the assignment more marketable from the assignee's point of view, it is a situation fraught with peril to an obligor, who may sign a contract without understanding the full import of the waiver. Under the waiver rule, for example, a farmer who buys a tractor on credit and discovers later that it does not work would still be required to pay a credit company that purchased the contract; his defense that the merchandise was shoddy would be unavailing (he would, as used to be said, be "having to pay on a dead horse").

For that reason, there are various rules that limit both the holder in due course and the waiver rule. Certain defenses, the so-called real defenses (infancy, duress, and fraud in the execution, among others), may always be asserted. Also, the waiver clause in the contract must have been presented in good faith, and if the assignee has actual notice of a defense that the buyer or lessee could raise, then the waiver is ineffective. Moreover, in consumer transactions, the UCC's rule is subject to state laws that protect consumers (people buying things used primarily for personal, family, or household purposes), and many states, by statute or court decision, have made waivers of defenses ineffective in such consumer transactions. Federal Trade Commission regulations also affect the ability of many sellers to pass on rights to assignees free of defenses that buyers could raise against them. Because of these various limitations on the holder in due course and on waivers, the "shoe rule" will not govern in consumer transactions and, if there are real defenses or the assignee does not act in good faith, in business transactions as well.

PROHIBITED ASSIGNMENTS

The general rule—as previously noted—is that most contract rights are assignable, and the law favors freely assignable rights. There are five exceptions to this rule however.

Material Change in Duties of the Obligor

When an **assignment** has the effect of materially changing the duties that the obligor must perform, it is ineffective. Changing the party to whom the obligor must make a payment is not a **material** change of **duty** that will defeat an assignment, since that, of course, is the purpose behind most assignments. Nor will a minor change in the duties the obligor must perform defeat the assignment. But, some changes are significant enough to bar assignments.

Several residents in the town of Centerville sign up on an annual basis with the Centerville *Times* to receive their morning paper. A customer who is moving out of town may assign his right to receive the paper to someone else within the delivery route. As long as the assignee pays for the paper, the assignment is effective; the only relationship the obligor has to the assignee is a routine delivery in exchange for payment. But if the change involves assigning the right to receive the paper to someone

that is outside of the delivery route, that change would be material, and the assignment could be invalid.

Assignment of Personal Rights

When it matters to the obligor who receives the benefit of his duty to perform under the contract, then the receipt of the benefit is a personal right that cannot be assigned. For example, a student seeking to earn pocket money during the school year signs up to do research work for a professor she admires and with whom she is friendly. The professor assigns the contract to one of his colleagues with whom the student does not get along. The assignment is ineffective because it matters to the student (the obligor) who the person of the assignee is. It is for this same reason that tenants usually cannot assign (sublet) their tenancies without the landlord's permission because it matters to the landlord who the person is that is living in the landlord's property.

CASE 12.1

Nassau Hotel Co. v. Barnett & Barse Corporation, 147 N.Y.S. 283 (1914)

MCLAUGHLIN, J.

Plaintiff owns a hotel at Long Beach, L. I., and on the 21st of November, 1912, it entered into a written agreement with the individual defendants Barnett and Barse to conduct the same for a period of years.…Shortly after this agreement was signed, Barnett and Barse organized the Barnett & Barse Corporation with a capital stock of $10,000, and then assigned the agreement to it. Immediately following the assignment, the corporation went into possession and assumed to carry out its terms. The plaintiff thereupon brought this action to cancel the agreement and to recover possession of the hotel and furniture therein, on the ground that the agreement was not assignable. [Summary judgment in favor of the plaintiff, defendant corporation appeals.]

The only question presented is whether the agreement was assignable. It provided, according to the allegations of the complaint, that the plaintiff leased the property to Barnett and Barse with all its equipment and furniture for a period of three years, with a privilege of five successive renewals of three years each. It expressly provided:

'That said lessees…become responsible for the operation of the said hotel and for the upkeep and maintenance thereof and of all its furniture and equipment in accordance with the terms of this agreement and the said lessees shall have the exclusive possession, control and management thereof. * * * The said lessees hereby covenant and agree that they will operate the said hotel at all times in a first-class business-like manner, keep the same open for at least six (6) months of each year, * * *' and 'in lieu of rental the lessor and lessees hereby covenant and agree that the gross receipts of such operation shall be, as received, divided between the parties hereto as follows: (a) Nineteen per cent. (19%) to the lessor. * * * In the event of the failure of the lessees well and truly to perform the covenants and agreements herein contained,' they should be liable in the sum of $50,000 as liquidated damages. That 'in consideration and upon condition that the said lessees shall well and faithfully perform all the covenants and agreements by them to be performed without evasion or delay the said lessor for itself and its successors, covenants and agrees that the said lessees, their legal representatives and assigns may at all times during said term and the renewals thereof

peaceably have and enjoy the said demised premises.' And that 'this agreement shall inure to the benefit of and bind the respective parties hereto, their personal representatives, successors and assigns.'

The complaint further alleges that the agreement was entered into by plaintiff in reliance upon the financial responsibility of Barnett and Barse, their personal character, and especially the experience of Barnett in conducting hotels; that, though he at first held a controlling interest in the Barnett & Barse Corporation, he has since sold all his stock to the defendant Barse, and has no interest in the corporation and no longer devotes any time or attention to the management or operation of the hotel.

…[C]learly…the agreement in question was personal to Barnett and Barse and could not be assigned by them without the plaintiff's consent. By its terms the plaintiff not only entrusted them with the care and management of the hotel and its furnishings—valued, according to the allegations of the complaint, at more than $1,000,000—but agreed to accept as rental or compensation a percentage of the gross receipts. Obviously, the receipts depended to a large extent upon the management, and the care of the property upon the personal character and responsibility of the persons in possession. When the whole agreement is read, it is apparent that the plaintiff relied, in making it, upon the personal covenants of Barnett and Barse. They were financially responsible. As already said, Barnett had had a long and successful experience in managing hotels, which was undoubtedly an inducing cause for plaintiff's making the agreement in question and for personally obligating them to carry out its terms.

It is suggested that because there is a clause in the agreement to the effect that it should 'inure to the benefit of and bind the respective parties hereto, their personal representatives and assigns,' that Barnett and Barse had a right to assign it to the corporation. But the intention of the parties is to be gathered, not from one clause, but from the entire instrument [Citation] and when it is thus read it clearly appears that Barnett and Barse were to personally carry out the terms of the agreement and did not have a right to assign it. This follows from the language used, which shows that a personal trust or confidence was reposed by the plaintiff in Barnett and Barse when the agreement was made.

In [Citation] it was said: "Rights arising out of contract cannot be transferred if they…involve a relation of personal confidence such that the party whose agreement conferred those rights must have intended them to be exercised only by him in whom he actually confided."

This rule was applied in [Citation] the court holding that the plaintiff—the assignee—was not only technically, but substantially, a different entity from its predecessor, and that the defendant was not obliged to entrust its money collected on the sale of the presses to the responsibility of an entirely different corporation from that with which it had contracted, and that the contract could not be assigned to the plaintiff without the assent of the other party to it.

The reason which underlies the basis of the rule is that a party has the right to the benefit contemplated from the character, credit, and substance of him with whom he contracts, and in such case he is not bound to recognize…an assignment of the contract.

The order appealed from, therefore, is affirmed.

Case questions

1. The corporation created to operate the hotel was apparently owned and operated by the same two men the plaintiff leased the hotel to in the first place. What objection would the plaintiff have to the corporate entity—actually, of course, a legal fiction—owning and operating the hotel?
2. The defendants pointed to the clause about the contract inuring to the benefit of the parties "and assigns." So the defendants assigned the contract. How could that not be allowed by the contract's own terms?
3. What is the controlling rule of law upon which the outcome here depends?

Assignment Forbidden by Statute or Public Policy

Various federal and state laws prohibit or regulate some contract assignments. For example, the assignment of future wages is regulated by state and federal law, such an attempt to try to effect such an assignment would not be valid. And even in the absence of statute, public policy might prohibit some assignments.

Contracts That Prohibit Assignment

A written contract may contain general language that prohibits assignment of rights or assignment of "the contract." Both the Restatement and UCC Section 2-210(3) declare that in the absence of any contrary circumstances, a provision in the agreement that prohibits assigning "the contract" bars "only the delegation to the assignee of the assignor's performance." In other words, unless the contract specifically prohibits assignment of any of its terms, a party is free to assign anything except his or her own duties. Even if a contractual provision explicitly prohibits it, a right to damages for breach of the whole contract is assignable under UCC Section 2-210(2) in contracts for goods. Likewise, UCC Section 9-318(4) invalidates any contract provision that prohibits assigning sums already due or to become due. Indeed, in some states, at common law, a clause specifically prohibiting assignment will fail. For example, the buyer and the seller agree to the sale of land and to a provision barring assignment of the rights under the contract. The buyer pays the full price, but the seller refuses to convey. The buyer then assigns to her friend the right to obtain title to the land from the seller. The latter's objection that the contract precludes such an assignment will fall on deaf ears in some states; the assignment is effective, and the friend may sue for the title. Bottom line, even though a contract may expressly state it cannot be assigned, that may not always be the case.

CASE 12.2

Rose v. Vulcan Materials Co. 194 S.E.2d 521 (N.C. 1973)

HUSKINS, J.

…Plaintiff [Rose], after leasing his quarry to J. E. Dooley and Son, Inc., promised not to engage in the rock-crushing business within an eight-mile radius of [the city of] Elkin for a period of ten years. In return for this promise, J. E. Dooley and Son, Inc., promised, among other things, to furnish plaintiff stone f.o.b. the quarry site at Cycle, North Carolina, at stipulated prices for ten years.…

By a contract effective 23 April 1960, Vulcan Materials Company, a corporation…, purchased the stone quarry operations and the assets and obligations of J. E. Dooley and Son, Inc.…[Vulcan sent Rose a letter, part of which read:]

Mr. Dooley brought to us this morning the contracts between you and his companies, copies of which are attached. This is to advise that Vulcan Materials Company assumes all phases of these contracts and intends to carry out the conditions of these contracts as they are stated.

In early 1961 Vulcan notified plaintiff that it would no longer sell stone to him at the prices set out in [the agreement between Rose and Dooley] and would thereafter charge plaintiff the same prices charged all of its other customers for stone. Commencing 11 May 1961, Vulcan raised stone prices to the plaintiff to a level in excess of the prices specified in [the Rose-Dooley agreement].

At the time Vulcan increased the prices of stone to amounts in excess of those specified in [the Rose-Dooley contract], plaintiff was engaged in his ready-mix cement business, using large quantities of stone, and had no other practical source of supply. Advising Vulcan that he intended to sue for breach of contract, he continued to purchase stone from Vulcan under protest.…

The total of these amounts over and above the prices specified in [the Rose-Dooley contract] is $25,231.57, [about $260,000 in 2024 dollars] and plaintiff seeks to recover said amount in this action.

The [Rose-Dooley] agreement was an executory bilateral contract under which plaintiff's promise not to compete for ten years gained him a ten-year option to buy stone at specified prices. In most states, the assignee of an executory bilateral contract is not liable to anyone for the nonperformance of the assignor's duties thereunder unless he expressly promises his assignor or the other contracting party to perform, or 'assume,' such duties.…These states refuse to imply a promise to perform the duties, but if the assignee expressly promises his assignor to perform, he is liable to the other contracting party on a third-party beneficiary theory. And, if the assignee makes such a promise directly to the other contracting party upon a consideration, of course he is liable to him thereon. [Citation]

A minority of states holds that the assignee of an executory bilateral contract under a general assignment becomes not only assignee of the rights of the assignor but also delegatee of his duties; and that, absent a showing of contrary intent, the assignee impliedly promises the assignor that he will perform the duties so delegated. This rule is expressed in Restatement, Contracts, s 164 (1932) as follows:

(1) Where a party under a bilateral contract which is at the time wholly or partially executory on both sides purports to assign the whole contract, his action is interpreted, in the absence of circumstances showing a

contrary intention, as an assignment of the assignor's rights under the contract and a delegation of the performance of the assignor's duties.

(2) Acceptance by the assignee of such an assignment is interpreted, in the absence of circumstances showing a contrary intention, as both an assent to become an assignee of the assignor's rights and as a promise to the assignor to assume the performance of the assignor's duties.' (emphasis added)

We…adopt the Restatement rule and expressly hold that the assignee under a general assignment of an executory bilateral contract, in the absence of circumstances showing a contrary intention, becomes the delegatee of his assignor's duties and impliedly promises his assignor that he will perform such duties.

The rule we adopt and reaffirm here is regarded as the more reasonable view by legal scholars and textwriters. Professor Grismore says:

It is submitted that the acceptance of an assignment in this form does presumptively import a tacit promise on the part of the assignee to assume the burdens of the contract, and that this presumption should prevail in the absence of the clear showing of a contrary intention. The presumption seems reasonable in view of the evident expectation of the parties. The assignment on its face indicates an intent to do more than simply to transfer the benefits assured by the contract. It purports to transfer the contract as a whole, and since the contract is made up of both benefits and burdens both must be intended to be included.…Grismore, Is the Assignee of a Contract Liable for the Nonperformance of Delegated Duties? 18 Mich.L.Rev. 284 (1920).

In addition, with respect to transactions governed by the Uniform Commercial Code, an assignment of a contract in general terms is a delegation of performance of the duties of the assignor, and its acceptance by the assignee constitutes a promise by him to perform those duties. Our holding in this case maintains a desirable uniformity in the field of contract liability.

We further hold that the other party to the original contract may sue the assignee as a third-party beneficiary of his promise of performance which he impliedly makes to his assignor, under the rule above laid down, by accepting the general assignment. *Younce v. Lumber Co.*, [Citation] (1908), holds that where the assignee makes an express promise of performance to his assignor, the other contracting party may sue him for breach thereof. We see no reason why the same result should not obtain where the assignee breaches his promise of performance implied under the rule of Restatement s 164. 'That the assignee is liable at the suit of the third party where he expressly assumes and promises to perform delegated duties has already been decided in a few cases (citing Younce). If an express promise will support such an action it is difficult to see why a tacit promise should not have the same effect.' Grismore, supra. Parenthetically, we note that such is the rule under the Uniform Commercial Code, [2-210].

We now apply the foregoing principles to the case at hand. The contract of 23 April 1960, between defendant and J. E. Dooley and Son, Inc., under which, as stipulated by the parties, 'the defendant purchased the assets and obligations of J. E. Dooley and Son, Inc.,' was a general assignment of all the assets and obligations of J. E. Dooley and Son, Inc., including those under [the Rose-Dooley contract]. When defendant accepted such assignment it thereby became delegatee of its assignor's duties under it and impliedly promised to perform such duties.

When defendant later failed to perform such duties by refusing to continue sales of stone to plaintiff at the prices specified in [the Rose-Dooley contract], it breached its implied promise of performance and plaintiff was entitled to bring suit thereon as a third-party beneficiary.

The decision…is reversed with directions that the case be certified to the Superior Court of Forsyth County for reinstatement of the judgment of the trial court in accordance with this opinion.

Case questions

1. Why did Rose need the crushed rock from the quarry he originally leased to Dooley?
2. What argument did Vulcan make as to why it should not be liable to sell crushed rock to Rose at the price set out in the Rose-Dooley contract?
3. What rule did the court here announce in deciding that Vulcan was required to sell rock at the price set out in the Rose-Dooley contract? That is, what is the controlling rule of law in this case?

Future Contracts

The law distinguishes between assigning future rights under an existing contract and assigning rights that will arise from a future contract. Rights contingent on a future event can be assigned in exactly the same manner as existing rights, as long as the contingent rights are already incorporated in a contract. Ben has a long-standing deal with his neighbor, Mrs. Robinson, to keep the latter's walk clear of snow at twenty dollars a snowfall. Ben is saving his money for a new printer, but when he is eighty dollars shy of the purchase price, he becomes impatient and cajoles a friend into loaning him the balance. In return, Ben assigns his friend the earnings from the next four snowfalls. The assignment is effective. However, a right that will arise from a future contract cannot be the subject of a present assignment.

PARTIAL ASSIGNMENTS

An assignor may assign part of a contractual right, but only if the obligor can perform that part of his contractual obligation separately from the remainder of his obligation. **Assignment** of part of a payment due is always enforceable. However, if the obligor objects, neither the assignor nor the assignee may sue him unless both are party to the suit. Mrs. Robinson owes Ben one hundred dollars. Ben assigns fifty dollars of that sum to his friend. Mrs. Robinson is perplexed by this assignment and refuses to pay until the situation is explained to her satisfaction. The friend brings suit against Mrs. Robinson. The court cannot hear the case unless Ben is also a party to the suit. This ensures all parties to the dispute are present at once and avoids multiple lawsuits.

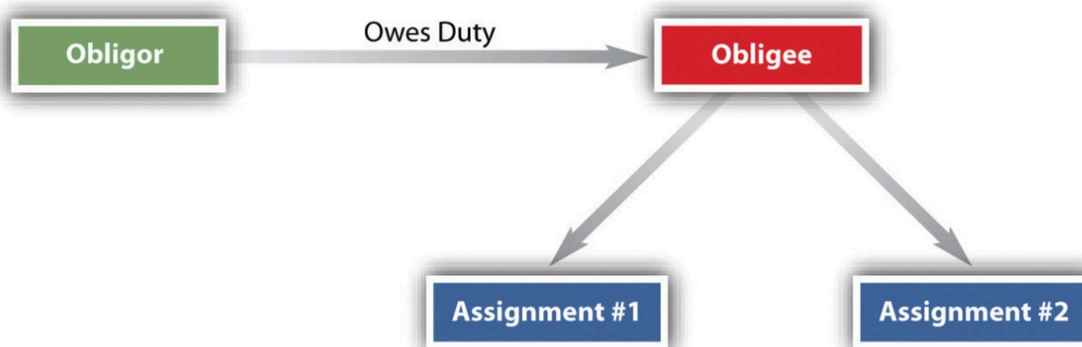
SUCCESSIVE ASSIGNMENTS

It may happen that an assignor assigns the same interest twice. With certain exceptions, the first assignee takes precedence over any subsequent assignee. One obvious exception is when the first **assignment** is ineffective or revocable. A subsequent assignment has the effect of revoking a prior assignment that is ineffective or revocable. Another exception: if in good faith the subsequent assignee

gives consideration for the assignment and has no knowledge of the prior assignment, he takes precedence whenever he obtains payment from, performance from, or a judgment against the obligor, or whenever he receives some tangible evidence from the assignor that the right has been assigned (e.g., a bank deposit book or an insurance policy).

Some states follow the different English rule: the first assignee to give notice to the obligor has priority, regardless of the order in which the assignments were made. Furthermore, if the assignment falls within the filing requirements of UCC Article 9 the first assignee to file will prevail.

Figure 12.2 Successive Assignments



ASSIGNOR'S WARRANTIES

An assignor has legal responsibilities in making assignments. Unless the contract explicitly states to the contrary, a person who assigns a right for value makes certain assignor's warranties to the assignee: that he will not upset the assignment, that he has the right to make it, and that there are no defenses that will defeat it. However, the assignor does not guarantee payment; assignment does not by itself amount to a warranty that the obligor is solvent or will perform as agreed in the original contract. Mrs. Robinson owes Ben fifty dollars. Ben assigns this sum to his friend. Before the friend collects, Ben releases Mrs. Robinson from her obligation. The friend may sue Ben for the fifty dollars. Or again, if Ben represents to his friend that Mrs. Robinson owes him (Ben) fifty dollars and assigns his friend that amount, but in fact Mrs. Robinson does not owe Ben that much, then Ben has breached his assignor's warranty. The assignor's warranties may be express or implied.

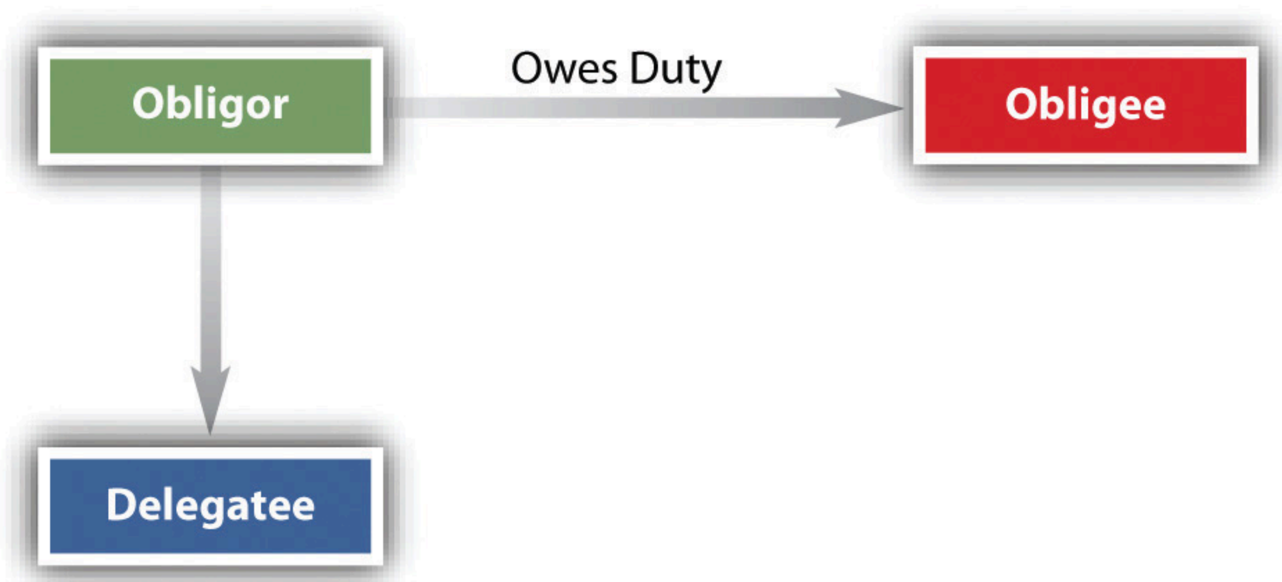
12.3 DELEGATION OF CONTRACT DUTIES

To this point, we have been considering the **assignment** of the assignor's rights (usually, though not solely, to money payments). But in every contract, a right connotes a corresponding **duty**, and these may be delegated. A **delegation** is the transfer to a third party of the duty to perform under a contract. The one who delegates is the**delegator**. Because most **obligees** are also **obligors**, most assignments of rights will simultaneously carry with them the delegation of duties. Unless public policy or the contract itself bars the delegation, it is legally enforceable.

In most states, at common law, duties must be expressly delegated. Under **Uniform Commercial Code (UCC)** Section 2-210(4) and in a minority of states at common law an assignment of "the contract" or of "all my rights under the contract" is not only an assignment of rights but also a

delegation of duties to be performed; by accepting the assignment, the **delegatee** (one to whom the delegation is made) implies a promise to perform the duties.

Figure 12.3 Delegation of Duties



EFFECT ON OBLIGOR

An **obligor** who delegates a **duty** (and becomes a **delegator**) does not thereby escape **liability** for performing the duty himself. The **obligee** of the duty may continue to look to the obligor for performance unless the original contract specifically provides for substitution by delegation. This is a big difference between **assignment** of contract rights and **delegation** of contract duties: in the former, the assignor is discharged (absent breach of assignor's warranties); in the latter, the delegator remains liable. The obligee (again, the one to whom the duty to perform flows) may also, in many cases, look to the delegatee, because the obligee becomes an intended beneficiary of the contract between the obligor and the delegatee, as discussed in. Of course, the obligee may subsequently agree to accept the delegatee and discharge the obligor from any further responsibility for performing the duty. A contract among three persons having this effect is called a novation; it is a new contract. Fred sells his house to Lisa, who assumes his mortgage. Fred, in other words, has delegated the duty to pay the bank to Lisa. If Lisa defaults, Fred continues to be liable to the bank, unless in the original mortgage agreement a provision specifically permitted any purchaser to be substituted without recourse to Fred, or unless the bank subsequently accepts Lisa and discharges Fred.

NONDELEGABLE DUTIES

Many duties may be delegated. Indeed, if they could not be delegated, much of the world's work would not get done. If you hire a construction company and an architect to design and build your house to certain specifications, the contractor may in turn hire individual craftspeople—plumbers, electricians, and the like—to do these specialized jobs, and as long as they are performed to specification, the contract terms will have been met. If you hired an architecture firm, though, you might not be

contracting for the specific services of a particular individual in that firm. Yet, as was the case with assignments, there are certain duties that cannot be delegated. These are discussed below.

Personal Services

Personal services are not delegable. If a contract is such that the promisee expects the obligor personally to perform the duty, the obligor may not delegate it. Suppose the Catskill Civic Opera Association hires a famous singer to sing in its production of*Carmen* and the singer delegates the job to her understudy. The delegation is ineffective, and performance by the understudy does not absolve the famous singer of liability for breach.

Public Policy

Public policy may prohibit certain kinds of delegations. A public official, for example, may not delegate the duties of her office to private citizens, although various statutes generally permit the delegation of duties to her assistants and subordinates.

Delegations Barred by Contract

As we have already noted, the contract itself may bar assignment. The law generally disfavors restricting the right to assign a benefit, but it will uphold a contract provision that prohibits delegation of a duty. Thus, as we have seen, UCC Section 2-210(3) states that in a contract for sale of goods, a provision against assigning "the contract" is to be construed only as a prohibition against delegating the duties.

12.4 THIRD-PARTY BENEFICIARIES

With **assignments** and **delegations**, we observed situations in which third-parties were brought into a pre-existing contract. An **intended third-party beneficiary**, on the other hand, is a party that was considered at the time the contract was made, and is part of the purpose for the contract in the first place. A party to a contract cannot enforce its terms; but if the party is intended to benefit from the performance of a contract between others, it makes sense that they should be able to enforce the contract.

TWO TYPES OF THIRD-PARTY BENEFICIARIES

In the vocabulary of the **Restatement**, a third person whom the parties to the contract intend to benefit is an intended beneficiary—that is, one who is entitled under the law of contracts to assert a right arising from a contract to which he or she is not a party. There are two types of **intended beneficiaries**.

Creditor Beneficiary

A **creditor beneficiary** is one to whom the promisor agrees to pay a debt of the promisee. For example, a father is bound by law to support his child. If the child's uncle (the **promisor**) contracts with the father (the **promisee**) to furnish support for the child, the child is a creditor beneficiary and could sue the uncle. Or again, suppose Customer pays Ace Dealer for a new car, and Ace delegates the duty of delivery to Beta Dealer. Ace is now a debtor: he owes Customer something: a car. Customer is a creditor; she is owed something: a car. When Beta performs under his delegated contract with

Ace, Beta is discharging the debt Ace owes to Customer. Customer is a creditor beneficiary of Dealers' contract and could sue either one for nondelivery. She could sue Ace because she made a contract with him, and she could sue Beta because—again—she was intended to benefit from the performance of Dealers' agreement.

Donee Beneficiary

The second type of intended beneficiary is a **donee beneficiary**. When the promisee is not indebted to the third person but intends for him or her to have the benefit of the promisor's performance, the third person is a donee beneficiary (and the promise is sometimes called a gift promise). For example, an insurance company (the promisor) promises to its policyholder (the promisee), in return for a premium, to pay $100,000 to his wife on his death; this makes the wife a donee beneficiary. The wife could sue to enforce the contract although she was not a party to it.

INCIDENTAL BENEFICIARY

If a person is not an intended beneficiary—not a creditor or donee beneficiary—then he or she is said to be only an **incidental beneficiary**, and that person has no rights. An **incidental third-party beneficiary** is a party who may actually benefit from a contract between two other parties, but that benefit is like a side effect of the contract, because the contract itself was not specifically intended to benefit them. In other words, the third party is not a direct party to the contract but might still receive some benefits from the contract if it is performed as intended. Incidental beneficiaries have no legal right to enforce the contract or sue for damages if the contract is breached.

The beneficiary's rights are always limited by the terms of the contract. A failure by the promisee to perform his part of the bargain will terminate the beneficiary's rights if the promisee's lapse terminates his own rights, absent language in the contract to the contrary.

MODIFICATION OF THE BENEFICIARY'S RIGHTS

Conferring rights on an intended beneficiary is relatively simple. Whether his rights can be modified or extinguished by subsequent agreement of the promisor and promisee is a more troublesome issue. The general rule is that the beneficiary's rights may be altered as long as there has been no vesting of rights (the rights have not taken effect). The time at which the beneficiary's rights vest differs among jurisdictions: some say immediately, some say when the beneficiary assents to the receipt of the contract right, some say the beneficiary's rights don't vest until she has detrimentally relied on the right. The Restatement says that unless the contract provides that its terms cannot be changed without the beneficiary's consent, the parties may change or rescind the benefit unless the beneficiary has sued on the promise, has detrimentally relied, or has assented to the promise at the request of one of the parties. Some contracts provide that the benefit never vests; for example, standard insurance policies today reserve to the insured the right to substitute beneficiaries, to borrow against the policy, to assign it, and to surrender it for cash.

GOVERNMENT CONTRACTS

The general rule is that members of the public are only incidental beneficiaries of contracts made by the government with a contractor to do public works. It is not illogical to see a contract between the

government and a company pledged to perform a service on behalf of the public as one creating rights in particular members of the public, but the consequences of such a view could be extremely costly because everyone has some interest in public works and government services.

A restaurant chain, hearing that the county was planning to build a bridge that would reroute commuter traffic, might decide to open a restaurant on one side of the bridge; if it let contracts for construction only to discover that the bridge was to be delayed or canceled, could it sue the county's contractor? In general, the answer is that it cannot. A promisor under contract to the government is not liable for the consequential damages to a member of the public arising from its failure to perform (or from a faulty performance) unless the agreement specifically calls for such liability or unless the promisee (the government) would itself be liable and a suit directly against the promisor would be consistent with the contract terms and public policy. When the government retains control over litigation or settlement of claims, or when it is easy for the public to insure itself against loss, or when the number and amount of claims would be excessive, the courts are less likely to declare individuals to be intended beneficiaries. But the service to be provided can be so tailored to the needs of particular persons that it makes sense to view them as intended beneficiaries.

CASE 12.3

Kornblut v. Chevron Oil Co., 62 A.D.2d 831 (N.Y. 1978)

HOPKINS, J.

The plaintiff-respondent has recovered a judgment after a jury trial in the sum of $519,855.98 [about $2.6 million in 2024 dollars] including interest, costs and disbursements, against Chevron Oil Company (Chevron) and Lawrence Ettinger, Inc. (Ettinger) (hereafter collectively referred to as defendants) for damages arising from the death and injuries suffered by Fred Kornblut, her husband. The case went to the jury on the theory that the decedent was the third-party beneficiary of a contract between Chevron and the New York State Thruway Authority and a contract between Chevron and Ettinger.

On the afternoon of an extremely warm day in early August, 1970 the decedent was driving northward on the New York State Thruway. Near Sloatsburg, New York, at about 3:00 p.m., his automobile sustained a flat tire. At the time the decedent was accompanied by his wife and 12-year-old son. The decedent waited for assistance in the 92 degree temperature.

After about an hour a State Trooper, finding the disabled car, stopped and talked to the decedent. The trooper radioed Ettinger, which had the exclusive right to render service on the Thruway under an assignment of a contract between Chevron and the Thruway Authority. Thereafter, other State Troopers reported the disabled car and the decedent was told in each instance that he would receive assistance within 20 minutes.

Having not received any assistance by 6:00 p.m., the decedent attempted to change the tire himself. He finally succeeded, although he experienced difficulty and complained of chest pains to the point that his wife and son were compelled to lift the flat tire into the trunk of the automobile. The decedent drove the

car to the next service area, where he was taken by ambulance to a hospital; his condition was later diagnosed as a myocardial infarction. He died 28 days later.

Plaintiff sued, inter alia, Chevron and Ettinger alleging in her complaint causes of action sounding in negligence and breach of contract. We need not consider the issue of negligence, since the Trial Judge instructed the jury only on the theory of breach of contract, and the plaintiff has recovered damages for wrongful death and the pain and suffering only on that theory.

We must look, then, to the terms of the contract sought to be enforced. Chevron agreed to provide "rapid and efficient roadside automotive service on a 24-hour basis from each gasoline service station facility for the areas…when informed by the authority or its police personnel of a disabled vehicle on the Thruway". Chevron's vehicles are required "to be used and operated in such a manner as will produce adequate service to the public, as determined in the authority's sole judgment and discretion". Chevron specifically covenanted that it would have "sufficient roadside automotive service vehicles, equipment and personnel to provide roadside automotive service to disabled vehicles within a maximum of thirty (30) minutes from the time a call is assigned to a service vehicle, subject to unavoidable delays due to extremely adverse weather conditions or traffic conditions."…

In interpreting the contract, we must bear in mind the circumstances under which the parties bargained. The New York Thruway is a limited access toll highway, designed to move traffic at the highest legal speed, with the north and south lanes separated by green strips. Any disabled vehicle on the road impeding the flow of traffic may be a hazard and inconvenience to the other users. The income realized from tolls is generated from the expectation of the user that he will be able to travel swiftly and smoothly along the Thruway. Consequently, it is in the interest of the authority that disabled vehicles will be repaired or removed quickly to the end that any hazard and inconvenience will be minimized. Moreover, the design and purpose of the highway make difficult, if not impossible, the summoning of aid from garages not located on the Thruway. The movement of a large number of vehicles at high speed creates a risk to the operator of a vehicle who attempts to make his own repairs, as well as to the other users. These considerations clearly prompted the making of contracts with service organizations which would be located at points near in distance and time on the Thruway for the relief of distressed vehicles.

Thus, it is obvious that, although the authority had an interest in making provision for roadside calls through a contract, there was also a personal interest of the user served by the contract. Indeed, the contract provisions regulating the charges for calls and commanding refunds be paid directly to the user for overcharges, evince a protection and benefit extended to the user only. Hence, in the event of an overcharge, the user would be enabled to sue on the contract to obtain a recovery.…Here the contract contemplates an individual benefit for the breach running to the user.…

By choosing the theory of recovery based on contract, it became incumbent on the plaintiff to show that the injury was one which the defendants had reason to foresee as a probable result of the breach, under the ancient doctrine of Hadley v Baxendale [Citation], and the cases following it…in distinction to the requirement of proximate cause in tort actions.…

The death of the decedent on account of his exertion in the unusual heat of the midsummer day in changing the tire cannot be said to have been within the contemplation of the contracting parties as a reasonably foreseeable result of the failure of Chevron or its assignee to comply with the contract.…

The case comes down to this, then, in our view: though the decedent was the intended beneficiary to sue under certain provisions of the contract—such as the rate specified for services to be rendered—he was not

the intended beneficiary to sue for consequential damages arising from personal injury because of a failure to render service promptly. Under these circumstances, the judgment must be reversed and the complaint dismissed, without costs or disbursements.

[Martuscello, J., concurred in the result but opined that the travelling public was not an intended beneficiary of the contract.]

Case questions

1. Chevron made two arguments as to why it should not be liable for Mr. Kornblut's death. What were they?
2. Obviously, when Chevron made the contract with the New York State Thruway Authority, it did not know Mr. Kornblut was going to be using the highway. How could he, then, be an intended beneficiary of the contract?
3. Why was Chevron not found liable for Mr. Kornblut's death when, clearly, had it performed the contract properly, he would not have died?

ACTIVITY 12A

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=248#h5p-28

End of Chapter Exercises

1. The Dayton Country Club offered its members various social activities. Some members were entitled, for additional payment, to use the golf course, a coveted amenity. Golfing memberships could not be transferred except upon death or divorce, and there was a long waiting list in this special category; if a person at the top of the list declined, the next in line was

eligible. Golfing membership rules were drawn up by a membership committee. Magness and Redman were golfing members. They declared bankruptcy, and the bankruptcy trustee sought, in order to increase the value of their debtors' estates, to assume and sell the golfing memberships to members on the waiting list, other club members, or the general public, provided the persons joined the club. The club asserted that under relevant state law, it was "excused from rendering performance to an entity other than the debtor"—that is, it could not be forced to accept strangers as members. Can these memberships be assigned?

2. Tenant leased premises in Landlord's shopping center, agreeing in the lease "not to assign, mortgage, pledge, or encumber this lease in whole or in part." Under the lease, Tenant was entitled to a construction allowance of up to $11,000 after Tenant made improvements for its uses. Prior to the completion of the improvements, Tenant assigned its right to receive the first $8,000 of the construction allowance to Assignee, who, in turn, provided Tenant $8,000 to finance the construction. Assignee notified Landlord of the assignment, but when the construction was complete, Landlord paid Tenant anyway; when Assignee complained, Landlord pointed to the nonassignment clause. Assignee sued Landlord. Who wins? [1]
3. Marian contracted to sell her restaurant to Billings for $400,000. The contract provided that Billings would pay $100,000 and sign a note for the remainder. Billings sold the restaurant to Alice, who agreed to assume responsibility for the balance due on the note held by Marian. But Alice had difficulties and declared bankruptcy. Is Billings still liable on the note to Marian?
4. Yellow Cab contracted with the Birmingham Board of Education to transport physically handicapped students. The contract provided, "Yellow Cab will transport the physically handicapped students of the School System…and furnish all necessary vehicles and personnel and will perform all maintenance and make all repairs to the equipment to keep it in a safe and efficient operating condition at all times."
5. Joan hired Groom to attend to her herd of four horses at her summer place in the high desert. The job was too much for Groom, so he told Tony that he (Groom) would pay Tony, who claimed expertise in caring for horses, to take over the job. Tony neglected the horses in hot weather, and one of them needed veterinarian care for dehydration. Is Groom liable?
6. Rensselaer Water Company contracted with the city to provide water for business, domestic, and fire-hydrant purposes. While the contract was in effect, a building caught on fire; the fire spread to Plaintiff's (MochCo.'s) warehouse, destroying it and its contents. The company knew of the fire but was unable to supply adequate water pressure to put it out. Is the owner of the warehouse able to maintain a claim against the company for the loss?
7. Rusty told Alice that he'd do the necessary overhaul on her classic car for $5,000 during the month of May, and that when the job was done, she should send the money to his son, Jim, as a graduation present. He confirmed the agreement in writing and sent a copy to Jim. Subsequently, Rusty changed his mind. What right has Jim?
8. Fox Brothers agreed to convey to Clayton Canfield Lot 23 together with a one-year option to purchase Lot 24 in a subdivision known as Fox Estates. The agreement contained no prohibitions, restrictions, or limitations against assignments. Canfield paid the $20,000 and took title to Lot 23 and the option to Lot 24. Canfield thereafter assigned his option rights in Lot 24 to the Scotts. When the Scotts wanted to exercise the option, Fox Brothers refused to convey the property to them. The Scotts then brought suit for specific performance. Who wins?
9. Rollins sold Byers, a businessperson, a flatbed truck on a contract; Rollins assigned the contract

to Frost, and informed Byers of the assignment. Rollins knew the truck had problems, which he did not reveal to Byers. When the truck needed $3,200 worth of repairs and Rollins couldn't be found, Byers wanted to deduct that amount from payments owed to Frost, but Frost insisted he had a right to payment. Upon investigation, Byers discovered that four other people in the state had experienced similar situations with Rollins and with Frost as Rollins's assignee. What recourse has Byers?

10. Merchants and resort owners in the San Juan Islands in Washington State stocked extra supplies, some perishable, in anticipation of the flood of tourists over Labor Day. They suffered inconvenience and monetary damage due to the union's Labor Day strike of the state ferry system, in violation of its collective bargaining agreement with the state and of a temporary restraining order. The owners sued the union for damages for lost profits, attorney fees, and costs, claiming the union should be liable for intentional interference with contractual relations (the owners' relations with their would-be customers). Do the owners have a cause of action?

REFERENCES

Aldana v. Colonial Palms Plaza, Inc., 591 So.2d 953 (Fla. Ct. App., 1991).

DuPont v. Yellow Cab Co. of Birmingham, Inc., 565 So.2d 190 (Ala. 1990).

Restatement (Second) of Contracts, Section 311.

Restatement (Second) of Contracts, Section 317(1).

Restatement (Second) of Contracts, Section 322.

Uniform Commercial Code, Section 9-206.

CHAPTER 13 - PERFORMANCE AND DISCHARGE

Learning Objectives

After studying this chapter, you should be able to:

1. Explain when performance, partial performance or no performance may discharge contractual obligations.
2. Compare and contrast complete performance, substantial performance, satisfactory performance and material breach.
3. Describe the various ways the parties to a contract may agree to terminate mutual obligations under the contract.
4. Identify when performance of the contract becomes variously impossible, very difficult, or useless, and that these circumstances may give rise to discharge.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=249#h5p-18

13.1 DISCHARGE OF CONTRACT DUTIES BY PERFORMANCE OR BREACH

Once a contract is entered, a party is liable to perform agreed-to contractual duties until **performance** is discharged. Stated another way, if a party fails to perform under a contract without being discharged, liability for damages arises. This Chapter deals with how contractual duties are discharged.

DISCHARGE BY PERFORMANCE

The term **performance** refers to the fulfillment of obligations specified in a contract. When parties enter into a contract, they agree to perform certain actions or provide certain goods or services as outlined in the contract terms. Once the contractual duty is fulfilled, the contract can be discharged by performance. The modern trend at common law (and explicit under the **Uniform Commercial Code (UCC)**, Section 1-203) is that the parties have a good-faith duty to each other perform. There is in every contract "an implied covenant of good faith" (honesty in fact in the transaction) that the

parties will deal fairly, keep their promises, and not frustrate the other party's reasonable expectations of what was given and what was received.

FULL PERFORMANCE

Full performance occurs when one party fulfills all of its obligations under the contract in the exact manner specified and without any deviation. Full performance, also called complete performance, of the contractual obligation discharges the duty. For example, in a contract to plumb a new bathroom, if Ralph the plumber does a fine job of plumbing Betty's new bathroom, she pays him. Both are discharged by full performance.

Under the UCC, Section 2-601 requires that the goods delivered according to the contract be the exact things ordered—that there be a **perfect tender** (unless the parties agree otherwise).

SUBSTANTIAL PERFORMANCE

Sometimes, a party may not fulfill every detail of the contract, but the performance is significant enough that the other party receives what was essentially bargained for. In such cases, the performance is considered **substantial performance**, and will serve to discharge a contract. However, damages may be owed in an amount that would compensate for the minor deficiencies in performance. These minor deficiencies would amount to a breach of contract, but the breaches would not be material. Therefore, these minor breaches would not prevent the duty from being discharged. If Ralph does all the plumbing for Betty's new bathroom but does not return once the bathroom is completely finished to hook up the toilet feed, he has not really "plumbed the new bathroom." He has left a small portion of the agreed upon work undone. In this situation where there has been substantial, although not **full performance**, the plumber would receive payment for the value of the plumbing services that were completed, and the homeowner would have a claim for damages for whatever it will cost to have the hook-up completed.

At classic common law, a duty could be performed completely or breached, with no middle ground. This would mean that the plumber in the scenario above would not be entitled to any payment at all. But under modern theories, the doctrine of substantial performance developed: if one side has substantially, but not completely, performed, so that the other side has received a benefit, the nonbreaching party owes something for the value received. What constitutes substantial performance is a question of fact, with the contest being whether a breach has gone beyond substantial performance and become a **material breach**.

CASE 13.1

TA Operating Corp. v. Solar Applications Engineering, Inc., 191 S.W.3d 173 (Tex. Ct. App. 2005)

STONE, J.

TA Operating Corporation, a truck stop travel center company, contracted with Solar Applications

Engineering, Inc. to construct a prototype multi-use truck stop in San Antonio for a fixed price of $3,543,233.…

[When the project was near] completion, TA sent Solar a "punch list" of items that needed to be finished to complete the building. Solar disputed several items on the list and delivered a response to TA listing the items Solar would correct.…Solar began work on the punch list items and filed a lien affidavit [a property that carries a lien can be forced into sale by the creditor in order to collect what is owed] against the project on October 2, 2000 in the amount of $472,392.77. TA understood the lien affidavit to be a request for final payment.

On October 18, 2000, TA sent notice to Solar that Solar was in default for not completing the punch list items, and for failing to keep the project free of liens. TA stated in the letter that Solar was not entitled to final payment until it completed the remainder of the punch list items and provided documentation that liens filed against the project had been paid.…Solar acknowledged at least two items on the punch list had not been completed, and submitted a final application for payment in the amount of $472,148,77.…TA refused to make final payment, however, contending that Solar had not complied with section 14.07 of the contract, which expressly made submission of a [lien-release] affidavit a condition precedent to final payment:…

The final Application for Payment shall be accompanied by:…complete and legally effective releases or waivers…of all lien rights arising out of or liens filed in connection with the work.

Although Solar did not comply with this condition precedent to final payment, Solar sued TA for breach of contract under the theory of substantial performance.…TA [asserts that] the doctrine of substantial performance does not excuse Solar's failure to comply with an express condition precedent to final payment.…

The first issue we must resolve is whether the doctrine of substantial performance excuses the breach of an express condition precedent to final payment that is unrelated to completion of the building. TA acknowledges that Solar substantially performed its work on the project, but contends its duty to pay was not triggered until Solar pleaded or proved it provided TA with documentation of complete and legally effective releases or waivers of all liens filed against the project.…TA contends that when the parties have expressly conditioned final payment on submission of [a liens-release] affidavit, the owner's duty to pay is not triggered until the contractor pleads or proves it complied with the condition precedent.

Solar contends that although it did not submit [a liens-release] affidavit in accordance with the contract, it may still recover under the contract pursuant to the substantial performance doctrine. Solar argues that to hold otherwise would bring back the common law tradition that the only way for a contractor to recover under a contract is full, literal performance of the contract's terms.…

While the common law did at one time require strict compliance with the terms of a contract, this rule has been modified for building or construction contracts by the doctrine of substantial performance. "Substantial performance" was defined by the Texas [court] in [Citation]:

To constitute substantial compliance the contractor must have in good faith intended to comply with the contract, and shall have substantially done so in the sense that the defects are not pervasive, do not constitute a deviation from the general plan contemplated for the work, and are not so essential that the object of the parties in making the contract and its purpose cannot without difficulty, be accomplished by remedying them. Such performance permits only such omissions or deviation from the contract as are

inadvertent and unintentional, are not due to bad faith, do not impair the structure as a whole, and are remediable without doing material damage to other parts of the building in tearing down and reconstructing.

…The doctrine of substantial performance recognizes that the contractor has not completed construction, and therefore is in breach of the contract. Under the doctrine, however, the owner cannot use the contractor's failure to complete the work as an excuse for non-payment. "By reason of this rule a contractor who has in good faith substantially performed a building contract is permitted to sue under the contract, substantial performance being regarded as full performance, so far as a condition precedent to a right to recover thereunder is concerned." [Citation]…

Solar argues that by agreeing substantial performance occurred, TA acknowledged that Solar was in "full compliance" with the contract and any express conditions to final payment did not have to be met. [Citation]: "[a] finding that a contract has been substantially completed is the legal equivalent of full compliance, less any offsets for remediable defects." Solar argues that TA may not expressly provide for substantial performance in its contract and also insist on strict compliance with the conditions precedent to final payment. We disagree. While the substantial performance doctrine permits contractors to sue under the contract, it does not ordinarily excuse the non-occurrence of an express condition precedent:

The general acceptance of the doctrine of substantial performance does not mean that the parties may not expressly contract for literal performance of the contract terms.…Stated otherwise, if the terms of an agreement make full or strict performance an express condition precedent to recovery, then substantial performance will not be sufficient to enable recovery under the contract.

15 Williston on Contracts § 44.53 (4th Ed.2000) (citing Restatement (Second) of Contracts, § 237, cmt. d (1981)).…

TA, seeking protection from double liability and title problems, expressly conditioned final payment on Solar's submission of a [liens-release] affidavit. Solar did not dispute that it was contractually obligated to submit the affidavit as a condition precedent to final payment, and it was undisputed at trial that $246,627.82 in liens had been filed against the project. Though the doctrine of substantial performance permitted Solar to sue under the contract, Solar did not plead or prove that it complied with the express condition precedent to final payment. Had Solar done so, it would have been proper to award Solar the contract balance minus the cost of remediable defects. While we recognize the harsh results occasioned from Solar's failure to perform this express condition precedent, we recognize that parties are free to contract as they choose and may protect themselves from liability by requesting literal performance of their conditions for final payment.…

[T]he trial court erred in awarding Solar the contract balance [as] damages, and we render judgment that Solar take nothing on its breach of contract claim.

Case questions

1. Why did Solar believe it was entitled to the contract balance here?

2. Why did the court determine that Solar should not have been awarded the contract damages that it claimed, even though it substantially complied?
3. How has the common law changed in regard to demanding strict compliance with a contract?

SATISFACTORY PERFORMANCE

Satisfactory performance in contract law refers to the fulfillment of contractual obligations to a degree that is acceptable to the other party in a contract. If the other party is satisfied with the performance and it meets their expectations, it is generally considered satisfactory and will discharge the contract. In other words, the standard to discharge the obligation is personal satisfaction. Using the plumbing example, if Ralph installs a Rainforest showerhead that is very different than the one Betty selected, but Betty decides she likes this showerhead better, her personal satisfaction will discharge the contractual obligation even though the performance does not meet the requirements of the contract as originally agreed.

Parties may contract to perform to one side's personal satisfaction. Andy tells Anne, a prospective client, that he will cut her hair better than her regular hairdresser, and that if she is not satisfied, she need not pay him. Andy cuts her hair, but Anne frowns and says, "I don't like it." Assume that Andy's work is excellent. Whether Anne must pay depends on the standard for judging to be employed—a standard of either objective or subjective satisfaction. The objective standard is that which would satisfy the reasonable purchaser. Most courts apply this standard when the contract involves the performance of a mechanical job or the sale of a machine whose performance is capable of objective measurement. So even if the obligee requires performance to his "personal satisfaction," the courts will hold that the obligor has performed if the service performed or the goods produced are, in fact, satisfactory. By contrast, if the goods or services contracted for involve personal judgment and taste, the duty to pay will be discharged if the obligee states personal (subjective) dissatisfaction. No reason at all need be given, but it must be for a good-faith reason, not just to escape payment.

MATERIAL BREACH

In addition to being discharged by performance as described above, a contract can be discharged by material nonperformance of the contractual duty. A **material breach** is a significant failure to fulfill the terms of a contract that goes to the root or essence of the agreement. It occurs when one party fails to perform a substantial and essential obligation under the contract. That failure of performance deprives the other party of the benefit they reasonably expected to receive from the agreement. Material breach substantially impairs the value of the contract for the non-breaching party. The non-breaching party has the right to consider the contract terminated and is generally released from further performance obligations under the contract. Going back to the plumbing example, if Ralph

doesn't do any work at all on Betty's bathroom, or almost none, then Betty owes him nothing. She—the non-breaching party—is discharged, and Ralph is liable for breach of contract.

Under UCC Section 2-106(4), a party that ends a contract breached by the other party is said to have effected a cancellation. The cancelling party retains the right to seek a remedy for breach of the whole contract or any unperformed obligation. The UCC distinguishes cancellation from termination, which occurs when either party exercises a lawful right to end the contract other than for breach. When a contract is terminated, all executory duties are discharged on both sides, but if there has been a partial breach, the right to seek a remedy survives.

ANTICIPATORY BREACH AND DEMAND FOR REASONABLE ASSURANCES

Anticipatory breach, also known as **anticipatory repudiation**, occurs in contract law when one party to a contract clearly and unequivocally communicates to the other party that they do not intend to fulfill their contractual obligations before the performance is due. In other words, this is when a promisor announces, before the time his performance is due, that he will not perform a contractual duty owed. Using the plumbing example again, we know that if Ralph doesn't do any work at all on Betty's bathroom there is a **material breach**. But, say that Ralph calls Betty a week before he is supposed to show up to work on her bathroom and tells her that he isn't going to do any work on her plumbing, this is an anticipatory breach.

A person cannot fail to perform a duty before performance is due, but the law allows the **promisee** to treat the situation as a material breach that gives rise to a claim for damages and discharges the **obligee** from performing duties required of him under the contract. The common-law rule was first recognized in the well-known 1853 British case *Hochster v. De La Tour*. In April, De La Tour hired Hochster as his courier, the job to commence in June. In May, De La Tour changed his mind and told Hochster not to bother to report for duty. Before June, Hochster secured an appointment as courier to Lord Ashburton, but that job was not to begin until July. Also in May, Hochster sued De La Tour, who argued that he should not have to pay Hochster because Hochster had not stood ready and willing to begin work in June, having already agreed to work for Lord Ashburton. The court ruled for the plaintiff Hochster:

> [I]t is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it. Thus, instead of remaining idle and laying out money in preparations which must be useless, he is at liberty to seek service under another employer, which would go in mitigation of the damages to which he would otherwise be entitled for a breach of the contract. It seems strange that the defendant, after renouncing the contract, and absolutely declaring that he will never act under it, should be permitted to object that faith is given to his assertion, and that an opportunity is not left to him of changing his mind.

Another type of anticipatory breach consists of any voluntary act by a party that destroys, or seriously impairs, that party's ability to perform the promise made to the other side. If a seller of land, having agreed to sell a lot to one person at a date certain, sells it instead to a third party before that time, there is an anticipatory breach. If Ralph the Plumber is supposed to plumb Betty's bathroom in June, but he

announces that he is taking a month-long trip to Europe in June, this is an anticipatory breach. In the first instance, there would be no point to showing up at the lawyer's office when the date arrives to await the deed, so the law gives a right to sue when the land is sold to the other person. In the second instance, there would be no point to waiting until June for the plumber to not do the job, so the law gives the right to sue when the future nonperformance is announced.

These same general rules prevail for contracts for the sale of goods under UCC Section 2-610.

Related to the concept of anticipatory breach is the idea that the obligee has a right to demand **reasonable assurances** from the obligor that contractual duties will be performed. If the obligee makes such a demand for reasonable assurances and no adequate assurances are forthcoming, the obligee may assume that the obligor will commit an anticipatory breach, and consider it so. That is, after making the contract, the obligee may come upon the disquieting news that the obligor's ability to perform is shaky. A change in financial condition occurs, an unknown claimant to rights in land appears, a labor strike arises, or any of a number of situations may arise that will interfere with the carrying out of contractual duties. Under such circumstances, the obligee has the right to a demand for reasonable assurance that the obligor will perform as contractually obligated. The general reason for such a rule is given in UCC Section 2-609(1), which states that a contract "imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired." Moreover, an obligee would be foolish not to make alternative arrangements, if possible, when it becomes obvious that his original obligor will be unable to perform. The obligee must have reasonable grounds to believe that the obligor will breach. The fear must be that of a failure of performance that would amount to a total breach; a minor defect that can be cured and that at most would give rise to an offset in price for damages will not generally support a demand for assurances.

Under UCC Section 2-609(1), the demand must be in writing, but at common law the demand may be oral if it is reasonable in view of the circumstances. If the obligor fails within a reasonable time to give adequate assurance, the obligee may treat the failure to do so as an anticipatory repudiation, or she may wait to see if the obligor might change his mind and perform.

ACTIVITY 13A

Which is Which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=249#h5p-30

13.2 DISCHARGE BY CONDITIONS

Usually contracts consist of an exchange of promises—a pledge or commitment by each party that somebody will or will not do something. Andy's promise to cut Anne's lawn "over the weekend" in return for Anne's promise to pay twenty-five dollars is a commitment to have the lawn mowed by Sunday night or Monday morning. These promises are known as independent or unconditional, because their performance does not depend on any outside event. Such promises, if contractually binding, create a present duty to perform.

Not all promises to perform under a contract are unconditional; a promise may be subject to a condition as well. A **condition** is an event the happening or nonhappening of which gives rise to a duty to perform (or discharges a duty to perform). Conditions may be express or implied; they may also be precedent, concurrent, subsequent, or to the satisfaction of a party.

EXPRESS CONDITIONS

Express conditions are stated in words in the contract, orally or written. Andy promises to mow Anne's lawn "provided it doesn't rain." "Provided it doesn't rain" is an express condition. If rain comes, there is no duty to cut the lawn, and Andy's failure to do so is not a breach of promise. Express conditions are usually introduced by language such as "provided that," "if," "when," "assuming that," "as soon as," "after," and the like.

IMPLIED CONDITIONS

Implied conditions are unexpressed but understood to be part of the contract. If Mr. Olson guarantees Jack's used car for ninety days, it is implied that his obligation to fix any defects doesn't arise until Jack lets him know the car is defective.

CONDITION PRECEDENT

A **condition precedent** is a term in a contract (express or implied) that requires performance only in the event something else happens first. Jack will buy a car from Mr. Olson if Jack gets financing. "If Jack gets financing" is a condition precedent.

CONDITION CONCURRENT (OR SIMULTANEOUS)

A **concurrent condition** arises when the duty to perform the contract is simultaneous: the promise of a landowner to transfer title to the purchaser and the purchaser to tender payment to the seller. The duty of each to perform is conditioned on the performance by the other. As a practical matter, of course, somebody has to make the first move, proffering deed or tendering the check, so simultaneous here means within the same transaction, and not at the exact same moment in time.

CONDITION SUBSEQUENT

A condition that terminates an already existing duty of performance is known as a **condition subsequent**. Ralph agrees to do preventive plumbing maintenance on an apartment building while the landlord is traveling across country for several weeks. On the landlord's return, the obligation to provide the maintenance is terminated.

CONDITION OF TIMELINESS

Typically, if a contract is not performed exactly on time it will not result in a material breach. The promisee has to accept the performance and deduct any losses caused by the delay. But, if the promisee does not want to accept performance that is not on time, the contract can require that "**time is of the essence**." This makes time, or timeliness, a condition of the contract. Time as a condition can be made explicit in a clause reciting that time is of the essence. If there is no express clause, the courts will read it in when the purpose of the contract was clearly to provide for performance at or by a certain time, and the promisee will gain little from late performance. But even express clauses are subject to a rule of reason, and if the promisor would suffer greatly by enforcement of the clause (and the promisee would suffer only slightly or not at all from a refusal to invoke it), the courts will generally excuse the untimely performance, as long as it was completed within a reasonable time. A builder's failure to finish a house by July 1 will not discharge the buyer's obligation to pay if the house is finished a week or even a month later, although the builder will be liable to the buyer for expenses incurred because of the lateness (storage charges for furniture, costs for housing during the interim, extra travel, and the like).

ACTIVITY 13B

You be the judge

Consider the condition of timeliness and the inclusion of "time is of the essence" in a contract described in the materials above. Contrast using this specific language and condition "time is of the essence" versus simply stating a deadline or due date in a contract, or to having no date mentioned in the contract by which performance is due. How do contracting parties know when stating a due date is enough for a court to adhere to that due date in interpreting a contract? Should also saying "time is of the essence" be required in order for a court to honor a due date? Should saying "time is of the essence" always be required in order for a court to honor a due date? What should we do to make sure the parties' intentions about timing under a contract are honored in the even of a dispute?

CONDITION OF SATISFACTION OF A THIRD PARTY

The duty to make a contract payment may be conditioned on the satisfaction of a third party. Building contracts frequently make the purchaser's duty to pay conditional on the builder's receipt of an architect's certificate of compliance with all contractual terms; road construction contracts often require that the work be done "to the satisfaction of the County Engineer." These conditions can be onerous. The builder has already erected the structure and cannot "return" what he has done. Nevertheless, because the purchaser wants assurance that the building (obviously a major purchase) or road meets his specifications, the courts will hold the contractor to the condition unless it is impossible to provide a certificate (e.g., architect may have died) or the architect has acted in bad faith, or the purchaser has somehow prevented the certificate from issuing. The third party's refusal to issue a certificate needs to be reasonable.

13.3 DISCHARGE BY AGREEMENT

Parties are free to agree to almost any contract they want, and they are free to agree to end the contract whenever they want. There are several ways this is done.

MUTUAL RESCISSION

The parties may agree to give up the duties to perform, called mutual **rescission**. This may be by a formal written release saying the obligor is discharged upon delivery of the writing or upon occurrence of a condition; or an obligation may be discharged by a contract not to sue about it.

The Restatement calls this an agreement of rescission. An agreement to rescind will be given effect even though partial performance has been made or one or both parties have a claim for partial breach. The agreement need not be in writing or even expressed in words. By their actions, such as failure to take steps to perform or enforce, the parties may signal their mutual intent to rescind. Andy starts to mow Anne's lawn as they agreed. He begins the job, but it is unbearably hot. She sees how uncomfortable he is and readily agrees with him when he says, "Why don't we just forget the whole thing?" Andy's duty to finish mowing is discharged, as is Anne's duty to pay Andy, either for the whole job or for the part he has done.

Research on business executives suggest that in the great majority of cases in which one party wishes to "cancel an order," the other party permits it without renegotiation, even though the cancellation amounts to a repudiation of a contract. Since the 'order' in this situation is the outcome of a contract, cancelling an order is the same as breaching a contract. This is why being able to agree to mutually rescind a contractual obligation is very important in doing business.

The legal consequences of most of these cancellations are an agreement of rescission. Would there still be damages as a consequence? Under UCC Section 2-720, the use of a word like "cancellation" or "rescission" does not by itself amount to a renunciation of the right to sue for breach of a provision that occurred before the rescission. If the parties mean to discharge each other fully from all duties owed, they must say so explicitly. Actions continue to speak more loudly than words, however, and in law, so can inactions. Legal rights under contracts may be lost by both parties if they fail to act; by abandoning their claims, they can affect rescission.

WAIVER

A second means of discharge is by **waiver**, whereby a party voluntarily gives up a right she has under a contract but doesn't give up the entire right to performance by the other side. Tenant is supposed to pay rent on the first of the month, but because his employer pays on the tenth, Tenant pays Landlady on that day. If Landlady accepts the late payment without objection, she has waived her right to insist on payment by the first of the month, unless the lease provides that no waiver occurs from the acceptance of any late payments.

CASE 13.2

Minor v. Chase Auto Finance Corporation, 372 S.W.3d 762 (Ark. 2010)

SHEFFIELD, J.

We have been asked to determine whether non-waiver and no-unwritten-modifications clauses in a [contract] preclude a creditor from waiving future strict compliance with the agreement by accepting late payments.…

Appellant Mose Minor (Minor) entered into a Simple Interest Motor Vehicle Contract and Security Agreement with Appellee Chase Auto Finance Corporation (Chase) to finance the purchase of a 2003 Toyota Tundra. By the terms of the agreement, Minor was to make sixty-six payments of $456.99 on the fourteenth of each month.…The agreement also included the following relevant provisions:

G. Default: If you…default in the performance of any promise you make in this contract or any other contract you have with us, including, but not limited to, failing to make any payments when due, or become insolvent, or file any proceeding under the U.S. Bankruptcy Code,…we may at our option and without notice or demand (1) declare all unpaid sums immediately due and payable subject to any right of reinstatement as required by law (2) file suit against you for all unpaid sums (3) take immediate possession of the vehicle (4) exercise any other legal or equitable remedy.…Our remedies are cumulative and taking of any action shall not be a waiver or prohibit us from pursuing any other remedy. You agree that upon your default we shall be entitled to recover from you our reasonable collection costs, including, but not limited to, any attorney's fee. In addition, if we repossess the vehicle, you grant to us and our agents permission to enter upon any premises where the vehicle is located. Any repossession will be performed peacefully.…

J. Other Agreements of Buyer:…(2) You agree that if we accept moneys in sums less than those due or make extensions of due dates of payments under this contract, doing so will not be a waiver of any later right to enforce the contract terms as written.…(12) All of the agreements between us and you are set forth in this contract and no modification of this contract shall be valid unless it is made in writing and signed by you and us.…

K. Delay in Enforcement: We can delay or waive enforcement of any of our rights under this contract without losing them.

Minor's first payment was late, as were several subsequent payments. At times he failed to make any payment for months. Chase charged a late fee for each late payment, and sent several letters requesting payment and offering to assist Minor with his account. Chase also warned Minor that continued failure to make payments would result in Chase exercising its legal options available under the agreement, including repossession of the vehicle.…At one point, Minor fell so far behind in his payments that Chase was on the verge of repossessing the vehicle. However…the parties agreed to a two-month extension of the agreement.…The extension agreement indicated that all other terms and conditions of the original contract would remain the same.

On November 2, 2004, Minor filed for bankruptcy [after which] Chase sent Minor a letter acknowledging that Minor's debt to Chase had been discharged in bankruptcy. The letter further stated that Chase still had

a valid lien on the vehicle, and if Minor wished to keep the vehicle, he would have to continue to make payments to Chase. Otherwise, Chase would repossess the vehicle.…

On September 28, 2006, a repossession agent…arrived at Minor's home some time in the afternoon to repossess the vehicle.…[Notwithstanding Minor's insistence that the agent stop] the agent removed Minor's possessions from the vehicle and towed it away. Chase sold the vehicle. The amount of the purchase price was reflected on Minor's account.…

On January 7, 2008, Minor filed a complaint against Chase [alleging] that, during the course of the contract, the parties had altered the provisions of the contract regarding Chase's right to repossess the vehicle and Chase had waived the right to strictly enforce the repossession clause. Minor further claimed that the repossession agent committed trespass and repossessed the vehicle forcibly, without Minor's permission, and through trickery and deceit, in violation of [state law]. Also, Minor asserted that he was not in default on his payments, pursuant to the repayment schedule, at the time Chase authorized repossession. Therefore, according to Minor, Chase committed conversion, and breached the Arkansas Deceptive Trade Practices Act [Citation], and enhanced by Arkansas Code Annotated section 4-88-202, because Minor is an elderly person. Minor sought compensatory and punitive damages.…

After hearing these arguments, the circuit court ruled that Minor had presented no evidence that the conduct of Chase or the repossession agent constituted grounds for punitive damages; that by the express terms of the contract Chase's acceptance of late payments did not effect a waiver of its rights in the future; that at the time of repossession, Minor was behind in his payments and in breach of the contract; that Chase had the right under the contract to repossess the vehicle and did not commit conversion; and that there was no evidence to support a claim that Chase had violated the Arkansas Deceptive Trade Practices Act.…

[W]e affirm our previous decisions that when a contract does not contain a non-waiver and a no-unwritten-modification provision and the creditor has established a course of dealing in accepting late payments from the debtor, the creditor waives its right to insist on strict compliance with the contract and must give notice to the debtor that it will no longer accept late payments before it can declare default of the debt. However, we announce today that, if a contract includes non-waiver and no-unwritten-modification clauses, the creditor, in accepting late payments, does not waive its right under the contract to declare default of the debt, and need not give notice that it will enforce that right in the event of future late payments.…

In arriving at this conclusion, we adhere to the principle that "a [contract] is effective according to its terms between the parties."…We have long held that non-waiver clauses are legal and valid. See [Citations] Also, [the Arkansas UCC 2-209(2)] declares that no-unwritten-modification provisions are binding.

We acknowledge that there is a difference of opinion amongst the courts in other jurisdictions over the effect of non-waiver and no-unwritten-modification clauses.…

We concur with the Supreme Court of Indiana's decision in [Citation], that a rule providing that non-waiver clauses could themselves be waived by the acceptance of late payments is "illogical, since the very conduct which the [non-waiver] clause is designed to permit[,] acceptance of late payment[,] is turned around to constitute waiver of the clause permitting the conduct." We also agree that the approach of jurisdictions that require creditors who have accepted late payments in the past to notify debtors that they expect strict compliance in the future, despite the existence of a non-waiver provision in the contract, is not "sound." Such a rule, we recognize, "begs the question of validity of the non-waiver clause." Finally, our

holding is in line with the Indiana Supreme Court's ruling that it would enforce the provisions of the contract, since the parties had agreed to them, and that it would not require the creditor to give notice, because the non-waiver clause placed the [creditor] in the same position as one who had never accepted a late payment. [Citations]…

Certified question answered; remanded to court of appeals.

Case questions

1. What is a nonwaiver clause?
2. Why did Mose think his late payments were not grounds for repossession of his truck?
3. Why would a creditor accept late payments instead of immediately repossessing the collateral?
4. Why did Mose lose?

SUBSTITUTED AGREEMENT

The parties may enter into a **novation**, either a new contract or one whereby a new person is substituted for the original obligor, and the latter is discharged, with the consent of all involved parties. If Mr. Olson is obligated to deliver a car to Jack, Jack and Mr. Olson may agree that Dewey Dealer should deliver the car to Jack instead of Mr. Olson; the latter is discharged by this novation. A substituted agreement may also simply replace the original one between the original parties.

ACCORD AND SATISFACTION

In an **accord and satisfaction** the parties to a contract (usually a disputed one) agree to substitute some performance different from what was originally agreed, and once this new agreement is executed, the original contract (as well as the more recent accord) is satisfied. But before then, the original agreement is only suspended: if the obligor does not satisfy the accord, the other side can sue on the original obligation or on the accord. This process is described more fully in the Chapter on Consideration.

13.4 DISCHARGE BY OPERATION OF LAW WHEN PERFORMANCE BECOMES VERY DIFFICULT

Every contract contains some element of risk: the buyer may run out of money before he can pay; the seller may run out of goods before he can deliver; the cost of raw materials may skyrocket, throwing off the manufacturer's financial calculations. Should the obligor's luck run out, ordinarily he is stuck with the consequences. He must either perform or risk paying damages for breach of contract, even if his failure is due to events beyond his control. Of course, an obligor can always limit his liability

by using the contract language to minimize risk. For instance, instead of obligating himself to deliver one million widgets, he can restrict his obligation to "one million units or factory output, whichever is less." Instead of guaranteeing to finish a job by a certain date, he can agree to use his "best efforts" to do so. Similarly, damages in the event of breach can be limited. A party can even include a clause canceling the contract in the event of an untoward happening. But if these provisions are absent, the obligor is generally held to the terms of his bargain. To avoid the harsh consequences of meeting the terms of a contract that has been impacted by circumstances outside the parties' control, there are exceptions which include the concepts of impossibility, impracticability, and frustration of purpose.

IMPOSSIBILITY

If performance is impossible, the duty is discharged on grounds of **impossibility**. The categories here are death or incapacity of a personal services contractor, destruction of a thing necessary for performance, and performance prohibited by government order.

Death or Incapacity of a Personal Services Contractor

Whether the death of a promisee impacts the performance of a contractual duty depends on the type of contract at issue. If the contract is personal in nature, performance is usually excused due to death or incapacity. If Buyer makes a contract to purchase a car and dies before delivery, Buyer's estate could be held liable; it is not impossible (for the estate) to perform. But, the estate of a painter hired to complete a portrait cannot be sued for damages if the painter dies before she could complete the work.

Destruction or Deterioration of a Thing Necessary for Performance

When a specific object is necessary for the obligor's performance, its destruction or deterioration making its use impracticable (or its failure to come into existence) discharges the obligor's duty. Diane's Dyers contracts to buy the annual wool output of the Sheepish Ranch, but the sheep die of an epidemic disease before they can be shorn. Since the specific thing for which the contract was made has been destroyed, Sheepish is discharged from its duty to supply Diane's with wool, and Diane's has no claim against the Ranch. However, if the contract had called for a quantity of wool, without specifying that it was to be from Sheepish's flock, the duty would not be discharged; since wool is available on the open market, Sheepish could buy that and resell it to Diane's.

Performance Prohibited by Government Regulation or Order

When a government promulgates a rule after a contract is made, and the rule either bars performance or will make it impracticable, the obligor's duty is discharged. An obligor is not required to break the law and risk the consequences. Financier Bank contracts to sell World Mortgage Company certain collateralized loan instruments. The federal government, in a bank reform measure, prohibits such sales. The contract is discharged. If the Supreme Court later declared the prohibition unconstitutional, World Mortgage's duty to buy (or Financier Bank's to sell) would not revive.

CASE 13.3

Parker v. Arthur Murray, Inc., 295 N.E.2d 487 (Ill. Ct. App. 1973)

STAMOS, J.

The operative facts are not in dispute. In November, 1959 plaintiff went to the Arthur Murray Studio in Oak Park to redeem a certificate entitling him to three free dancing lessons. At that time he was a 37 year-old college-educated bachelor who lived alone in a one-room attic apartment in Berwyn, Illinois. During the free lessons the instructor told plaintiff he had 'exceptional potential to be a fine and accomplished dancer' and generally encouraged further participation. Plaintiff thereupon signed a contract for 75 hours of lessons at a cost of $1000. At the bottom of the contract were the bold-type words, 'NON-CANCELABLE, NEGOTIABLE CONTRACT.' This initial encounter set the pattern for the future relationship between the parties. Plaintiff attended lessons regularly. He was praised and encouraged regularly by the instructors, despite his lack of progress. Contract extensions and new contracts for additional instructional hours were executed. Each written extension contained the bold-type words, 'NON-CANCELABLE CONTRACT,' and each written contract contained the bold-type words, 'NON-CANCELABLE NEGOTIABLE CONTRACT.' Some of the agreements also contained the bold-type statement, 'I UNDERSTAND THAT NO REFUNDS WILL BE MADE UNDER THE TERMS OF THIS CONTRACT.'

On September 24, 1961 plaintiff was severely injured in an automobile collision, rendering him incapable of continuing his dancing lessons. At that time he had contracted for a total of 2734 hours of lessons, for which he had paid $24,812.80 [about $255,000 in 2024 dollars]. Despite written demand defendants refused to return any of the money, and this suit in equity ensued. At the close of plaintiff's case the trial judge dismissed the fraud count (Count II), describing the instructors' sales techniques as merely 'a matter of pumping salesmanship.' At the close of all the evidence a decree was entered under Count I in favor of plaintiff for all prepaid sums, plus interest, but minus stipulated sums attributable to completed lessons.

Plaintiff was granted rescission on the ground of impossibility of performance. The applicable legal doctrine is expressed in the Restatement of Contracts, s 459, as follows:

A duty that requires for its performance action that can be rendered only by the promisor or some other particular person is discharged by his death or by such illness as makes the necessary action by him impossible or seriously injurious to his health, unless the contract indicates a contrary intention or there is contributing fault on the part of the person subject to the duty.…

Defendants do not deny that the doctrine of impossibility of performance is generally applicable to the case at bar. Rather they assert that certain contract provisions bring this case within the Restatement's limitation that the doctrine is inapplicable if 'the contract indicates a contrary intention.' It is contended that such bold type phrases as 'NON-CANCELABLE CONTRACT,' 'NON-CANCELABLE NEGOTIABLE CONTRACT' and 'I UNDERSTAND THAT NO REFUNDS WILL BE MADE UNDER THE TERMS OF THIS CONTRACT' manifested the parties' mutual intent to waive their respective rights to invoke the doctrine of impossibility. This is a construction which we find unacceptable. Courts engage in the construction and interpretation of contracts with the sole aim of determining the intention of the parties. We need rely on no construction aids to conclude that plaintiff never contemplated that by signing a contract with such terms as 'NON-CANCELABLE' and 'NO REFUNDS' he was waiving a remedy

expressly recognized by Illinois courts. Were we also to refer to established tenets of contractual construction, this conclusion would be equally compelled. An ambiguous contract will be construed most strongly against the party who drafted it. [Citation] Exceptions or reservations in a contract will, in case of doubt or ambiguity, be construed least favorably to the party claiming the benefit of the exceptions or reservations. Although neither party to a contract should be relieved from performance on the ground that good business judgment was lacking, a court will not place upon language a ridiculous construction. We conclude that plaintiff did not waive his right to assert the doctrine of impossibility.

Plaintiff's Count II, which alleged fraud and sought punitive damages, was dismissed by the trial judge at the close of plaintiff's case. It is contended on appeal that representations to plaintiff that he had 'exceptional potential to be a fine and accomplished dancer,' that he had 'exceptional potential' and that he was a 'natural born dancer' and a 'terrific dancer' fraudulently induced plaintiff to enter into the contracts for dance lessons.

Generally, a mere expression of opinion will not support an action for fraud. [Citation] In addition, misrepresentations, in order to constitute actionable fraud, must pertain to present or pre-existing facts, rather than to future or contingent events, expectations or probabilities. [Citation] Whether particular language constitutes speculation, opinion or averment of fact depends upon all the attending facts and circumstances of the case. [Citation] Mindful of these rules, and after carefully considering the representations made to plaintiff, and taking into account the business relationship of the parties as well as the educational background of plaintiff, we conclude that the instructors' representations did not constitute fraud. The trial court correctly dismissed Count II. We affirm.

Affirmed.

Case questions

1. Why is it relevant that the plaintiff was "a bachelor who lived alone in a one-room attic apartment"?
2. The contract here contained a "no cancellation" clause; how did the court construe the contract to allow cancellation?
3. Plaintiff lost on his claim of fraud. What defense was successful and why?
4. What is the controlling rule of law here?

COMMON-LAW IMPRACTICABILITY

Impracticability is said to exist when there is a radical departure from the circumstances that the parties reasonably contemplated would exist at the time they entered into the contract; on such facts, the courts might grant relief. They will do so when extraordinary circumstances (often called "acts of God" or "**force majeure**") make it unjust to hold a party liable for performance. Although the justification for judicial relief could be found in an implied condition in all contracts that extraordinary events shall not occur, the Restatement eschews so obvious a bootstrap logic and adopts

the language of UCC Section 2-615(a), which states that the crux of the analysis is whether the nonoccurrence of the extraordinary circumstance was "a basic assumption on which the contract was made." If it was—if, that is, the parties assumed that the circumstance would not occur—then the duty is discharged if the circumstance later does occur.

In one well-known case, *Autry v. Republic Productions*, the famous cowboy movie star Gene Autry had a contract to perform to the defendant. He was drafted into the army in 1942; it was, temporarily at least, impossible for him to perform his movie contractual obligations incurred prior to his service. When he was discharged in 1945, he sued to be relieved of the prewar obligations. The court took notice that there had been a long interruption in Autry's career and of "the great decrease in the purchasing power of the dollar"—postwar inflation—and determined that to require him to perform under the old contract's terms would work a "substantial hardship" on him. A world war is an extraordinary circumstance. The temporary impossibility had transformed into impracticability.

Impracticability refers to the performance, not to the party doing it. Only if the performance is impracticable is the obligor discharged. The distinction is between "the thing cannot be done" and "I cannot do it." The former refers to that which isobjectively impracticable, and the latter to that which is subjectively impracticable. That a duty is subjectively impracticable does not excuse it if the circumstances that made the duty difficult are not extraordinary. A buyer is liable for the purchase price of a house, and his inability to raise the money does not excuse him or allow him to escape from a suit for damages when the seller tenders the deed. If Andy promises to transport Anne to the football stadium for ten dollars, he cannot wriggle out of his agreement because someone smashed into his car (rendering it inoperable) a half hour before he was due to pick her up. He could rent a car or take her in a taxi, even though that will cost considerably more than the sum she agreed to pay him. But if the agreement was that he would transport her in his car, then the circumstances make his performance **objectively impracticable**—the equivalent of impossible—and he is excused.

COMMERCIAL IMPRACTICABILITY

This common-law concept of impracticability has been adopted by the UCC. When performance cannot be undertaken except with extreme difficulty or at highly unreasonable expense, it might be excused on the theory ofcommercial impracticability. However, "impracticable" (the action is impossible) is not the same as "impractical" (the action would yield an insufficient return or would have little practical value). The courts allow a considerable degree of fluctuation in market prices, inflation, weather, and other economic and natural conditions before holding that an extraordinary circumstance has occurred. A manufacturer that based its selling price on last year's costs for raw materials could not avoid its contracts by claiming that inflation within the historical range had made it difficult or unprofitable to meet its commitments. Examples of circumstances that could excuse might be severe limitations of supply due to war, embargo, or a natural disaster. Thus, a ship-owner who contracted with a purchaser to carry goods to a foreign port would be excused if an earthquake destroyed the harbor or if war broke out and the military authorities threatened to sink all vessels that entered the harbor. But if the ship-owner had planned to steam through a canal that is subsequently closed when a hostile government seizes it, his duty is not discharged if another route is available, even if the route is longer and consequently more expensive.

FRUSTRATION OF PURPOSE

If the parties made a basic assumption, express or implied, that certain circumstances would not arise, but those circumstances do arise, then a party is discharged from performing his duties if his principal purpose in making the contract falls under the doctrine of **frustration of purpose**. The frustration of purpose doctrine comes into play when circumstances make the value of one party's performance virtually worthless to the other. This is not a rule of objective impossibility. It operates even though the parties easily might be able to carry out their contractual duties. The frustration of purpose rule does not permit one party to escape a contract simply because he will make less money than he had planned or because one potential benefit of the contract has disappeared. The purpose that is frustrated must be the core of the contract, known and understood by both parties, and the level of frustration must be severe; that is, the value of the contract to the party seeking to be discharged must be destroyed or nearly destroyed.

The classic illustration of frustration of purpose is the litigation that gave birth to the rule: the so-called coronation cases. In 1901, when King Edward VII was due to be crowned following the death of Queen Victoria, a parade route was announced for the coronation. Scores of people rented rooms in buildings that lined the streets of the route to watch the grand spectacle. But the king fell ill, and the procession was canceled. Many expectant viewers failed to pay, and the building owners took them to court; many lessees who had paid took the owners to court to seek refunds. The court declared that the lessees were not liable because the purpose of the contract had been frustrated by the king's illness.

Supervening government regulations (though here different from illegality), floods that destroy buildings in which an event was to take place, and business failures may all contribute to frustration of purpose. But there can be no general rule: the circumstances of each case are determinative. Suppose, for example, that a manufacturer agrees to supply a crucial circuit board to a computer maker who intends to sell his machine and software to the government for use in the international space station's ventilation systems. After the contract is made but before the circuit boards are delivered, the government decides to scrap that particular space station module. The computer manufacturer writes the circuit board maker, canceling the contract. Whether the manufacturer is discharged depends on the commercial prospects for the computer and the circuit board. If the circuit board can be used only in the particular computer, and it in turn is only of use on the space station, the duty to take the boards is discharged. But if the computer can be sold elsewhere, or the circuit boards can be used in other computers that the manufacturer makes, it is liable for breach of contract, since its principal purpose—selling computers—is not frustrated.

As before, the parties can provide in the contract that the duty is absolute and that no supervening event shall give rise to discharge by reason of frustration of purpose.

ACTIVITY 13C

Debate the Case

E-Co is a manufacturing company specializing in electronics. Plugs-R-Us is a retail chain specializing in consumer electronics. In 2019, E-Co agrees to supply Plugs-R-Us with electronic goods for sale in stores across the country. A written contract outlines the specifications, quantities, and delivery schedules for the products as well as late deliveries and quality standards that must be met. Several months after the contract was signed, the COVID-19 pandemic emerges, causing widespread disruptions in global supply chains, transportation, and manufacturing industries. E-Co faces challenges in sourcing raw materials due to factory closures and logistical issues. Additionally, government-imposed lockdowns and social distancing measures impact production capacity and workforce availability. Plugs-R-Us experiences a significant decline in foot traffic and consumer demand in their stores due to public health concerns and economic uncertainties.

Based on what you learned about the doctrines of impossibility, impracticability, and frustration of purpose, debate whether and how each of these doctrines might apply to the various contracts in this scenario. Identify and discuss the factors that Courts would use to decide cases like this one. Research and identify one internet source that informs your view.

End of Chapter Exercises

1. Theresa hired Contractor to construct a large office building. Theresa's duty to pay Contractor was conditioned on receipt of a statement from her architect that the building complied with the terms of the contract. Contractor completed the building but used the wrong color fixtures in the bathrooms. The architect refused to approve the work, but under state law, Contractor was considered to have substantially performed the contract. Is he entitled to payment, less damages for the improper fixtures? Explain.
2. In early 1987, Larry McLanahan submitted a claim to Farmers Insurance for theft of his 1985 Lamborghini while it was on consignment for sale in the Los Angeles area. The car had sustained extensive damage, which McLanahan had his mechanic document. The insurance policy contained this language: "Allow us to inspect and appraise the damaged vehicle before its repair or disposal." But after considerable delay by Farmers, McLanahansold the car to a cash buyer without notifying Farmers. He then sued Farmers for its refusal to pay for damages to his car. Upon what legal theory did Farmers get a summary judgment in its favor?
3. Plaintiff sold a tavern to Defendants. Several months later, Defendants began to experience severe problems with the septic tank system. They informed Plaintiff of the problem and demanded the return of their purchase money. Plaintiff refused. Defendants took no formal action against Plaintiff at that time, and they continued to operate the tavern and make their monthly payments under the contract. Some months later, Defendants met with state officials from the Departments of Environmental Quality, Health, and Liquor Control Commission. The officials warned Defendants that because of the health hazards posed by the septic tank problems, Defendants' licenses might not be renewed. As a result, Defendants decided to close the tavern and attempt to reopen when the septic tank was repaired. Defendants advertised a going-out-of-business sale. The purpose of the sale was to deplete the tavern's inventory before closing. Plaintiff learned about the sale and discovered that Defendants had removed certain personal property from the tavern. He sued the Defendants, claiming, among other things, that

they had anticipatorily breached their contract with him, though he was receiving payments on time. Did the Defendants' actions amount to an anticipatory breach?

4. Julius, a manufacturer of neckties, contracted to supply neckties to a wholesaler. When Julius's factory burned, he failed to supply any, and the wholesaler sued. Is Julius excused from performance by impossibility?
5. Plaintiff (a development corporation) contracted to buy Defendant's property for $1.8 million. A term in the contract read: "The sale…shall be closed at the office of Community Title Company on May 16th at 10:00 am.…Time is of the essence in this contract." Defendant appeared at the office at 10:00 a.m. on the day designated, but the Plaintiff's agent was not there. Defendant waited for twenty minutes, then left. Plaintiff's agent arrived at 10:30 a.m. and announced that he would not have funds for payment until 1:30 p.m., but Defendant refused to return; she had already made other arrangements to finance her purchase of other real estate. Plaintiff sued Defendant for specific performance. Who wins, and why?
6. A contract between the Koles and Parker-Yale provided for completion of the Koles's condominium unit within 180 days. It also authorized the Koles to make written changes in the plans and specifications. Construction was not completed within the 180-day period, and the Koles, prior to completion, sent a letter to Parker-Yale rescinding the contract. Were the Koleswithin their rights to rescind the contract?
7. Plaintiff contracted to buy Defendant's commercial property for $1,265,000. Under the terms of the agreement, Defendant paid $126,000 as an earnest-money deposit, which would be retained by Plaintiff as liquidated damages if Defendant failed to close by the deadline. Tragically, Defendant's husband died four days before the closing deadline, and she was not able to close by the deadline. She was relying on her husband's business to assist her in obtaining the necessary financing to complete the purchase, and after his death, she was not able to obtain it. Plaintiff sued for the $126,000; Defendant argued that the purpose of the contract was frustrated due to the untimely death of her husband. Is this a good argument?
8. Buyer contracted to buy Seller's house for $290,000; the contract included a representation by Buyer "that he has sufficient cash available to complete this purchase." Buyer was a physician who practiced with his uncle. He had received assurances from his uncle of a loan of $200,000 in order to finance the purchase. Shortly after the contract was executed, the uncle was examined by a cardiologist, who found his coronary arteries to be dangerously clogged. As a result, the uncle immediately had triple bypass surgery. After the operation, he told Buyer that his economic future was now uncertain and that therefore it was impossible for him to finance the house purchase. Meanwhile, Seller, who did not know of Buyer's problem, committed herself to buy a house in another state and accepted employment there as well. Buyer was unable to close; Seller sued. Buyer raised as a defense impossibility or impracticability of performance. Is the defense good?
9. Pursuant to a contract for the repair and renovation of a swimming pool owned by Defendant (City of Fort Lauderdale), Plaintiff commenced the work, which included resurfacing the inside of the pool, and had progressed almost to completion. Overnight, vandals damaged the work Plaintiff had done inside the pool, requiring that part of the work be redone. Plaintiff proceeded to redo the work and billed Defendant, who paid the contract price but refused to pay for the additional work required to repair the damage. Did the damage constitute destruction of subject matter discharging Plaintiff from his obligation to complete the job

without getting paid extra?

10. Apache Plaza (the landlord) leased space to Midwest Savings to construct a bank building in Apache's shopping mall, based on a prototype approved by Apache. Midwest constructed the building and used it for twelve years until it was destroyed by a tornado. Midwest submitted plans for a new building to Apache, but Apache rejected the plans because the new building was larger and had less glass than the old building or the prototype. Midwest built it anyway. Its architect claimed that certain changes in the structure of the new building were required by new regulations and building codes, but he admitted that a building of the stipulated size could have been constructed in compliance with the applicable codes. Apache claimed $210,000 in damages over the term of the lease because the new building consumed more square feet of mall space and required more parking. Midwest claimed it had substantially complied with the lease requirements. Is this a good defense?

REFERENCES

Apache Plaza, Ltd. Midwest Sav. Ass'n, 456 N.W.2d 729 (Minn. App. 1990).

Autry v. Republic Productions, 180 P.2d 144 (Calif. 1947).

Christy v. Pilkinton, 273 S.W.2d 533 (Ark. 1954).

Crum v. Grant, 692 P.2d 147 (Or. App., 1984).

Hochster v. De La Tour, 2 Ellis & Blackburn 678 (Q.B. 1853).

Restatement (Second) of Contracts, Section 237(d).

Restatement (Second) of Contracts, Section 261.

Restatement (Second) of Contracts, Section 283.

Sociological Review 28, no. 1 (1963): 55, 61.

Stewart Macaulay, "Non-contractual Relations in Business: A Preliminary Study," *American*

Uniform Commercial Code, Section 2-106(3).

Uniform Commercial Code, Section 2-615.

Uniform Commercial Code, Section 2-725.

CHAPTER 14 - REMEDIES

Learning Objectives

After studying this chapter, you should be able to:

1. Explain the reason for contract remedies and how courts decide which remedies are appropriate.
2. Describe the interests that are protected by contract remedies.
3. Calculate and apply the types of legal remedies.
4. Apply the types of equitable remedies.
5. Discuss the limitations on contract remedies.

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://rvcc.pressbooks.pub/businesslaw131/?p=250#h5p-19

14.1 THEORY OF CONTRACT REMEDIES

People choose to enter contracts because they genuinely want the benefit of the bargain that they made with the other party. To get that benefit, each promisor will generally perform their end of the deal. Thus, most contracts are discharged by performance, not breached. But, when a valid agreement has been made and the promisor's duties have not been discharged there is a **breach** of contract. This Chapter is concerned with the rights of the parties in a situation where there is a breach of contract, when there is a failure of performance, or when the contract has been avoided because of incapacity or misrepresentation or other justifications for **voidable contracts**.

Contract remedies are intended to make the non-breaching party whole. The two categories of remedies for breach of contract are **legal remedies** and **equitable remedies**. Legal remedies are mostly monetary damages, while equitable remedies are focused on ways to make a party whole like **specific performance**, **injunctions**, and **restitution**. Generally, a party to a contract is not forced to perform. Either party has the power (though not the right) to breach. Sometimes it may make more sense to breach a contract when it is economically more advantageous to breach and suffer the consequence than to perform.

To illustrate this, imagine that TechSoft Inc., agrees to create a sophisticated chatbot for another company, BusinessTech Enterprises, for $1 million. As TechSoft gets started working on the project, BusinessTech discovers that a new technology makes it possible to create a more accurate chatbot for $500,000, half the price. Because of this, BusinessTech decides to breach the contract. As long as the penalties for breach are less than $500,000 it makes financial sense to breach the contract. In addition, the breach also allows BusinessTech to use a newer and more accurate technology. TechSoft gets some money in the form of penalties for breach, and BusinessTech gets a cheaper and more advanced technology. A breach, in such a case, is economically and technologically smarter.

The focus of this Chapter is the way in which the law seeks to make the aggrieved party whole when there is a breach of contract.

PURPOSE OF REMEDIES

The overall purpose of contract remedies is to ensure that contracts are enforced and that parties are held accountable for fulfilling their obligations under a contract. The existence of such remedies helps to promote trust and reliability in business transactions, and can provide a way to resolve disputes that may arise during the course of a business relationship. Contract remedies aim to put the non-breaching party in the position he or she would have been in had there been no breach. The purpose is not to punish the breaching party, but to make the non-breaching party whole.

Contract remedies can be either legal or equitable in nature, and they may include monetary **damages**, **specific performance**, or cancellation and **restitution**. **Legal remedies** are damages to compensate the non-breaching party for any losses suffered as a result of the breach. Damages are money paid by one party to another due to a breach. These remedies may include **compensatory damages**, which are intended to put the non-breaching party in the position they would have been in had the contract been fully performed, or **consequential damages**, which are intended to compensate the non-breaching party for any additional losses that were caused by the breach.

Equitable remedies, on the other hand, are designed to discourage, prevent, or remedy a breach of contract rather than to compensate for losses. One common equitable remedy is **specific performance**, which requires the breaching party to fulfill their contractual obligations. Another equitable remedy is cancellation and **restitution**, which allows the non-breaching party to cancel the contract and recover any payments or property that they provided to the breaching party. Finally, an injunction, or judicial order, can direct a party to stop doing something that would violate the contract. Both legal and equitable remedies are explored more fully throughout the Chapter.

PARTIES HAVE THE POWER—BUT NOT THE RIGHT—TO BREACH

In view of the importance given to the intention of the parties in forming and interpreting contracts, it may seem surprising that the remedy for every breach is not a judicial order that the obligor carry out his or her undertakings. But it is not. Some duties cannot be performed after a breach, because time and circumstances will have altered their purpose and rendered many worthless. Some duties have a lesser value after a breach, and so the non-breaching party may no longer be interested in receiving

the performance that was originally promised. If a Court were to order a contract be performed, it may require the parties to continue a relationship when neither are interested in or willing to do so.

Even when it would be theoretically possible for courts to order contracting parties to carry out their contracts, this remedy is rare. A party is permitted to breach a contract. As noted in the TechSoft example above, the law of remedies often provides the parties with an incentive to break the contract in order to make a good business decision. If breached, a contract that requires performance without exception will also require a court to manage and oversee that performance to assure it is acceptable under the original terms of a contract. This calls on courts to manage relationships – an admittedly difficult task. For example, take a contract for a construction contract for a large building project. Such a contract would include detailed specifications and timelines that the contractor must adhere to in order to complete the project according to the owner's expectations. Now imagine that there is a breach of contract and the contractor fails to meet the specified requirements or timelines. If a court orders that the contractor continue to perform, the court can potentially be required to manage and oversee the performance of the contract. As part of the court's order, there could be regular progress reports, site visits, or other measures to ensure that the project is proceeding as planned and that the contractor is meeting their obligations under the contract. And, it is certainly possible that the non-breaching party will not be satisfied with the performance of the contractor anyway, or be concerned about the quality of the work or other aspects of the deal that caused the breach in the first place. Thus, they would need a vehicle to lodge these complaints with the court. Now, think about this for a moment. Have you ever seen a judge at a construction site checking in to make sure that a contractor is hard at work on contracting duties? There is a reason you've never seen this – courts are ill equipped to provide this level of supervision when ordering that contractual duties are completed as opposed to breached. Providing remedies in the form of damages instead simply makes more sense in most breach situations.

For these reasons, the common law looks more toward compensating the promisee for his or her loss than toward compelling the promisor to perform. In short, the promisor has a choice: perform under the original contract or pay a court's award in the event of breach. In general, the fundamental purpose of contract remedies is to put the non-breaching party in the position it would have been in had there been no breach.

14.2 PROMISEE'S INTERESTS PROTECTED BY CONTRACT

Contract remedies serve to protect three different interests: an expectation interest, a reliance interest, and a restitution interest. A promisee will have at least one of these interests and may have two or all three.

An **expectation interest** is the benefit for which the promisee bargained; the remedy is to put him in a position as good as that which he would have been in had the contract been performed.

A **reliance interest** is the loss suffered by relying on the contract and taking actions consistent with the expectation that the other party will abide by it; the remedy is reimbursement that restores the promisee to his position before the contract was made.

A **restitution interest** is that which restores to the promisee any benefit he conferred on the promisor: the remedy is return or repayment of the benefit conferred by the promise.

Consider a scenario where a landowner **repudiates** an **executory contract** with a builder to construct a garage on her property for $100,000. The builder has not yet started the work. When the project was completed, the builder had anticipated a $10,000 profit (in other words, the garage would have cost $90,000 to build). In a lawsuit against the landowner for breach of contract, what remedies can the builder expect to recover? It is unlikely that a court would order that the garage be constructed anyway, so instead the court will look to the builder's three possible interests. Since the builder has not yet started his work, he has given the owner nothing, and therefore has no restitution interest. Nor has he any reliance interest, since we are assuming that he has not paid out any money for supplies, hired a work crew, or advanced money to subcontractors. But he anticipated a profit, and so he has an expectation interest of $10,000.

Let's change the scenario to include that the builder had already dug out the foundation and poured concrete, at a cost of $15,000, when the landowner repudiated the contract. His expectation interest has become $25,000 (the difference between $100,000 and $75,000, the money he will save by not having to finish the job). His reliance interest is $15,000, because this is the amount he has already spent. He may also have a restitution interest, depending on how much the foundation of the house is worth to the owner. (The value could be more or less than the sum of money actually expended to produce the foundation; for example, the builder might have had to pay his subcontractors for a greater share of the job than they had completed, and those sums therefore would not be reflected in the worth of the foundation.)

Normally, the promisee will choose which of the three interests to pursue. This is called **election of remedies**. Election of remedies in contract law refers to the principle that allows a party who has been wronged in a contract to choose among different available legal remedies or courses of action to address the breach. Once a party elects a particular remedy and pursues it, they generally cannot change their mind and pursue a different remedy for the same breach of contract. As is to be expected, the choice hinges on the circumstances of the case, his feelings, and the amount at stake.

ACTIVITY 14A

Which is Which

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=250#h5p-31

14.3 LEGAL REMEDIES: DAMAGES

Damages are a common legal remedy used to compensate the non-breaching party for the harm caused by the breach. The aim of awarding damages is to put the injured party in the position they would have been in if the contract had been performed, insofar as money can accomplish this. The promisee, also called the non-breaching party, has the right to damages (a money award) in a breach of contract action if that is required to make her whole, unless the contract itself or other circumstances suspend or discharge that right. Six types of damages are discussed below.

COMPENSATORY DAMAGES

Compensatory damages are damages paid (i.e. money) to directly compensate the non-breaching party for the value of what was not done or not performed under the contract. Compensatory damages are based on the expectation interest and aim to put the non-breaching party in the position they would have been in if the contract had been performed as promised. In other words, compensatory damages are calculated to cover the actual financial loss suffered by the non-breaching party due to the breach of contract. For example, if you hired someone to paint a room in your house for $500, and that person breached the contract, your damages would be the difference between $500 and the cost of the replacement painter. If the new painter got $750, then damages would be $250. Yet, the calculation is frequently difficult, especially when the performance is a service that is not easily duplicated. If Rembrandt breached a contract to paint your portrait, the loss could not be measured simply by inquiring how much Van Gogh would charge to do the same thing. Nevertheless, in theory, whatever net value would ultimately have been conferred on the non-breaching party is the proper measure of compensatory damages.

Since the non-breaching party usually has obligations under the contract also, a breach by the other party discharges his duty to perform and may result in savings. Or he may have made substitute arrangements and realized at least a partial profit on the substitution (because the substitution cost less). Or, as in the case of the builder, he may have purchased goods intended for the job that can be used elsewhere. In all these situations, the losses avoided—savings, profits, or value of goods—are subtracted from the losses incurred to arrive at the net damages. The non-breaching party may recover his actual losses, not more. Suppose an employer breaches a contract with a prospective employee who was to begin work for a year at a salary of $35,000. The employee quickly finds other, similar work at a salary of $30,000. Aside from whatever he might have had to spend searching for the job (**incidental damages**), his compensatory damages are limited to $5,000, the difference between what he would have earned and what he is earning.

Lost volume can be a troublesome problem in calculating damages. This problem arises when the non-breaching party, a supplier of goods or services, enters a second contract when the buyer repudiates. The question is whether the second contract is a substituted performance or an additional one. If it is substituted, damages may be little or nothing; if additional, the entire expectation interest may be recovered. For example, an automobile dealer contracts to sell a car in inventory. Shortly before the deal is closed, the buyer calls up and repudiates the contract. The dealer then sells the car to someone else. If the dealer can show that he could have sold an identical car to the second purchaser regardless of what the first purchaser did, then the second sale stands on its own and cannot be used to offset the net profit recoverable from the first purchaser. The factual inquiry in lost volume cases

is whether the non-breaching party would have engaged in the second transaction if the breach had never occurred.

INCIDENTAL DAMAGES

In addition to **compensatory damages**, the non-breaching party may recover **incidental damages**. Incidental loss includes expenditures that the non-breaching party incurs in attempting to minimize the loss that flows from the breach. Incidental damages are the direct and immediate costs incurred as a result of a breach of contract. Examples of incidental damages may include expenses related to finding a replacement for the non-performing party, such as additional shipping costs, storage fees, or travel expenses. To arrange for substitute goods or services, the non-breaching party might have to pay a premium or special fee to locate another supplier or source of work. These premiums or fees are part of the damages calculation.

CONSEQUENTIAL DAMAGES

Consequential damages are damages that are not directly caused by the breach, but rather arise as a consequence of the breach. They are typically more remote and indirect than incidental damages. Consequential damages may include lost profits, lost business opportunities, and other economic losses that result from the non-performance of a contract. The key difference between incidental and consequential damages is the degree of proximity between the damage and the breach. Incidental damages are more closely connected to the breach and are therefore easier to quantify, while consequential damages are more remote and may be more difficult to calculate. These are damages incurred by the non-breaching party without action on his part because of the breach. Consequential damages are also sometimes referred to as indirect or special damages.

Consider an example of a business that contracts with a shipping company to deliver goods to its customers. The shipping company fails to deliver the goods to customers on time, and as a result, the business incurs losses. In this scenario, incidental damages might include the cost to the business of storing the goods while waiting for them to be picked up and delivered by the shipping company, or the cost of hiring another shipping company to deliver the goods instead. Consequential damages, on the other hand, might include the lost profits the company suffered as a result of the delayed delivery, or the cost of losing customers who were unhappy with the late delivery and decided to take their business elsewhere. So, incidental damages are the direct costs incurred as a result of the breach, such as storage or shipping fees, while consequential damages are the indirect losses that result from the breach, such as lost profits or lost business opportunities.

Foreseeability is an important factor in determining whether consequential damages are recoverable in a legal case. In general, a party can only recover consequential damages that were **foreseeable** at the time the contract was entered into. If the consequential damages were not foreseeable at the time of the contract, then they may not be recoverable. For example, if the shipping company in the example above failed to deliver goods on time and, as a result, the business lost a major client, the lost profits from that client might be recoverable if it was foreseeable that the late delivery could lead to the business suffering the loss of the client. On the other hand, if the loss of the major client was not foreseeable at the time of the contract, then the damages associated with this loss would not

be recovered as consequential damages. In sum, if the damages were foreseeable, then they may be recoverable, but if they were not foreseeable, then they may not be recoverable.

CASE 14.1

EBWS, LLC v. Britly Corp., 928 A.2d 497 (Vt. 2007)

REIBER, C.J.

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

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

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

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

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

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

On appeal, Britly contends that because there is no contractual or legal obligation for EBWS to purchase milk or pay its employees, these are not foreseeable damages. EBWS counters that it is common knowledge

that cows continue to produce milk, even if the processing plant is not working, and thus it is foreseeable that this loss would occur. We conclude that these damages are not the foreseeable result of Britly's breach of the construction contract and reverse the award.…

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

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

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

Award for consequential damages is reversed.…

Case questions

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

4. What could EBWS have done at the time of contracting to protect itself against the damages it would incur in the event the creamery suffered downtime due to faulty construction?

NOMINAL DAMAGES

Nominal damages are symbolic in nature and are awarded when a contract has been technically breached, but no actual loss has been suffered by the non-breaching party. These damages are typically a small amount, such as $1, and serve as recognition that a breach occurred even though it did not result in significant harm. In a case where there has been a breach of contract, courts can award nominal damages when the losses associated with the damages are trivial or when losses associated with the damages are speculative and cannot be proven.

In the shipping contract situation above, if the delay in the delivery of the shipped goods did not result in any quantifiable loss to the business, a court may award nominal damages. This would be a very small symbolic amount that would reflect that the business was wronged by the shipping company's breach of their contract. Nominal damages might also be awarded if the business is unable to provide evidence of the exact amount of damages it suffered as a result of the delayed delivery of the goods by the shipping company. The court may find that the damages suffered by the company are speculative and therefore uncertain. Damages are speculative when it is difficult to quantify the exact financial harm suffered by the non-breaching party, or when it is unclear whether the damages claimed can be directly attributed to the breach of contract. So, the court might award nominal damages to reflect that the business was wronged but could not prove precisely how it incurred damages.

LIQUIDATED DAMAGES

Liquidated damages refer to a predetermined amount of money that a party agrees to pay in the event of a breach of contract. This amount is typically agreed upon and specified in the contract at the time the contract is formed. Liquidated damages are often used in contracts where it may be difficult to calculate the actual damages that would result from a breach of contract. Liquidated damages may also be used in situations where it makes more sense to designate an amount of damages in advance of a breach, as a way to minimize disputes over damages and potential litigation between contracting parties. It's important to note that the liquidated damages clause must be reasonable and proportional to the harm that may result from a breach, or it may be deemed unenforceable by a court. Liquidated damages cannot be used to punish a party for breaching by requiring the payment of damages far in excess of what the law would otherwise allow. In our shipping company example, the contract could specify that the shipping company must pay the business $100 for every day beyond the agreed-upon delivery date that the goods remain undelivered. That means if the goods are delivered three days late, the shipping company would have to pay the company $300 in liquidated damages. If you have a cell phone contract, you likely have a liquidated damages clause in that contract, which you might

be calling an 'early termination fee.' Courts will enforce a liquidated damages provision as long as the actual amount of damages is difficult to ascertain and the sum is reasonable in light of the expected or actual harm. If the liquidated sum is unreasonably large, the excess is termed a penalty and is said to be against public policy and unenforceable.

CASE 14.2

Watson v. Ingram, 881 P.2d 247 (Wash. 1994)

JOHNSON, J.

…In the summer of 1990, Wayne Watson offered to buy James Ingram's Bellingham home for $355,000, with a $15,000 [about $36,500 in 2024 dollars] earnest money deposit.…

Under the agreement, the entire amount of the purchase price was due in cash on or before December 3, 1990.…The agreement required Watson to pay a $15,000 earnest money deposit into escrow at Kelstrup Realty, and provided that "[i]n the event of default by Buyer, earnest money shall be forfeited to Seller as liquidated damages, unless Seller elects to seek actual damages or specific performance. Lastly, the agreement contained a provision entitled "BUYER'S REPRESENTATIONS," which stated, "Buyer represents that buyer has sufficient funds available to close this sale in accordance with this agreement, and is not relying on any contingent source of funds unless otherwise set forth in this agreement".…

On November 10, 1990, Watson sent a written proposal to Ingram seeking to modify the original agreement. The proposed modification would have allowed Watson to defer paying $54,000 of the $355,000 sale price for between 6 and 12 months after the scheduled December closing date. In exchange, Ingram would receive a second lien position on certain real estate Watson owned.

According to Ingram, the November 10 proposal was the first time he realized Watson did not have financing readily available for the purchase of the house. Ingram notified Watson on November 12, 1990, that he would not agree to modify the original agreement and intended to strictly enforce its terms. Ingram was involved in a child custody suit in California and wanted to move to that state as soon as possible.…[Further efforts by Ingram to sell to third parties and by Watson to get an extension from Ingram failed.]

In September 1991, Ingram finally sold the house to a third party for $355,000, the same price that Watson had agreed to pay in December 1990.

Ingram and Watson each sought to recover Watson's $15,000 earnest money held in escrow. On December 4, 1990, Ingram wrote to Kelstrup Realty, indicating he was entitled to the $15,000 earnest money in escrow because Watson had defaulted. In January 1991, Watson filed this action to recover the earnest money, alleging it amounted to a penalty and Ingram had suffered no actual damages.…

The trial court found the earnest money "was clearly intended by both parties to be non-refundable" if Watson defaulted and determined $15,000 was "a reasonable forecast by [Ingram and Watson] of damages that would be incurred by [Ingram] if [Watson] failed to complete the purchase". The court entered judgment in favor of Ingram for the amount of the earnest money plus interest. The court also awarded

Ingram his attorney fees pursuant to the parties' agreement. The Court of Appeals, Division One, affirmed. Watson now appeals to this court.

This case presents a single issue for review: whether the parties' contract provision requiring Watson to forfeit a $15,000 nonrefundable earnest money deposit is enforceable as liquidated damages. Liquidated damages clauses are favored in Washington, and courts will uphold them if the sums involved do not amount to a penalty or are otherwise unlawful. [Citation] To determine whether liquidated damages clauses are enforceable, Washington courts have applied a 2-part test from the Restatement of Contracts.…Liquidated damages clauses are upheld if the following two factors are satisfied:

First, the amount fixed must be a reasonable forecast of just compensation for the harm that is caused by the breach. Second, the harm must be such that it is incapable or very difficult of ascertainment.

The question before this court is whether this test is to be applied as of the time of contract formation (prospectively) or as of the time of trial (retrospectively). We have previously held, the "[r]easonableness of the forecast will be judged as of the time the contract was entered". [Citations]

In contrast, a prior Division One opinion relied upon by Petitioner held the reasonableness of the estimate of damages and the difficulty of ascertainment of harm should be measured as of the time of trial, and earnest money agreements should not be enforceable as liquidated damages if the non-breaching party does not suffer actual damage. [Citations]

We…adopt the date of contract formation as the proper timeframe for evaluating the Restatement test. The prospective approach concentrates on whether the liquidated sum represents a reasonable prediction of the harm to the seller if the buyer breaches the agreement, and ignores actual damages except as evidence of the reasonableness of the estimate of potential damage.

We believe this approach better fulfills the underlying purposes of liquidated damages clauses and gives greater weight to the parties' expectations. Liquidated damages permit parties to allocate business and litigation risks. Even if the estimates of damages are not exact, parties can allocate and quantify those risks and can negotiate adjustments to the contract price in light of the allocated risks. Under the prospective approach, courts will enforce the parties' allocation of risk so long as the forecasts appear reasonable when made. [Citations]

In addition to permitting parties to allocate risks, liquidated damages provisions lend certainty to the parties' agreements and permit parties to resolve disputes efficiently in the event of a breach. Rather than litigating the amount of actual damages, the non-breaching party must only establish the reasonableness of the agreement. The prospective approach permits parties to rely on their stipulated amounts without having to precisely establish damages at trial. In contrast, if the reasonableness of the amount is judged retrospectively, against the damage actually suffered, the "parties must fully litigate (at great expense and delay) that which they sought not to litigate." [Citation].

Petitioner argues the prospective approach treats buyers unfairly because it permits sellers to retain earnest money deposits even when the seller suffers no actual damage, and this violates the principle that contract damages should be compensatory only. He further contends that by evaluating parties' liquidated damages agreements against actual damages established at trial, courts can most effectively determine whether such agreements were reasonable and fair.

We disagree. As this court has previously explained, "[w]e are loath to interfere with the rights of parties to

contract as they please between themselves [Citations] It is not the role of the court to enforce contracts so as to produce the most equitable result. The parties themselves know best what motivations and considerations influenced their bargaining, and, while, "[t]he bargain may be an unfortunate one for the delinquent party,…it is not the duty of courts of common law to relieve parties from the consequences of their own improvidence…" [Citations]

The retrospective approach fails to give proper weight to the parties' negotiations. At the time of contract formation, unpredictable market fluctuations and variations in possible breaches make it nearly impossible for contracting parties to predict "precisely or within a narrow range the amount of damages that would flow from breach." [Citations]. However, against this backdrop of uncertainty, the negotiated liquidated damages sum represents the parties' best estimate of the value of the breach and permits the parties to allocate and incorporate these risks in their negotiations. Under the prospective approach, a court will uphold the parties' agreed upon liquidated sum so long as the amount represents a reasonable attempt to compensate the non-breaching party. On the other hand, if the reasonableness of a liquidated damages provision is evaluated under a retrospective approach, the parties cannot confidently rely on their agreement because the liquidated sum will not be enforced if, at trial, it is not a close approximation of the damage suffered or if no actual damages are proved.…

Having adopted the date of contract formation as the proper timeframe for evaluating the Restatement test, the Restatement's second requirement loses independent significance. The central inquiry is whether the specified liquidated damages were reasonable at the time of contract formation.…

We also agree with the Court of Appeals that in the context of real estate agreements, a requirement that damages be difficult to prove at trial would undermine the very purposes of the liquidated damage provision: "certainty, assurance that the contract will be performed, and avoidance of litigation". [Citation] It would "encourage litigation in virtually every case in which the sale did not close, regardless of whether the earnest money deposit was a reasonable estimate of the seller's damages." [Citation]

In sum, so long as the agreed upon earnest money agreement, viewed prospectively, is a reasonable prediction of potential damage suffered by the seller, the agreement should be enforced "without regard to the retrospective calculation of actual damages or the ease with which they may be proved". The prospective difficulty of estimating potential damage is a factor to be used in assessing the reasonableness of the earnest money agreement…

The decision of the Court of Appeals is affirmed.

Case questions

1. What does the court here mean when it says that liquidated damages clauses allow the parties to "allocate and incorporate the risks [of the transaction] in their negotiations"?
2. Why is it relevant that the plaintiff Ingram was engaged in a child-custody dispute and wanted to move to California as soon as possible?
3. What, in plain language, is the issue here?
4. How does the court's resolution of the issue seem to the court the better analysis?

5. Why did the plaintiff get to keep the $15,000 when he really suffered no damages?
6. Express the controlling rule of law out of this case.

PUNITIVE DAMAGES

Punitive damages are those awarded for the purpose of punishing a defendant in a civil action. These damages are meant to punish the breaching party for their behavior rather than to compensate the injured party. They are proper in cases in which the defendant has acted willfully and maliciously and are thought to deter others from acting similarly. Punitive damages are more common in cases of intentional **torts** (civil wrongs) rather than breach of contract. Since the purpose of contract law is compensation, not punishment, punitive damages have not traditionally been awarded, with one exception—when the breach of contract is also a tort for which punitive damages may be recovered. Punitive damages typically awarded in tort claims when the tortfeasor's behavior is malicious or willful (reckless conduct causing physical harm, deliberate defamation of one's character, a knowingly unlawful taking of someone's property), and some kinds of contract breach are also tortious. For example, when a creditor holding collateral as security under a contract for a loan sells the collateral to a good-faith purchaser for value even though the debtor was not in default, he has breached the contract and committed the tort of conversion; punitive damages may be awarded, assuming the behavior was willful and not merely mistaken. But in the shipping company example that we've used throughout this section, punitive damages would not be available absent some indication of willfully tortious conduct on the part of the shipping company.

Punitive damages are not fixed by law. The judge or jury may award at its discretion whatever sum is believed necessary to redress the wrong or deter like conduct in the future. This means that a richer person may be slapped with much heavier punitive damages than a poorer one in the appropriate case. But the judge in all cases may remit (reduce) some or all of a punitive damage award if he or she considers it excessive.

ACTIVITY 14B

Debate

Punitive damages are rarely available in breach of contract actions. Because contract breaches often result due to sound business decisions, contract law focuses on compensatory rather than punitive remedies. But not everyone that enters a contract is a business making a business decision. Sometimes, contracting is personal. Take, for example, a couple planning a wedding reception that contracts with their dream venue.

While the original couple has the date and event secured by a contract, a celebrity contacts the venue looking for the same date, but will only book if no other events are held at the venue so as to secure privacy. The celebrity offers to pay well more than the original couple is able to pay. The venue breaches the contract with the original couple. The venue knows it will only pay compensatory damages and will be able to do so easily with the extra income from the celebrity event. The couple, on the other hand, has now been thrust into an incredibly stressful situation as they were counting on having their reception already planned. Now, they have to explore alternatives, inform their guests, re-plan the day to fit the new venue, and perhaps will have their event at a location they do not love. This is not an arm's length transaction from the vantage point of the couple.

- Should punitive damages be made available in contract actions more frequently? If so, what legal standards should be applied to the availability of punitive damages.
- Should the law be more focused on discouraging breach and if so would allowing for punitive damages be a step in the right direction?
- Are there other reforms that you would recommend aimed at discouraging breach?

14.4 EQUITABLE REMEDIES

When legal remedies are inadequate to make the non-breaching party whole, or a breach of contract involves unique circumstances that make monetary compensation insufficient, equitable remedies may be available. **Equitable remedies** are non-monetary remedies that are designed to put the non-breaching party in the position they would have been in if the contract had been performed as promised. Equitable remedies include **specific performance**, **injunctions**, and **restitution**. Specific performance requires the breaching party to fulfill their contractual obligations, while injunctions prevent the breaching party from taking certain actions. Restitution is a remedy that allows the parties to return to the consideration the non-breaching party gave so as to return the parties to the precontract status. Each of these types of equitable remedies are discussed below.

THREE TYPES OF EQUITABLE REMEDIES

Specific Performance

Specific performance is an **equitable remedy** that is available in limited situations when one party to a contract fails to perform their obligations under the contract. It is a court-ordered remedy that requires the breaching party to fulfill their contractual obligations as promised. In other words, specific performance is a remedy that compels the breaching party to do what they promised to do in the contract. For example, Emily signs a contract to sell Charlotte a gold samovar, a Russian antique of great sentimental value because it once belonged to Charlotte's mother. Emily then repudiates the contract and refuses to transfer gold samovar. In a lawsuit, a court may properly grant Charlotte an order of specific performance against Emily, which means that Charlotte will get the gold samovar instead of legal damages. Specific performance essentially gives the non-breaching party the benefit of their bargain, by requiring the breaching party to fulfill their obligations under the contract.

Specific performance is a very limited remedy: it is *only* available for breach of contract to sell a unique item, that is, a unique item of personal property (the samovar), or a parcel of real estate (all real estate is unique). But if the item is not unique, so that the non-breaching party can go out and buy another

one, then the legal remedy of money damages will solve the problem. Specific performance is not available as a remedy to force a person to perform a service, as this would be involuntary servitude. **Courts will generally only order specific performance if the non-breaching party can show that monetary damages are inadequate and that specific performance is necessary to avoid an unjust result.**

Injunction

An **injunction** is the second type of **equitable remedy** available in contract (it is also available in tort). It is a court order directing a person to stop doing that which she should not do. In the context of contract law, injunctions are often used as an equitable remedy to prevent a breach of contract. For example, if an employer has a valid noncompete contract with an employee, and the employee, in breach of that contract, nevertheless undertakes to compete with his former employer, a court may **enjoin** (issue an order of injunction), directing the former employee to stop such competition. Or if Seller promises to give Buyer the right of first refusal on a parcel of real estate or a unique work of art, but Seller, in breach of a written promise, offers the thing to a third party, a court may enjoin Seller from selling it to the third party. Injunctions are often used when monetary damages would not be an adequate remedy for a breach of contract. This may be because the harm caused by the breach is ongoing, or because the harm is difficult to quantify in monetary terms. Injunctions can be particularly useful in cases where the harm caused by a breach of contract is irreparable, meaning that it cannot be undone through monetary compensation alone.

It is important to note that injunctions are a discretionary remedy, meaning that a court may choose to grant or deny an injunction based on the particular circumstances of the case. Additionally, injunctions can be temporary or permanent, depending on the circumstances of the case. If a person violates an injunction, which is a court order, he may be held in contempt of court and even wind up in jail.

CASE 14.3

Madison Square Garden Corporation v. Carnera, 52 F.2d 47 (2d Cir. Ct. App. 1931)

CHASE, J.

On January 13, 1931, the plaintiff and defendant by their duly authorized agents entered into the following agreement in writing:

1. Carnera agrees that he will render services as a boxer in his next contest (which contest, hereinafter called the 'First Contest.'…

9. Carnera shall not, pending the holding of the First Contest, render services as a boxer in any major boxing contest, without the written permission of the Garden in each case had and obtained. A major contest is understood to be one with Sharkey, Baer, Campolo, Godfrey, or like grade heavyweights, or heavyweights who shall have beaten any of the above subsequent to the date hereof. If in any boxing contest engaged in by Carnera prior to the holding of the First Contest, he shall lose the same, the Garden shall at

its option, to be exercised by a two weeks' notice to Carnera in writing, be without further liability under the terms of this agreement to Carnera. Carnera shall not render services during the continuance of the option referred to in paragraph 8 hereof for any person, firm or corporation other than the Garden. Carnera shall, however, at all times be permitted to engage in sparring exhibitions in which no decision is rendered and in which the heavy weight championship title is not at stake, and in which Carnera boxes not more than four rounds with any one opponent.'…

Thereafter the defendant, without the permission of the plaintiff, written or otherwise, made a contract to engage in a boxing contest with the Sharkey mentioned in paragraph 9 of the agreement above quoted, and by the terms thereof the contest was to take place before the first contest mentioned in the defendant's contract with the plaintiff was to be held.

The plaintiff then brought this suit to restrain the defendant from carrying out his contract to box Sharkey, and obtained the preliminary injunction order, from which this appeal was taken. Jurisdiction is based on diversity of citizenship and the required amount is involved.

The District Court has found on affidavits which adequately show it that the defendant's services are unique and extraordinary. A negative covenant in a contract for such personal services is enforceable by injunction where the damages for a breach are incapable of ascertainment. [Citations]

The defendant points to what is claimed to be lack of consideration for his negative promise, in that the contract is inequitable and contains no agreement to employ him. It is true that there is no promise in so many words to employ the defendant to box in a contest with Stribling or Schmeling, but the agreement read as a whole binds the plaintiff to do just that, provided either Stribling or Schmeling becomes the contestant as the result of the match between them and can be induced to box the defendant. The defendant has agreed to 'render services as a boxer' for the plaintiff exclusively, and the plaintiff has agreed to pay him a definite percentage of the gate receipts as his compensation for so doing. The promise to employ the defendant to enable him to earn the compensation agreed upon is implied to the same force and effect as though expressly stated. [Citations] The fact that the plaintiff's implied promise is conditioned, with respect to the contest with the winner of the Stribling-Schmeling match, upon the consent of that performer, does not show any failure of consideration for the defendant's promise, [Citation].

As we have seen, the contract is valid and enforceable. It contains a restrictive covenant which may be given effect. Whether a preliminary injunction shall be issued under such circumstances rests in the sound discretion of the court. [Citation] The District Court, in its discretion, did issue the preliminary injunction.…

Order affirmed.

Case questions

1. Why did the plaintiff not want the defendant to engage in any boxing matches until and except the ones arranged by the plaintiff?
2. What assertion did the defendant make as to why his promise was not enforceable? Why

wasn't that argument accepted by the court?

3. If the defendant had refused to engage in a boxing match arranged by the plaintiff, would a court force him to do what he had promised?

Restitution

The third type of **equitable remedy** is **restitution**. Restitution is a remedy applicable to several different types of cases: those in which the contract was avoided because of incapacity or misrepresentation, those in which the other party breached, and those in which the party seeking restitution breached. As the word implies, *restitution* is a restoring to one party of what he gave to the other. Therefore, only to the extent that the injured party conferred a benefit on the other party may the injured party be awarded restitution. The point is, a person who breaches a contract should not suffer a punishment, and the non-breaching party should not be unjustly enriched.

Total Nonperformance by Breaching Party

The non-breaching party is always entitled to restitution in the event of total breach by nonperformance or **repudiation**, unless both parties have performed all duties except for payment by the other party of a definite sum of money for the injured party's performance. For example, Calhoun, a contractor, agrees to build $3,000 worth of fences for only $2,000 and completes the construction. Arlene, the landowner, refuses to pay. Calhoun's only right is to get the $2,000; he does not have a restitution right to $2,500, the market price of his services (or $3,000, the amount by which her property increased in value); he is entitled, instead, only to $2,000, his contract price. Had Arlene repudiated prior to completion, however, Calhoun would then have been entitled to restitution based either on the market price of the work or on the amount by which he enhanced her property. If the one-party breaches, the non-breaching party is generally entitled to restitution of property that can be returned. Suppose Arlene gives Calhoun a valuable Ming vase in return for his promise to construct the fences. Upon Calhoun's breach, Arlene is entitled to specific restitution of the vase.

Measuring restitution interest can be problematic. The courts have considerable discretion to award either what it would have cost to hire someone else to do the work that the non-breaching party performed (generally, the market price of the service) or the value that was added to the property of the party in breach by virtue of the claimant's performance. Calhoun, the contractor, agrees to construct ten fences around Arlene's acreage at the market price of $25,000. After erecting three, Calhoun has performed services that would cost $7,500, market value. Assume that he has increased the value of Arlene's grounds by $8,000. If Arlene repudiated, there are two measures of Calhoun's restitution interest: $8,000, the value by which the property was enhanced, or $7,500, the amount it would have cost Arlene to hire someone else to do the work. Which measure to use depends on who repudiated the contract and for what reason. In some cases, the enhancement of property or wealth

measurement could lead to an award vastly exceeding the market price for the service. In such cases, the smaller measure is used. For a doctor performing lifesaving operations on a patient, restitution would recover only the market value of the doctor's services—not the monetary value of the patient's life.

Part Performance and Then Breach

A party who has substantially performed and then breached is entitled to restitution of a benefit conferred on the injured party, if the injured party has refused (even though justifiably) to complete his own performance owing to the other's breach. Since the party in breach is liable to the injured party for damages for loss, this rule comes into play only when the benefit conferred is greater than the amount the non-breaching party has lost. Arlene agrees to sell her property to Calhoun for $120,000, and Calhoun makes a partial payment of $30,000. He then repudiates. Arlene turns around and sells the property to a third party for $110,000. Calhoun—the breaching party—can get his money back, less the damages Arlene suffered as a result of his breach. He gets $30,000 minus the $10,000 loss Arlene incurred. He gets $20,000 in restitution. Otherwise Arlene would be enriched by Calhoun's breach: she'd get $140,000 in total for real estate worth $120,000. But if he gets $20,000 of his $30,000 back, she receives $110,000 from the third party and $10,000 from Calhoun, so she gets $120,000 total (plus, we hope, incidental damages, at least).

Restitution in Other Cases

Upon repudiation of an oral contract governed by the **Statute of Frauds**, the non-breaching party is not entitled to her **expectation interest**, but she may recover in restitution unless the purpose of the statute would be frustrated. When one party avoids a contract owing to lack of capacity, mistake, misrepresentation, duress, or the like, she is entitled to restitution for benefit conferred on the other party. Restitution is also available if a contract duty is discharged or never arises because (1) performance was impracticable, (2) the purpose of the contract was frustrated, (3) a condition did not occur, or (4) a beneficiary disclaimed his benefit.

ACTIVITY 14C

Which is which?

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://rvcc.pressbooks.pub/businesslaw131/?p=250#h5p-32

14.5 LIMITATIONS ON CONTRACT REMEDIES

We have observed that the purpose of remedies in contract law is, where possible, to put the non-breaching party in as good a position as he would have been in had there been no breach. There are, however, several limitations or restrictions affecting when a person can claim remedies, in both law (damages) and equity. Of course the contract itself may—if not unconscionable—limit remedies. Beyond that, the non-breaching party must be able to articulate with some degree of certainty what her damages are; the damages must be foreseeable; the non-breaching party must have made a reasonable effort to mitigate the damages; she must sometime elect to go with one remedy and forgo another; she cannot seek to avoid a contract if she has lost the power to do so. We turn to these points.

FORESEEABILITY

If the damages that flow from a breach of contract lack **foreseeability**, they will not be recoverable. Failures to act, like acts themselves, have consequences. As the old fable has it, "For want of a nail, the kingdom was lost." To put a non-breaching party in the position he would have been in had the contract been carried out could mean, in some cases, providing compensation for a long chain of events. In many cases, that would be unjust, because a person who does not anticipate a particular event when making a contract will not normally take steps to protect himself (either through limiting language in the contract or through insurance). The law is not so rigid; a loss is not compensable to the non-breaching party unless the breaching party, at the time the contract was made, understood the loss was foreseeable as a probable result of his breach.

Of course, the loss of the contractual benefit in the event of breach is always foreseeable. A company that signs an employment contract with a prospective employee knows full well that if it breaches, the employee will have a legitimate claim to lost salary. But it likely would have no reason to know that the employee's holding the job for a certain length of time was a condition of his grandfather's gift of $1 million.

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

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

Thus, when the party in breach did not know and has no reason to know that the contract entailed a special risk of loss, the burden must fall on the non-breaching party. As we have seen, damages attributable to losses that flow from events that do not occur in the ordinary course of events are known as consequential or special damages. The exact amount of a loss need not be foreseeable; it is the nature of the event that distinguishes between claims for ordinary or consequential damages. A repair shop agrees to fix a machine that it knows is intended to be resold. Because it delays, the sale is lost. The repair shop, knowing why timeliness of performance was important, is liable for the lost profit, as long as it was reasonable. It would not be liable for an extraordinary profit that the seller could have made because of circumstances peculiar to the particular sale unless they were disclosed.

The special circumstances need not be recited in the contract. It is enough for the party in breach to have actual knowledge of the loss that would occur through his breach. Moreover, the **parol evidence rule** does not bar introduction of evidence bearing on the party's knowledge before the contract was signed. So the lesson to a promisee is that the reason for the terms he bargains for should be explained to the promisor—although too much explanation could kill a contract. A messenger who is paid five dollars to deliver a letter across town is not likely to undertake the mission if he is told in advance that his failure for any reason to deliver the letter will cost the sender $1 million, liability to be placed on the messenger.

Actual knowledge is not the only criterion, because the standard of foreseeability is objective, not subjective. That means that if the party had reason to know—if a reasonable person would have understood—that a particular loss was probable should he breach, then he is liable for damages. What one has reason to know obviously depends on the circumstances of the case, the parties' prior dealings, and industry custom. A supplier selling to a middleman should know that the commodity will be resold and that delay or default may reduce profits, whereas delay in sale to an end user might not. If it was foreseeable that the breach might cause the non-breaching party to be sued, the other party is liable for legal fees and a resulting judgment or the cost of a settlement.

Even though the breaching party may have knowledge, the courts will not always award full consequential damages. In the interests of fairness, they may impose limitations if such an award would be manifestly unfair. Such cases usually crop up when the parties have dealt informally and there is a considerable disproportion between the loss caused and the benefit the non-breaching party had agreed to confer on the party who breached. The messenger may know that a huge sum of money rides on his prompt delivery of a letter across town, but unless he explicitly contracted to bear liability for failure to deliver, it is unlikely that the courts would force him to ante up $1 million when his fee for the service was only five dollars.

MITIGATION OF DAMAGES

Contract law encourages the non-breaching party to avoid loss wherever possible; this is called **mitigation of damages**. The concept is a limitation on damages in law. So there can be no recovery if the non-breaching party had an opportunity to avoid or limit losses and failed to take advantage of it. Such an opportunity exists as long as it does not impose, in the Restatement's words, an "undue risk, burden or humiliation." The effort to mitigate need not be successful. As long as the non-breaching party makes a reasonable, good-faith attempt to mitigate his losses, damages are recoverable.

Mitigation crops up in many circumstances. Thus, a non-breaching party who continues to perform after notice that the promisor has breached or will breach may not recover for expenses incurred in continuing to perform. And losses from the use of defective goods delivered in breach of contract are not compensable if the non-breaching party knew before use that they were defective. Often the non-breaching party can make substitute arrangements—find a new job or a new employee, buy substitute goods or sell them to another buyer—and his failure to do so will limit the amount of damages he will recover from the party who breaches. Under the general rule, failure to mitigate when possible permits the promisor to deduct from damages the amount of the loss that the non-breaching party could have avoided. When there is a readily ascertainable market price for goods, damages are equal to the difference between the contract price and the market price.

A substitute transaction is not just any possible arrangement; it must be suitable under the circumstances. Factors to be considered include the similarity, time and place of performance, and whether the difference between the contracted-for and substitute performances can be measured and compensated. A prospective employee who cannot find substitute work within her field need not mitigate by taking a job in a wholly different one. An advertising salesperson whose employment is repudiated need not mitigate by taking a job as a taxi driver. When the only difference between the original and the substitute performances is price, the non-breaching party must mitigate, even if the substitute performer is the original promisor.

The non-breaching party must mitigate in a timely fashion, but each case is different. If it is clear that the promisor has unconditionally repudiated before performance is due, the non-breaching party must begin to mitigate as soon as practicable and should not wait until the day performance is due to look for an alternative.

As long as the non-breaching party makes a reasonable effort to mitigate, the success of that effort is not an issue in assessing damages. If a film producer's original cameraman breaches the contract, and if the producer had diligently searched for a substitute cameraman, who costs $150 extra per week and it later came to light that the producer could have hired a cameraman for $100, the company is entitled nevertheless to damages based on the higher figure.

CASE 14.4

Shirley MacLaine Parker v. Twentieth Century-Fox Film Corporation, 474 P.2d 689 (Cal. 1970)

BURKE, J.

Defendant Twentieth Century-Fox Film Corporation appeals from a summary judgment granting to plaintiff the recovery of agreed compensation under a written contract for her services as an actress in a motion picture. As will appear, we have concluded that the trial court correctly ruled in plaintiff's favor and that the judgment should be affirmed.

Plaintiff is well known as an actress.…Under the contract, dated August 6, 1965, plaintiff was to play the female lead in defendant's contemplated production of a motion picture entitled "Bloomer Girl." The

contract provided that defendant would pay plaintiff a minimum "guaranteed compensation" of $53,571.42 per week for 14 weeks commencing May 23, 1966, for a total of $750,000 [about $7,072,000 in 2024 dollars]. Prior to May 1966 defendant decided not to produce the picture and by a letter dated April 4, 1966, it notified plaintiff of that decision and that it would not "comply with our obligations to you under" the written contract.

By the same letter and with the professed purpose "to avoid any damage to you," defendant instead offered to employ plaintiff as the leading actress in another film tentatively entitled "Big Country, Big Man" (hereinafter, "Big Country"). The compensation offered was identical, as were 31 of the 34 numbered provisions or articles of the original contract. Unlike "Bloomer Girl," however, which was to have been a musical production, "Big Country" was a dramatic "western type" movie. "Bloomer Girl" was to have been filmed in California; "Big Country" was to be produced in Australia. Also, certain terms in the proffered contract varied from those of the original. Plaintiff was given one week within which to accept; she did not and the offer lapsed. Plaintiff then commenced this action seeking recovery of the agreed guaranteed compensation.

The complaint sets forth two causes of action. The first is for money due under the contract; the second, based upon the same allegations as the first, is for damages resulting from defendant's breach of contract. Defendant in its answer admits the existence and validity of the contract, that plaintiff complied with all the conditions, covenants and promises and stood ready to complete the performance, and that defendant breached and "anticipatorily repudiated" the contract. It denies, however, that any money is due to plaintiff either under the contract or as a result of its breach, and pleads as an affirmative defense to both causes of action plaintiff's allegedly deliberate failure to mitigate damages, asserting that she unreasonably refused to accept its offer of the leading role in "Big Country."

Plaintiff moved for summary judgment…[T]he motion was granted…for $750,000 plus interest…in plaintiff's favor. This appeal by defendant followed.…

The general rule is that the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment. [Citation] However, before projected earnings from other employment opportunities not sought or accepted by the discharged employee can be applied in mitigation, the employer must show that the other employment was comparable, or substantially similar, to that of which the employee has been deprived; the employee's rejection of or failure to seek other available employment of a different or inferior kind may not be resorted to in order to mitigate damages. [Citations]

In the present case defendant has raised no issue of reasonableness of efforts by plaintiff to obtain other employment; the sole issue is whether plaintiff's refusal of defendant's substitute offer of "Big Country" may be used in mitigation. Nor, if the "Big Country" offer was of employment different or inferior when compared with the original "Bloomer Girl" employment, is there an issue as to whether or not plaintiff acted reasonably in refusing the substitute offer. Despite defendant's arguments to the contrary, no case cited or which our research has discovered holds or suggests that reasonableness is an element of a wrongfully discharged employee's option to reject, or fail to seek, different or inferior employment lest the possible earnings therefrom be charged against him in mitigation of damages.

Applying the foregoing rules to the record in the present case, with all intendments in favor of the party opposing the summary judgment motion—here, defendant—it is clear that the trial court correctly ruled that plaintiff's failure to accept defendant's tendered substitute employment could not be applied in

mitigation of damages because the offer of the "Big Country" lead was of employment both different and inferior, and that no factual dispute was presented on that issue. The mere circumstance that "Bloomer Girl" was to be a musical review calling upon plaintiff's talents as a dancer as well as an actress, and was to be produced in the City of Los Angeles, whereas "Big Country" was a straight dramatic role in a "Western Type" story taking place in an opal mine in Australia, demonstrates the difference in kind between the two employments; the female lead as a dramatic actress in a western style motion picture can by no stretch of imagination be considered the equivalent of or substantially similar to the lead in a song-and-dance production.

Additionally, the substitute "Big Country" offer proposed to eliminate or impair the director and screenplay approvals accorded to plaintiff under the original "Bloomer Girl" contract, and thus constituted an offer of inferior employment. No expertise or judicial notice is required in order to hold that the deprivation or infringement of an employee's rights held under an original employment contract converts the available "other employment" relied upon by the employer to mitigate damages, into inferior employment which the employee need not seek or accept. [Citation]

In view of the determination that defendant failed to present any facts showing the existence of a factual issue with respect to its sole defense—plaintiff's rejection of its substitute employment offer in mitigation of damages—we need not consider plaintiff's further contention that for various reasons, including the provisions of the original contract set forth in footnote 1, Ante, plaintiff was excused from attempting to mitigate damages.

The judgment is affirmed.

Case questions

1. Why did Ms. MacLaine refuse to accept the employment opportunity offered by the defendant?
2. Why did the defendant think it should not be liable for any damages as a result of its admitted breach of the original contract?
3. Who has the burden of proof on mitigation issues—who has to show that no mitigation occurred?
4. Express the controlling rule of law out of this case.

CERTAINTY OF DAMAGES

A party can recover only that amount of damages in law which can be proved with reasonable certainty. Some damages are more difficult to prove than others – such as lost profits and loss of goodwill. For example, Alf is convinced that next spring the American public will be receptive to polka-dotted belts with his name monogrammed in front. He arranges for a garment factory to produce 300,000 such belts, but the factory, which takes a large deposit from him in advance, misplaces the order and does not produce the belts in time for the selling season. When Alf discovers the failure, he cannot raise more money to go elsewhere, and his project fails. He cannot recover

damages for lost profits because that number is entirely speculative; no one can prove how much he would have made, if anything, because no one would be able to say how much he would have sold without a track record. He can, instead, seek restitution of the monies advanced. If he had rented a warehouse to store the belts, he would also be able to recover his reliance interest.

Proof of lost profits is not always difficult: a seller can generally demonstrate the profit he would have made on the sale to the buyer who has breached. It becomes more difficult, as Alf's case demonstrates, when the seller has breached the contract. A buyer who contracts for but does not receive raw materials, supplies, and inventory cannot show definitively how much he would have netted from the use he planned to make of them. But he is permitted to prove how much money he has made in the past under similar circumstances, and he may proffer financial and market data, surveys, and expert testimony to support his claim. When proof of profits is difficult or impossible, the courts may grant a nonmonetary award, such as specific performance.

LOSS OF POWER OF AVOIDANCE

You will recall that there are several circumstances under which a person may avoid a contract: duress, undue influence, misrepresentation (fraudulent, negligent, or innocent), or mistake. But a party may lose the right to avoid, and thus the right to any remedy, in several other ways, as well.

DELAY

If a party is the victim of fraud, she must act promptly to rescind at common law, or she will lose that right and her remedy will be limited to damages in tort.

AFFIRMATION

An **infant** who waits too long to **disaffirm** (again, delay) will have **ratified** the contract, as will one who—notwithstanding being the victim of duress, undue influence, mistake, or any other grounds for avoidance—continues to operate under the contract with full knowledge of his right to avoid. Of course the disability that gave rise to the power of avoidance must have passed before affirmation works.

RIGHTS OF THIRD PARTIES

The intervening rights of third parties may terminate the power to avoid. For example, Michelle, a minor, sells her watch to Betty Buyer. Up to and within a reasonable time after reaching majority, Michelle could avoid—disaffirm—the contract. But if, before that time, Betty sells the watch to a third party, Michelle cannot get it back from the third party. Similarly, Salvador Seller sells his car to Bill Buyer, who pays for it with a bad check. If the check bounces, Salvador can rescind the deal—Bill's consideration (the money represented by the check) has failed: Salvador could return the check and get his car back. But if, before the check from Bill bounces, Bill in turn sells the car to Pat Purchaser, Salvador cannot avoid the contract. Pat gets to keep the car. There are, however, some exceptions to this rule.

AGREEMENT OF THE PARTIES LIMITING REMEDIES

Certainly it is the general rule that parties are free to enter into any kind of a contract they want, so

long as it is not illegal or unconscionable. The inclusion into the contract of a **liquidated damages** clause—mentioned previously—is one means by which the parties may make an agreement affecting damages. But beyond that it is very common for one side to limit its liability, or for one side to agree that it will pursue only limited remedies against the other in case of breach. Such agreed-to limitations on the availability of remedies are generally acceptable provided they are conspicuous, bargained-for, and not unconscionable. In consumer transactions, courts are more likely to find a contracted-for limitation of remedies unconscionable than in commercial transactions, and under the **Uniform Commercial Code (UCC)** there are further restrictions on contractual remedy limitations.

For example, Juan buys ten bags of concrete to make a counter and stand for his expensive new barbecue. The bags have this wording in big print: "Attention. Our sole liability in case this product is defective will be to provide you with a like quantity of nondefective material. We will not be liable for any other damages, direct or indirect, express or implied." Such a limitation on liability is acceptable. If the concrete is defective, the concrete top breaks, and Juan's new barbecue is damaged, he will get nothing but some new bags of good concrete. He could have shopped around to find somebody who would deliver concrete with no limitation on liability. As it is, his remedies are limited by the agreement he entered into.

Election of Remedies

At Common Law

Another limitation on remedies—at common law—is the concept of **election of remedies**. The nature of a loss resulting from a contract breach may be such as to entitle one party to a choice among two or more means to redress the grievance, where the choices are mutually exclusive.

At classic common law, a person who was defrauded had an election of remedies: she could, immediately upon discovering the fraud, rescind, or she could retain the item (real estate or personal property) and attempt to remedy the fraudulently defective performance by suing for damages, but not both. Buyer purchases real estate from Seller for $300,000 and shortly discovers that Seller fraudulently misrepresented the availability of water. Buyer spends $60,000 trying to drill wells. Finally he gives up and sues Seller for fraud, seeking $360,000. Traditionally at common law, he would not get it. He should have rescinded upon discovery of the fraud. Now he can only get $60,000 in damages in tort. The purpose of the election of remedies doctrine is to prevent the victim of fraud from getting a double recovery, but it has come under increasing criticism. Here is one court's observation: "A host of commentators support elimination of the election of remedies doctrine. A common theme is that the doctrine substitutes labels and formalism for inquiry into whether double recovery results in fact. The rigid doctrine goes to the other extreme, actually resulting in the under compensation of fraud victims and the protection of undeserving wrongdoers."

Some states have eliminated the requirement that an aggrieved party make an election of contract remedies, allowing a party to an action to pursue multiple remedies for breach.

Under the UCC

The doctrine of **election of remedy** has been rejected by the UCC, which means that the remedies are cumulative in nature. According to Section 2-703(1): "Whether the pursuit of one remedy bars

another depends entirely on the facts of the individual case." UCC, Section 2-721, provides that neither demand for rescission of the contract in the case of misrepresentation or fraud, nor the return or rejection of goods, bars a claim for damages or any other remedy permitted under the UCC for nonfraudulent breach.

ACTIVITY 14D

You Be the Judge

The TV show "Shark Tank" is popular among students studying business. On this show, budding entrepreneurs pitch their business ideas to a panel of wealthy investors, hoping to secure a deal that could potentially transform their dreams into reality. The negotiations take place on reality TV, but the investments are real, and costly. What happens after the cameras stop rolling?

Consider the following scenario: An entrepreneur successfully secures a verbal agreement with a Shark on the show. The terms of the deal include a significant investment in exchange for a specified percentage of equity in the entrepreneur's business. Both parties express their intention to move forward with the deal. A little celebration and a handshake occur between Shark and Entreprenuer. However, post-show, the investor backs out, for any number of reasons, during a period of due duligence before handing over the promised investment. Another possible outcome is that the deal closes but is changed from the verbal agreement that is seen on TV.

Does the televised negotiation that is the verbal agreement made on Shark Tank constitute a legally binding contract? If it isn't a contract, then what is it?

Is an investor's decision to back out of a deal after the show considered a breach of contract? Why or why not?

Explore potential legal remedies available to the entrepreneur if the investor's actions are indeed deemed a breach of contract. Are there any circumstances under which an Entrepreneur's decision to back out of a deal would cause damages for an investor? If so, what types of damages are more likely?

TORT VERSUS CONTRACT

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

- **Statute of limitations**. Most statutes of limitations prescribe longer periods for contract than for tort actions.
- Allowable damages. **Punitive damages** are more often permitted in tort actions, and certain kinds of injuries are compensable in tort but not in contract suits—for example, pain and suffering.
- Expert testimony. In most cases, the use of experts would be the same in either tort or

contract suits, but in certain contract cases, the expert witness could be dispensed with as, for example, in a contract case charging that the physician abandoned the patient.

- Insurance coverage. Most policies do not cover intentional torts, so a contract theory that avoids the element of willfulness would provide the plaintiff with a surer chance of recovering monetary damages.

LEGAL VERSUS EXTRALEGAL REMEDIES

A party entitled to a legal remedy is not required to pursue it. Lawsuits are disruptive not merely to the individuals involved in the dispute but also to the ongoing relationships that may have formed around the parties, especially if they are corporations or other business enterprises. Buyers must usually continue to rely on their suppliers, and sellers on their buyers. Not surprisingly, therefore, many businesspeople refuse to file suits even though they could, preferring to settle their disputes privately or even to ignore claims that they might easily press. Indeed, the decision whether or not to sue is not one for the lawyer but for the client, who must analyze a number of pros and cons, many of them not legal ones at all.

End of Chapter Exercises

1. Owner of an auto repair shop hires Contractor to remodel his shop but does not mention that two days after the scheduled completion date, Owner is to receive five small U.S. Army personnel carrier trucks for service, with a three-week deadline to finish the job and turn the trucks over to the Army. The contract between Owner and Army has a liquidated damages clause calling for $300 a day for every day trucks are not operable after the deadline. Contractor is five days late in finishing the remodel. Can Owner claim the $1,500 as damages against Contractor as a consequence of the latter's tardy completion of the contract? Explain.
2. Inventor develops an electronic billiard table that looks like a regular billiard table, but when balls drop into the pocket, various electronic lights and scorekeeping devices activate. Inventor contracted with Contractor to manufacture ten prototypes and paid him $50,000 in advance, on a total owed of $100,000 ($10,000 for each completed table). After the tables were built to accommodate electronic fittings, Inventor repudiated the contract. Contractor broke the ten tables up, salvaged $1,000 of wood for other billiard tables, and used the rest for firewood. The ten intact tables, without electronics, could have been sold for $500 each ($5,000 total). Contractor then sued Inventor for the profit Contractor would have made had Inventor not breached. To what, if anything, is Contractor entitled by way of damages and why?
3. Calvin, a promising young basketball and baseball player, signed a multiyear contract with a professional basketball team after graduating from college. After playing basketball for one year, he decided he would rather play baseball and breached his contract with the basketball team. What remedy could the team seek?
4. Theresa leased a one-bedroom apartment from Landlady for one year at $500 per month. After three months, she vacated the apartment. A family of five wanted to rent the apartment, but Landlady refused. Three months later—six months into what would have been Theresa's term—Landlady managed to rent the apartment to Tenant for $400 per month. How much does

Theresa owe, and why?

5. Plaintiff, a grocery store, contracted with Defendant, a burglar alarm company, for Defendant to send guards to Plaintiff's premises and to notify the local police if the alarm was activated. The contract had this language: "It is agreed that the Contractor is not an insurer, that the payments here are based solely on the value of the service in the maintenance of the system described, that it is impracticable and extremely difficult to fix the actual damages, if any, which may proximately result from a failure to perform its services, and in case of failure to perform such services and a resulting loss, its liability shall be limited to $500 as liquidated damages, and not as a penalty, and this liability shall be exclusive." A burglary took place and the alarm was activated, but Defendant failed to respond promptly. The burglars left with $330,000. Is the liquidated damages clause—the limitation on Plaintiff's right to recover—valid?
6. The decedent, father of the infant Plaintiff, was killed in a train accident. Testimony showed he was a good and reliable man. Through a representative, the decedent's surviving child, age five, recovered judgment against the railroad (Defendant). Defendant objected to expert testimony that inflation would probably continue at a minimum annual rate of 5 percent for the next thirteen years (until the boy attained his majority), which was used to calculate the loss in support money caused by the father's death. The calculations, Defendant said, were unreasonably speculative and uncertain, and damages must be proven with reasonable certainty. Is the testimony valid?
7. Plaintiff produced and directed a movie for Defendant, but contrary to their agreement, Plaintiff was not given screen credit in the edited film (his name was not shown). The film was screened successfully for nearly four years. Plaintiff then sued (1) for damages for loss of valuable publicity or advertising because his screen credits were omitted for the four years and (2) for an injunction against future injuries. The jury awarded Plaintiff $25,000 on the first count. On the second count, the court held Plaintiff should be able to "modify the prints in his personal possession to include his credits." But Plaintiff appealed, claiming that Defendant still had many unmodified prints in its possession and that showing those films would cause future damages. What remedy is available to Plaintiff?
8. In 1929 Kerr Steamship Company, Inc. (Plaintiff), delivered to Defendant, the Radio Corporation of America (RCA), a fairly long telegram—in code—to be transmitted to Manila, Philippine Islands, with instructions about loading one of Kerr's ships. By mistake, the telegraph was mislaid and not delivered. As a result of the failure to transmit it, the cargo was not loaded and the freight was lost in an amount of $6,675.29 [about $120,000 in 2024 dollars], profit that would have been earned if the message had been sent. Plaintiff said that because the telegram was long and because the sender was a ship company, RCA personnel should have known it was important information dealing with shipping and therefore RCA should be liable for the consequential damages flowing from the failure to send it. Is RCA liable?
9. Defendant offered to buy a house from Plaintiff. She represented, verbally and in writing, that she had $15,000 to $20,000 of equity in another house and would pay this amount to Plaintiff after selling it. She knew, however, that she had no such equity. Relying on these intentionally fraudulent representations, Plaintiff accepted Defendant's offer to buy, and the parties entered into a land contract. After taking occupancy, Defendant failed to make any of the contract payments. Plaintiff's investigation then revealed the fraud. Based on the fraud, Plaintiff sought rescission, ejectment, and recovery for five months of lost use of the property and out-of-pocket expenses. Defendant claimed that under the election of remedies doctrine, Plaintiff

seller could not both rescind the contract and get damages for its breach. How should the court rule?

10. Buyers contracted to purchase a house being constructed by Contractor. The contract contained this clause: "Contractor shall pay to the owners or deduct from the total contract price $100.00 per day as liquidated damages for each day after said date that the construction is not completed and accepted by the Owners and Owners shall not arbitrarily withhold acceptance." Testimony established the rental value of the home at $400–$415 per month. Is the clause enforceable?
11. Buyer contracts to buy a 1941 four-door Cadillac convertible from Seller for $75,000. Seller, having found a Third Party who will pay $85,000 for the car, refuses to sell to Buyer. What is Buyer's remedy?
12. Assume Third Party had paid the $85,000 and Seller was ordered to sell to Buyer. What is Third Party's remedy?
13. Professor Smith contracts to teach business law at State University for the academic year. After the first term is over, she quits. Can State University get an order of specific performance or an injunction requiring Professor Smith to return for the second term?
14. Now suppose that the reason Professor Smith quit work at State University is because she got a better job at Central University, fifteen miles away. Can State University get an injunction prohibiting her from teaching at Central University?
15. A chef who has never owned her own restaurant sues a contractor who failed to finish building the chef's first restaurant on time. She presents evidence of the profits made by similar restaurants that have been in business for some time. Is this good evidence of the damages she has suffered by the delay? To what damages is she entitled?
16. Rebecca, seventeen years and ten months old, buys a party dress for $300. She wears it to the junior prom but determines it doesn't look good on her. She puts it in her closet and forgets about it until six months later, when she decides to return it to the store. Is she now entitled to the remedy of rescission?

REFERENCES

Canal, E. (2022, October 12). We fact-checked seven seasons of Shark Tank Deals. here are the results. Forbes. https://www.forbes.com/sites/emilycanal/2016/10/21/about-72-of-deals-that-happen-on-shark-tank-dont-turn-out-as-seen-on-tv/?sh=4cab7f334ed1

Hadley v. Baxendale (1854), 9 Ex. 341, 354, 156 Eng.Rep. 145, 151.

Head & Seemann, Inc. v. Gregg, 311 N.W.2d 667 (Wis. App. 1981).

Merritt v. Craig, 746 A.2d 923 (Md. 2000).

Restatement (Second) of Contracts, Section 350.

Restatement (Second) of Contracts, Section 373.

GLOSSARY

absolute privilege
a privilege that exempts a person from liability especially for defamation regardless of intent or motive

abuse of process
the use of legal process by illegal, malicious, or perverted means

acceptance
agreeing verbally or in writing to the terms of a contract, which is one of the requirements to show there was a contract

accord and satisfaction
an agreement to accept less than is legally due in order to wrap up the matter

actual cause
cause in fact

adequacy of consideration
the condition that consideration is fair and reasonable under the circumstances of the agreement

affirmative defenses
statements in a response to a civil lawsuit which excuse or justify the behavior on which the lawsuit is based.

agreement
a meeting of the minds; an agreement is made when two people reach an understanding about a particular issue, including their obligations, duties, and rights

agreement in principle
an outline of terms for a contract, often incomplete and a precursor to a more complete contract

alternative dispute resolution (ADR)
a catchall term that describes a variety of methods that parties can use to resolve disputes outside of court, including negotiation, conciliation, mediation, collaborative practice, and the many types of arbitration

answer
a defendant's written response to a plaintiff's initial court filing (called a complaint or petition)

anticipatory breach
when one party to a contract clearly and unequivocally communicates to the other party that they

do not intend to fulfill their contractual obligations before the performance is due; anticipatory repudiation

anticipatory repudiation
when one party to a contract clearly and unequivocally communicates to the other party that they do not intend to fulfill their contractual obligations before the performance is due; anticipatory breach

Appellate Division of the Superior Court
an intermediate appellate court that receives appeals from trial courts, tax courts and administrative agencies

appellate jurisdiction
the power of a court to review and revise a lower court's decision

arbitration
an out-of-court procedure for resolving disputes in which one or more people -- the arbitrator(s) -- hear evidence and make a decision

arbitrator
individual, often an expert in the law and subject matter at issue, who presides over arbitration proceedings

assault
(1) the threat of immediate harm or offense of contact or (2) any act that would arouse reasonable apprehension of imminent harm

assignee
a person to whom a property right is transferred

assignment
the transfer of rights under a contract from one party to another party

assignor
the party who transfers their rights to another

assumption of risk
(1) a legal defense that a defendant can use in a negligence lawsuit if it can be shown that plaintiff voluntarily and knowingly accepted the risks associated with a certain activity or situation, and therefore, the defendant should not be held liable for any resulting injuries or harm; (2) the act of contracting to take over a risk

avoid
to take action to void a voidable contract

award
1) The written decision of an arbitrator or commissioner (or any nonjudicial arbiter) setting out

the arbitrator's award. 2) The amount awarded in a money judgment to a party to a lawsuit, arbitration, or administrative claim

bankruptcy
A federal legal process for debtors seeking to eliminate or repay their debts

bargained-for exchange
a benefit or detriment that the parties to a contract agree to as the price of performance in return for a promise

battery
unauthorized and harmful or offensive physical contact with another person that causes injury

bid (at auction)
an offer to pay or charge a specific price, under set terms, for an item or service

bilateral contract
a contract in which both parties exchange promises to perform

black letter laws
in common law legal systems, refers to well-established legal rules that are no longer subject to reasonable dispute

Blue laws
statutes or ordinances that forbid or regulate an activity, such as the sale of liquor on Sundays.

breach
a failure or violation of a legal obligation -- for example, a failure to perform a contract (breaching its terms)

business law
the body of rules, whether by convention, agreement, or national or international legislation, governing the dealings between persons in commercial matters

business to consumer (B2C)
a transaction that takes place between a business and an individual as the end customer

business to employee (B2E)
a transaction between a business and its employee

business-to-business (B2B)
a sector of business activity that focuses on commerce performed between businesses

capacity
legal ability of an individual or entity to enter into a binding contract and be held legally responsible for their actions and obligations under that contract

capital offense
a criminal charge that is punishable by the death penalty

case law
the law based on judicial opinions (including decisions that interpret statutes), as opposed to law based on statutes, regulations, or other sources

case of first impression
a court case that presents a new question or issue for legal interpretation (or at least new within that court's jurisdiction)

causation
establishing a direct link between the defendant's breach of duty and the harm suffered by the plaintiff

cause of action
a specific legal claim for which a plaintiff seeks compensation

civil
noncriminal

civil law
a generic term for all non-criminal law, usually relating to settling disputes between private citizens

civil-law system
a system of laws that is based on legal code

class action
a lawsuit in which a large number of people with similar legal claims join together in a group (the class) to sue someone, usually a company or organization

closing argument
the final argument by an attorney on behalf of the client after all evidence has been produced for both sides

common law
the body of law derived from judicial decisions rather than from statutes or constitutions

comparative negligence
a personal injury law rule that lets an injured person recover damages (money) in court, even if their own negligence played a part in causing the underlying accident

compensate
receive payment for damages suffered

compensatory damages
money awarded to compensate plaintiffs for harm they've suffered

complaint
: the first document filed with the court (actually with the County Clerk or Clerk of the Court) by a person or entity claiming legal rights against another

concealment
: the act of deliberately hiding material information during the negotiation or formation of a contract

concurrent condition
: a situation in which one party must fulfill a condition at the same time that the other party fulfills a mutual condition

concurrent jurisdiction
: jurisdiction that is shared by different courts and that may allow for removal

condition
: an event the happening or nonhappening of which gives rise to a duty to perform (or discharges a duty to perform)

condition precedent
: a term in a contract (express or implied) that requires performance only in the event something else happens first

condition subsequent
: a condition that terminates an already existing duty of performance

consequential damages
: damage or injury that does not directly and immediately result from a wrongful act, but is a consequence of the initial act

consideration
: a benefit that is of value to both parties, which must be bargained for between the parties and is the essential reason for a party entering into a contract

contingent fee
: a fee to a lawyer which will be due and payable only if there is a successful conclusion of the legal work, usually winning or settling a lawsuit in favor of the client (particularly in negligence cases), or collecting funds due with or without filing a lawsuit

contract
: an agreement that the law will hold the parties to

contract under seal
: a contract that does not require consideration in order to be binding but that must be sealed, delivered, and show a clear intention of the parties to create a contract under seal

contractual capacity
the legal ability of an individual or entity to enter into a binding contract and be held legally responsible for their actions and obligations under that contract

contributory negligence
a common law rule that prevents a personal injury plaintiff from recovering damages (money) in court if the plaintiff bears any amount of blame for the underlying accident

counteroffer
a response made by the offeree to the offeror that proposes different terms or conditions than those contained in the original offer

court-ordered arbitration
mandatory referral of a certain class of civil suits to an arbitration hearing

courts of appeal
any court (state or federal) which hears appeals from judgments and rulings of trial courts or lower appeals courts

covenant not to sue
a promise to refrain from suing someone in return for the settlement of a legal dispute

creditor beneficiary
one to whom the promisor agrees to pay a debt of the promisee

criminal case
a lawsuit brought by a prosecutor employed by the federal, state, or local government that charges a person with the commission of a crime

criminal law
laws written by Congress and state legislators that make certain behavior illegal and punishable by fines and/or imprisonment

critical legal studies (CLS) school of thought
a school of thought advancing the idea that the legal system perpetuates the status quo in terms of economics, race, and gender by using manipulable concepts and by creating an imaginary world of social harmony regulated by law

cross-examination
the opportunity for the attorney (or an unrepresented party) to ask questions in court of a witness who has testified in a trial on behalf of the opposing party

damages
1) the money awarded to one party because of an injury or loss caused by another party; and 2) the harm an injured party suffers because of another party's wrongful conduct

de minimis non curat lex
the law does not govern trifles; law ignores insignificant details

defamation
making a false statement that causes injury to a person's good name or reputation

defamed
one about whom untrue statements have been made which damages his reputation

defendant
the person or entity against whom a criminal or civil case is filed

delegatee
one to whom the duty to perform under a contract is transferred

delegation
the transfer to a third party of the duty to perform under a contract

delegator
the party who delegates the duty to perform under the contract to a third party

depositions
oral testimony given under oath outside of court, typically recorded by a court reporter

direct examination
initial questioning of witness by the party calling them to the stand

directed verdict
a ruling by a judge, typically made after the plaintiff has presented all of its evidence but before the defendant puts on its case, that awards judgment to the defendant

disaffirm
to repudiate or reject a contract that has been previously entered into

discovery
a formal investigation—governed by court rules—conducted before trial by all parties to a lawsuit to find evidence that can be used to present claims or defenses at trial, to find out what evidence other parties will use at trial, and to support its position during settlement negotiations

dispute
the assertion of conflicting claims or rights between parties involved in a legal proceeding, such as a lawsuit, mediation, or arbitration

district courts
a trial court for federal cases in a court district, which is all or a portion of a state

diversity of citizenship jurisdiction
the authority of federal courts to hear cases between parties from different states if the amount in controversy exceeds a certain threshold

donee beneficiary
a direct beneficiary whom the party paying for the other party's performance intends to benefit as a gift or donation

duress
The use of force, false imprisonment, coercion, threats, or psychological pressure to compel someone to act contrary to his or her wishes or interests

duty
a legal relationship, created by law or contract, in which a person or business owes something to another

duty of care
a duty to use due care toward others in order to protect them from unnecessary risk of harm

ecofeminist school of legal thought
a belief that domination of men over both women and the rest of the natural world is the root of legal exploitation of women and the degradation of the natural environment

Eighth Amendment
"Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted."

election of remedies
the principle that allows a party who has been wronged in a contract to choose among different available legal remedies or courses of action to address the breach

en banc
French for "on the bench," used to indicate that all of the judges on an appeals court panel are participating in a case

enabling act
a law that permits what was previously prohibited or that creates new powers; enabling statute

enjoin
a court orders that someone either do a specific act, cease a course of conduct or be prohibited from committing a certain act; such an order is called an injunction

equitable remedies
ways to make a party whole, for example through specific performance, injunctions, or restitution

estoppel
a bar or obstruction which precludes a person from asserting a right or prevents one from denying a fact

exclusive jurisdiction
jurisdiction granted only to a particular court to the exclusion of others

exculpatory clause
a contract clause that exempts one party from tort liability to the other for harm caused intentionally or recklessly

executed contract
a contract in which all parties involved have fully performed and completed their obligations

execution
the act of finishing, carrying out, or performing as required, as in fulfilling one's obligations under a contract, plan, or court order

executive order
a declaration by the president or a governor which has the force of law, usually based on existing statutory powers, and requiring no action by the Congress or state legislature

executory contract
a contract in which one or more parties have not yet fulfilled their obligations or duties

exemplary damages
damages awarded over and above special and general damages to punish a losing party's willful or malicious misconduct; sometimes called punitive damages

expectation interest
the interest of a party to a breached contract in receiving the benefit of the bargain by being put in a position as good as that which would have resulted had the contract been performed

express contract
a contract in which the terms and conditions are explicitly stated, either orally or in writing, with the intent of both parties to enter a contract

express ratification
when a party explicitly confirms or approves the previously voidable contract

false imprisonment
the wrongful, intentional restraint of another person without the legal right to do so

fault
responsibility for wrongdoing or failure

Federal Arbitration Act (FAA)
a federal statute under which parties are required to participate in arbitration when they have agreed by contract to do so, even in state court matters

federal question jurisdiction
the authority of federal district courts to hear lawsuits based on subjects enumerated in the U.S. Constitution or when a federal statute is involved

flat rate fee
: a single, fixed rate for a particular service or package of services

for cause challenge
: a party's request that the judge dismiss a potential juror from serving on a jury by providing a valid legal reason why he shouldn't serve

forbearance
: voluntarily refraining from doing something, such as asserting a legal right

force majeure
: a contract provision that excuses performance if it is rendered impractical by a supervening event (sometimes known as an Act of God); French for "a greater force"

foreseeability
: the ability to reasonably anticipate the potential results of an action, such as the damage or injury that may happen if one is negligent or breaches a contract

foreseeable
: being such as may be reasonably anticipated

formal contract
: a contract that requires a specific form or format to be legally valid and enforceable

forum
: refers to the court in which a lawsuit is filed or in which a hearing or trial is conducted

fraudulent misrepresentation
: a false statement or assertion of a material fact, made with the intent to deceive the other party, and induce the other party to enter into a contract

frustration of purpose
: when unexpected events arise which make a contract impossible to be performed, entitling the frustrated party to rescind the contract without paying damages

full faith and credit
: a rule found in Article IV, sec. 1 of the U.S. Constitution that requires courts and agencies in one state to recognize, respect, and enforce legal judgments and other actions from other states

full performance
: when one party fulfills all of its obligations under the contract in the exact manner specified and without any deviation; complete performance

gambling contract
: an agreement between two or more parties to wager or bet on the outcome of a future event or contest over which the bettors have no control and which typically involves chance

general jurisdiction
the authority to hear and decide a wide variety of cases, both civil and criminal, without being limited to specific subject matters or certain types of legal disputes

guarantor
a person or entity who promises to perform upon the default of another; surety

guardian
a person who has been appointed by a judge to take care of a minor child or incompetent adult (both called "ward") personally and/or manage that person's affairs

harm
physical or mental damage

hazardous activities
inherently dangerous actions that have the potential to cause significant harm or damage

historical school of thought
believes that societies should base their legal decisions of today on the examples of the past

holding
any ruling or decision of a court

hourly rate
a pricing structure by which attorneys charge an amount based on time spent on a case

illegality
the state of not being legally authorized

illusory promise
a statement that appears to be a promise but, in reality, does not actually impose any obligation on the person making the statement and therefore lacks legal sufficiency

implied in law contract
quasi contract

implied ratification
when a party behaves in a manner consistent with accepting a contract or in a manner inconsistent with disaffirming the contract

implied-in-fact
a contract in which the agreement is not explicitly stated in words but is inferred from the conduct and actions of the parties involved

impossibility
when an act cannot be performed due to physical impediments, nature, or unforeseen events which is a legitimate basis to rescind a contract

impracticability
: incapable of being performed or accomplished by the means employed or at command; not practicable

in pari delicto
: Latin for "in equal fault," which means that two (or more) people are all at fault or are all guilty of a crime

in personam jurisdiction
: the jurisdiction granted a court over persons before it that allows the court to issue a binding judgment

in rem jurisdiction
: a court's authority to make decisions and rulings concerning a specific property or asset, rather than over a particular individual

incidental beneficiary
: a third-party beneficiary to a contract whom the parties to the contract did not intend to benefit

incidental damages
: the direct and immediate costs incurred as a result of a breach of contract

incompetency
: the condition of lacking the ability to handle one's affairs due to mental or physical incapacity

infant
: A person under the age of 18

informal contract
: any contract that is not a formal contract

injunctions
: a writ (order) issued by a court ordering someone to do something or prohibiting some act after a court hearing

innocent misrepresentation
: a false statement that is made without any knowledge that it is false

integrated contract
: one or more writings constituting a final expression of one or more terms of an agreement

integration clause
: a provision in a contract stating that the contract represents the full and final agreement of the parties and supersedes any other agreements, oral or written, on the same subject

intended third-party beneficiary
: a party that was considered at the time the contract was made, and is part of the purpose for the contract in the first place

intentional infliction of emotional distress (IIED)
a legal claim that allows individuals to seek compensation for severe emotional distress or mental anguish caused by the intentional and outrageous conduct of another party

intentional interference with contractual relations
a third party intentionally takes actions to disrupt or interfere with an existing contractual relationship between two parties

intentional torts
a deliberate act that causes harm to another, and for which the injured person may sue the wrongdoer for damages

interest in land
the pleasure, comfort and advantage that a person may derive from the occupancy of land

international law
while there is no one, specific body of international law, the term is taken to mean the collection of treaties, customs, and multilateral agreements governing the interaction of nations and multinational businesses or nongovernmental organizations

interrogatories
written questions that one party sends to the other which the recipient is required to answer under oath

invasion of privacy
violating an individual's right to keep certain aspects of their personal life private

irrevocable
not possible to revoke

judge-made law
a law that is made by judicial decision

judicial decision
a determination made by a court

jurisdiction
the authority given by law to a court to try cases and rule on legal matters within a particular geographic area and/or over certain types of legal cases

law
a body of rules of action or conduct prescribed by a controlling authority, and having binding legal force

legal positivism
the theory that legal rules are valid only because they are enacted by an existing political authority or accepted as binding in a given society (not because they are grounded in morality or in natural law)

legal realist

belief that the social context of law is important because life and society are constantly changing and certain laws and doctrines have to be altered or modernized to remain current

legal remedies

damages to compensate the non-breaching party for any losses suffered as a result of the breach

legal sufficiency

the identification of the legal detriments in a contract - an action, forbearance, or a promise of such from the promisee

legal value

benefit, profit or gain received from an agreement

legality

strict adherence to law; the quality of being legal

letter of credit

a letter addressed by a banker to a correspondent certifying that a person named therein is entitled to draw on the writer's credit up to a certain sum

liability

the state of being legally responsible for something

libel

make an untruthful statement about a person, published in writing or through broadcast media, that injures the person's reputation or standing in the community

limited competency

a determination by a court that a person has the capacity to manage some but not all of his activities

limited jurisdiction

when a particular court has a narrowly defined authority over certain types of cases, such as bankruptcy, claims against the government, probate, family matters, or immigration

liquidated damages

an amount of money agreed upon by both parties that a party who breaches the contract will pay to the other party

long arm statute

a statute allowing a state to exercise personal jurisdiction over a non-resident defendant who has certain contacts with the state

mailbox rule

a rule by which an acceptance is effective and binding on the parties at the moment it is sent or deposited in a mailbox

majority rule of law
: more than half the states follow this law

malicious prosecution
: a tort causing someone to be prosecuted for a criminal act, knowing that there was no probable cause to believe that the plaintiff committed the crime

material
: relevant and significant

material breach
: a significant failure to fulfill the terms of a contract that goes to the root or essence of the agreement

mediation
: a process that involves opposing parties in a dispute meeting with a neutral third party (called the "mediator") who helps them negotiate a resolution outside of court

mediation-arbitration
: a mediation followed by an arbitration when the mediation does not produce a satisfactory outcome

mediator
: a person who conducts mediations as a neutral third party to work with parties in dispute and try to reach a resolution

mental incapacity
: an inability through mental illness or significant cognitive impairment to carry on the everyday affairs of life or to care for one's person or property with reasonable discretion

merger clause
: a clause in a contract stating that the contract is a complete statement of the agreement and supersedes any prior terms, representations, or agreements whether made orally or in writing

minimum contacts
: a legal requirement that for a lawsuit to go forward against a nonresident defendant of a given state, the defendant must have some connections with that state

minitrial
: a procedure that allows the parties to present their case to decision makers on both sides of the dispute, following discovery

minor
: someone under legal age, which is generally 18, except for certain purposes such as drinking alcoholic beverages.

minority rule of law
: less than half the states follow this rule

mirror image rule

a doctrine stipulating that any acceptance of an offer is deemed to be an unconditional assent to the terms of the offer exactly as it is, without any changes or modifications

misrepresentation

a false statement or assertion made by one party to a contract during the negotiation or formation of such contract

mistake

a belief about a fact that is not in accord with the truth

mitigation of damages

the requirement that someone injured by another's negligence or breach of contract must take reasonable steps to reduce the damages, injury, or cost, and to prevent them from getting worse

motion for summary judgment

a legal request made by a party to a lawsuit, asking the court to decide the case or specific claims in their favor without going to trial

motions

a formal request made by one party to a lawsuit (the moving party) asking the court to take a specific action or make a particular decision

mutual mistake

both parties are wrong about the subject of the contract

mutuality of obligation

if one party to a contract has not made a binding obligation, neither is the other party bound

natural law

an objective norm or set of objective norms governing human behavior, similar to the positive laws of a human ruler, but binding on all people alike and usually understood as involving a superhuman legislator

necessary

a basic need of life such as food, shelter and basic medical services

needs contract

a seller agrees to meet all the buyer’s requirements; a requirements contract

negligence

failure to use reasonable care, resulting in injury or property damage to another

negligence per se

negligence due to a violation of law designed to protect the public, such as a speed limit or building code

negligent misrepresentation
: a false statement that is made due to negligence, carelessness, or a lack of reasonable care in ascertaining its accuracy

negligent torts
: a tort claim that arises when a person or entity is careless and that carelessness injures or harms someone

negotiable instrument
: a transferable instrument (as a note, check, or draft) containing an unconditional promise or order to pay to a holder or to the order of a holder upon issue, possession, demand, or at a specified time

negotiation
: a give-and-take discussion that attempts to reach an agreement or settle a dispute

New Jersey Supreme Court
: the state's highest appellate court

nominal damages
: a small amount of money awarded to the plaintiff in a civil lawsuit when a judge or jury finds that the plaintiff has suffered a legal wrong but is not awarded compensatory damages

noncompete agreement
: an agreement or contract not to interfere or compete with a former employer (as by working with a competitor)

nondisclosure
: failure or refusal to make something known

nonvoidable
: not capable of being made void

novation
: the voluntary substitution of a new contract for an old one, usually to change the parties, duties, or payment terms

nuisance
: the unreasonable interference with another person's use and enjoyment of their property

objective intention
: the objective of a reasonable person under the same circumstances, as compared to subjective intention

objective standard
: a legal standard that is based on conduct and perceptions external to a particular person

objective theory of contracts
: a fundamental principle in contract law that focuses on the objective intent of the parties involved in a contract rather than their subjective beliefs or intentions

obligee
: one to whom an obligation is made

obligor
: one who makes and has an obligation

offense
: a violation of the law; a crime

offer
: a specific proposal to enter into an agreement with another; an offer is essential to the formation of an enforceable contract

offeree
: one to whom an offer is made

offeror
: one who makes an offer

one-year rule
: an agreement that cannot be performed within one year from its making must be evidenced by some writing to be enforceable

opening statement
: a statement made by an attorney or self-represented party at the beginning of a trial before evidence is introduced

option contract
: a contract in which a time period is specified within which an offer must be accepted

ordinance
: a law adopted by a town or city council, county board of supervisors, or other municipal governing board

original jurisdiction
: the authority of a court to hear and decide a matter before it can be reviewed by another court

outputs contract
: a buyer agrees to purchase the seller's entire output of goods

parol evidence rule
: establishes that a written contract intended to be the parties' complete understanding discharges all prior or contemporaneous promises, statements, or agreements that add to, vary, or conflict with it

past consideration
: something that has already been given or some act that has already been performed that cannot therefore be induced by the other party's thing, act, or promise in exchange and is not truly a consideration

past performance doctrine
: performance or action that has taken place prior to entering a contract

pendent jurisdiction
: in federal procedure, the policy that allows a federal court to decide a legal question normally tried in state courts because it is based on the same facts as a lawsuit which is under federal court jurisdiction

peremptory challenges
: the right to dismiss or excuse a potential juror during jury selection without having to give a reason

perfect tender
: that the goods delivered according to the contract are the exact things ordered

performance
: fulfillment of an obligation required by contract

personal jurisdiction
: the right to dismiss or excuse a potential juror during jury selection without having to give a reason

physical and mental examinations
: a court-ordered examination by a qualified medical professional of a person's physical or mental condition

positive law
: statutory man-made law (as compared to "natural law")

positivist
: examining in a precise way what a law or rule itself says

possibility test
: a method to determine if a contract could *possibly* be completed within a year and thus is not subject to the statute of fraud's one-year rule

precedent
: an opinion of a federal or state court of appeals establishing a legal principle or rule that must be followed by lower courts when faced with similar legal issues

preexisting duty
: a party's offer of a performance already required under an existing contract is insufficient consideration for modification of the contract

prenuptial agreement
: an agreement made by a couple before marriage that controls certain aspects of their relationship, usually the management and ownership of property, and sometimes whether alimony will be paid if the couple later divorces

pretrial conference
: a proceeding attended by the parties to an action and a judge or magistrate and held at a party's request or on the judge's initiative for the purpose of focusing the issues, making discovery, entering into stipulations, obtaining rulings, and dealing with any matters that may facilitate fair and efficient disposition of the case including settlement

private judging
: a process in which active or retired judges may be hired for private trials

procedural law
: the rules of courts and administrative agencies

promisee
: one to whom a promise is made

promisor
: one who makes a promise

promissory estoppel
: a legal principle that prevents a person who made a promise from reneging when someone else has reasonably relied on the promise and will suffer a loss if the promise is broken

property
: anything that is owned by a person or entity

proximate cause
: a cause that is not too remote or unforeseeable

public policy
: government policies that affect the whole population

puffery
: an exaggeration of the value of a product, a business, or property for promotional purposes

punitive damages
: damages awarded in a lawsuit as a punishment and example to others for malicious, evil or particularly fraudulent acts

qualified privilege
: a privilege especially in the law of defamation that may be defeated especially by a showing of actual malice

quasi contract
: an obligation imposed by a judge to prevent injustice and thus not a contract

ratification
: confirmation of an action which was not pre-approved and may not have been authorized

real assent
: the genuine and voluntary agreement of all parties involved in a contract to its terms and conditions

reasonable assurances
: a promise from a contracting party for future performance of the contract

recognizance
: an obligation of record entered into before a court or magistrate requiring the performance of an act (such as appearance in court) usually under penalty of a money forfeiture

recross-examination
: examination of a witness after redirect examination

redirect examination
: an additional direct examination of a witness following cross-examination

regulation
: a rule, adopted under authority granted by a statute, issued by a municipal, county, state or federal agency

regulatory license
: a license intended to protect the public health, safety, and welfare

reliance
: dependence on another person's (or entity's) statements or actions

reliance interest
: the interest of a party to a breached contract in being compensated for detriments suffered (as expenses incurred) in reliance on the agreement

repudiates
: to reject as unauthorized or as having no binding force

repudiation
: actions demonstrating that one party to a contract refuses to perform an obligation

requests for admission
: written requests asking the opposing party to admit or deny specific statements or facts

requests for production
formal requests for specific documents, electronically stored information, or tangible items relevant to the case

requirements contract
a buyer agrees to purchase the seller's entire output of goods; a needs contract

rescission
cancellation of a contract by mutual agreement of the parties

Restatement (Second) of Contracts
a legal treatise from the second series of the Restatements of the Law which seeks to inform judges and lawyers about general principles of contract common law

restitution
returning property or its monetary value to the rightful owner

restitution interest
the interest of a party to a breached contract in having restored any benefit she conferred on the promisor

restraint of trade
any activity (including agreements among competitors or companies doing business with each other) that tends to limit trade, sales, and transportation in interstate commerce or has a substantial impact on interstate commerce

revenue license
a license that is imposed for the sake of raising revenue and to ensure that practitioners register their address so they can be served papers for a lawsuit if needed

revocation
cancellation of a contract by the parties to it

right
an entitlement to something, whether to a concept like justice or due process, or to a legally enforceable claim or interest

rule
a regulation issued by a court or government agency

satisfactory performance
the fulfillment of contractual obligations to a degree that is acceptable to the other party in a contract

school of thought
a way of thinking

service of process

the delivery of copies of legal documents such as summons, complaint, subpoena, order to show cause (order to appear and argue against a proposed order), writs, notice to quit the premises, and certain other documents, usually by personal delivery to the defendant or other person to whom the documents are directed

slander

make an untruthful oral (spoken) statement about a person that harms the person's reputation or standing in the community

sovereign immunity

the absolute immunity of a sovereign government (as a state) from being sued

specific performance

a contract remedy provided by a court that orders the losing side to perform its part of an agreement rather than, or possibly in addition to, paying money damages to the winner

standing

the right to file a lawsuit or file a petition under the circumstances

stare decisis

an informal rule judges often follow when deciding cases that counsels judges to follow precedents—decisions and opinions from similar cases that were decided in the past; Latin for "let the decision stand"

statute

a written law passed by the legislative branch of government—Congress or a state legislature—and usually signed into law by the head of the executive branch of government—the president or a state governor

Statute of Frauds

a law in every state that requires certain types of documents to be in writing and signed by the party to be charged (usually, the defendant in a lawsuit)

statute of limitations

a law which sets the maximum period of time which one can wait before filing a lawsuit

strict liability torts

a tort in which liability is imposed without regard to fault

strict product liability

absolute responsibility for a defective product that does not require the plaintiff to prove negligence because negligence is presumed

subject matter jurisdiction

the jurisdiction of a court over the subject, type, or cause of action of a case that allows the court to issue a binding judgment

subjective intention
: what an individual personally intends under a particular circumstance, as compared to objective intention

subjective standard
: a legal standard that is specific to a particular person and based on the person's individual views and experiences

substantial performance
: fulfillment of the obligations agreed to in a contract, with only slight variances from the exact terms and/or unimportant omissions or minor defects

substantive law
: statutory or written law that governs the rights and obligations of everyone within its jurisdiction

summons
: a court document stating the name of the plaintiff and their attorney and directing the defendant to respond to the complaint within a fixed time period

Sunday contracts
: contracts entered into on a Sunday and subject to Blue Laws

Superior Court of New Jersey
: the general trial court of New Jersey within which most cases originate

Supremacy Clause
: Article VI, clause 2 of the U.S. Constitution, which says that the Constitution, federal laws, and federal treaties are "the supreme Law of the Land;" as such, when state law conflicts or interferes with the operation of federal law, courts often look to the supremacy clause to find that federal law must prevail

surety
: someone who promises to perform upon the default of another; a guarantor

sword and shield doctrine
: a legal principle that pertains to the use of a contract's terms as both a sword to enforce the contract and a shield to defend against claims under the contract

third-party rights
: the ability of third parties or outsiders to enforce contractual rights or to be bound by contractual obligations even though they are not a party to the contract

time is of the essence
: time, or timeliness, is a condition of the contract

tortfeasor
: a person who commits an intentional or negligent tort—a wrongful act that harms another

tortious
: constituting a tort—a wrongful act that harms another

torts
: a wrongful act that causes injury

transferee
: one to whom a transfer is made

transferor
: one who makes a transfer

treaty
: a formal and legally binding agreement between the U.S. government and one or more foreign governments or international organizations

trespass
: intentionally going on land that belongs to someone else or putting something on someone else's property and refusing to remove it

unconscionability
: when one party to a contract takes advantage of the other due to unequal bargaining positions, perhaps because of the disadvantaged party's recent trauma, physical infirmity, ignorance, inability to read, or inability to understand the language

unconscionable contract
: a contract that is very one-sided, unfair, the product of unequal bargaining power, or oppressive

undue influence
: improper influence over someone who is making financial decisions, commonly pertaining to making gifts, leaving property at death, or signing a contract

unenforceable contract
: a contract that some rule of law bars a court from enforcing

unforeseen difficulty
: difficulties that could not be foreseen that arise after a contract is made

Uniform Commercial Code (UCC)
: a set of statutes governing the conduct of business, sales, warranties, negotiable instruments, loans secured by personal property and other commercial matters

Uniform Electronic Transactions Act (UETA)
: an act published by the Uniform Law Commission in 1999 giving electronic signatures and records (including contracts) the same legal effect as traditional handwritten signatures and paper documents under the statute of frauds

unilateral contract
an agreement to pay in exchange for performance, if the potential performer chooses to act

unilateral mistake
a mistake made by one party to a contract

usury
extending credit at an exorbitant or illegally high interest rate

valid contract
a legally binding and enforceable agreement that meets all the essential elements required by contract law

venue
the specific geographic location or district where a legal case is heard or tried

verdict
a jury's decision after a trial, which becomes final when accepted by the judge

vicarious liability
legal responsibility that one individual or entity bears when someone else has actually committed the act leading to liability

void contract
an agreement that is lacking one or more of the legal elements of a contract

voidable contract
a contract that may become unenforceable by one party but can be enforced by the other

voir dire
French for "to speak the truth," this is the questioning in court of prospective jurors by a judge or attorneys

waiver
the intentional and voluntary giving up of a right, either by an express statement or by conduct (such as by not enforcing a right)

writ of certiorari
order of a higher court to a lower court to send all the documents in a case to it so the higher court can review the lower court's decision

wrongful use of civil proceedings
the initiation of a civil lawsuit without proper grounds or with an improper motive, resulting in harm to the defendant