Unit 6 – Contracts

I. Definition

A contract is a voluntary agreement between two or more parties that a court will enforce. The rights and obligations created by a contract apply only to the parties to the contract (i.e., those who agreed to them) and not to anyone else.

II. Elements

In order for a contract to be valid, certain elements must exist:

(A) Competent parties. In order for a contract to be enforceable, the parties must have legal capacity. Even though most people can enter into binding agreements, there are some who must be protected from deception. The parties must be over the age of majority (18 under most state laws) and have sufficient mental capacity to understand the significance of the contract.

Regarding the age requirement, if a minor enters a contract, that agreement can be voided by the minor but is binding on the other party, with some exceptions. (Contracts that a minor makes for necessaries such as food, clothing, shelter or transportation are generally enforceable.) This is called a voidable contract, which means that it will be valid (if all other elements are present) unless the minor wants to terminate it. The consequences of a minor avoiding a contract may be harsh to the other party. The minor need only return the subject matter of the contract to avoid the contract. If the subject matter of the contract is damaged the loss belongs to the nonavoiding party, not the minor.

Regarding the mental capacity requirement, if the mental capacity of a party is so diminished that he cannot understand the nature and the consequences of the transaction, then that contract is also voidable (he can void it but the other party can not). Furthermore, if the party with diminished mental capacity cannot act in a reasonable manner regarding the contract and if the other party knew of the defect, then that contract is void. Mental disease alone does not necessarily mean that a party is mentally incompetent for contractual purposes.

The distinction between a voidable and a void contract is that a voidable contract is enforceable unless avoided by the protected party. A void contract cannot be enforced by anyone.

(B) Proper subject matter. The purpose of the contract must be a legal one in order for the contract to be valid. Subject matter is not proper if it is contrary to public policy (such as an agreement to commit a tort or a crime or an agreement in restraint of trade), immoral (the only use of the subject matter is to violate the law), or if it violates a statute (such as a gambling contract or a usurious contract.)
(C) Offer. An offer is a statement that creates a power of acceptance in the offeree. It does not have to be in a certain form. However, to be valid, an offer must be communicated to the offeree, it must express an intent of willingness to enter into a contract (with serious intent and not as a joke or as merely preliminary negotiations), and it must be sufficiently definite and certain (especially with regard to the identity of the parties, the subject matter, the price and the time and place of performance). It is generally effective when the communication is received by the offeree.

(D) Acceptance. The power of acceptance lies only with the offeree, and the acceptance must relate to the terms of the offer (with no changes to the terms of the offer or counteroffer, if applicable). The acceptance is effective when it is dispatched (put out of the offeree’s possession). This is called the “mailbox rule” (if use of the mails is a reasonable method of accepting, then the acceptance is effective when posted). This rule is interpreted broadly and not limited just to use of the mails. The acceptance must be made within any time limit and in any manner as specified by the offer.

A counteroffer terminates the offer. A counteroffer is treated as if it were a new offer. Any change to the offer by the offeree results in the termination of the offer and the creation of a counteroffer. A grudging acceptance by the offeree includes complaints about the oppressiveness of the agreement but no alteration of the terms of the original offer. Grudging acceptances are problematic because they create confusion about whether there has been an acceptance or a counteroffer. This may lead to litigation.

(E) Consideration. To be enforceable, a contract must have sufficient “consideration.” Consideration is something of value (money, labor, goods or a promise to act or not act) given in exchange for a return promise or a performance and only if the parties intend to make such an exchange. Consideration is something that is bargained for and given in exchange for a promise or a performance.

III. Types of Contracts

An express contract is one whose terms are specifically stated, either orally or in writing. A contract is bilateral if both the offeror and the offeree make promises. Each party must perform and can expect the other party also to perform. A contract is called unilateral if only one party makes a promise. The offeror (the one who makes the promise) expects the offeree to accept the offer by actually performing an act, not by making a promise to perform the act.

Newspaper advertisements are not generally offers. Ads are considered to be solicitations of offers and do not bind the advertiser. The exception is an advertisement of a reward which is treated as an offer to form a unilateral contract. Note that other law such as consumer protection statutes or unfair trade practices statutes may impose restrictions on advertisers.
An implied contact is one where the terms are inferred, in whole or in part, from conduct and circumstances rather than from written or spoken works. The only legal difference between an implied contract and an express contract is the way that mutual assent is given. An “implied-in-fact” contract is one where the conduct of the parties and the circumstances of the transaction make it reasonable to assume that the parties had an understanding between them, and thus a contract enforceable by the court, in spite of the absence of spoken or written words of agreement.

Also, in a case where the circumstances are such that one person should have a right and the other a responsibility, in spite of a lack of an intention or agreement for such, the court will find a contract “implied by law.” If there is something that someone ought to do, the court will find that he has an obligation to do it. This is actually the opposite of an express contract because here the contract arises from the liability rather than from the mutual intention of the parties, and thus it is called a “quasi-contract.” It is an alternative remedy (called restitution) which keeps one party from being unjustly enriched at the expense of the other party.

IV. Statute of Frauds

Under certain circumstances, a contract must be in writing to be enforceable. Most states have adopted a form of a celebrated English law passed by Parliament in 1677 called the Statute of Frauds. Under North Carolina law, the following types of contracts, among others, must be in writing: a sale of goods for $500 or more, a promise to pay the debt of another, a promise made in exchange for marriage, a promise that cannot be performed within one year from the date of the agreement, promises concerning a sale of land and leases that are longer than three years from the date of forming the contract (lease).

V. Exceptions to the Writing Requirement

A negative result of requiring that certain contracts be in writing is that a person could make an oral promise with the intent of breaking that promise later on the grounds that it was not in writing, as required by the Statute of Frauds. To prevent this unfair result, the court will sometimes enforce an oral contract even when the Statute of Frauds would ordinarily require a writing. If there has been partial performance by one party in reliance on the promised performance of the other party and the performing party has relied on the oral agreement to his substantial detriment and the court finds that this performance, which conforms to the provisions of the contract, would not have occurred without reliance on the agreement, then the court will not allow the defense by the non-performing party that the agreement was not in writing.

Another way to avoid a strict application of the Statute of Frauds is the doctrine of promissory estoppel. If a promise is made which the promisor can reasonably expect will induce action by the promisee and it does, then the promisor cannot raise the Statute of Frauds as a defense that the promise is unenforceable. This prevents an injustice from a noncompliance with the writing requirement.
VI. Parol Evidence Rule

Even when an enforceable contract exists, questions may arise regarding the meaning of specific terms of the contract, and a party may wish to provide evidence outside of the contract to answer the questions. Under the parol evidence rule, if an agreement is in writing, that writing is the best evidence of the agreement between the parties. Generally, evidence of prior or contemporaneous agreements or negotiations are not admissible to contradict a term of the written contract. This means that oral promises made during the contract negotiations are invalid unless incorporated within the written document.

An exception to this rule exists where there are ambiguous terms in the contract. In this case, the court will allow additional evidence to clarify the terms of the agreement. Oral statements made subsequent to the contract may be admitted to clarify or contradict the terms of the contract, unless the contract contains an integration clause (the contract specifically states that the contract may not be contradicted or supplemented by outside written or oral negotiations or agreements).

VII. Remedies for Breach

If one party fails to perform a duty under a contract, he is said to have breached the contract. This relieves the other party from an obligation to perform and also entitles the other party to seek damages or other appropriate relief as a remedy. The most common remedy is an award of money damages in an amount to make the injured party whole. A jury decides what is a fair amount for this purpose based on the facts of the case.

The injured party may not feel that monetary damages will be enough of a remedy and may also ask to have the contract performed as agreed. This remedy is called specific performance and will usually only be granted where the subject matter of the contract is unique in some way (e.g., the sale of land).

Another remedy for a breach of a contract is called an injunction, which is an order by the court to restrain or compel a requested action. For example, an employment contract could have a provision that prohibits the employee from taking another similar position with a competitor in the same area. The enforcement of this provision after a breach by the employee would be a negative injunction (prohibiting an action).

If an injured party would be more damaged by accepting performance of the contract as proposed by the defaulting party than by getting out of the contract and seeking damages, he may ask the court to rescind (cancel or terminate) the contract and give him restitution (such as payment of any benefits already transferred).

VIII. Defenses
Sometimes there is a significant change in circumstances between the time a contract is entered and when performance must occur. Usually courts do not take intervening events as an excuse for non-performance. However, there are some exceptions to that rule. One is the doctrine of impossibility. The court will excuse performance and terminate the contract if it finds that, after entering the contract, circumstances have changed to an extent that could not be reasonably foreseen by the parties (e.g., an essential commodity is destroyed or a provider of personal services dies).

The court may also recognize the doctrine of impracticability. In this case, the court will excuse non-performance when that performance, even though theoretically possible, would involve extreme and unreasonable difficulty, expense, injury, or loss which could not have been anticipated by the parties (e.g., an aerial pesticide applicator loses his only plane in a storm).

An additional defense is the one of mistake. For example, if a party believes in the existence of a fact or thing material to the contract which does not in fact exist and he would not have entered the contract without that belief, he may be excused from his obligation under the contract (e.g., the sale of an “infertile” cow that turns out to be pregnant).

IX. Stipulated or Liquidated Damages

Parties to a contract can specify in the contract the amount of damages in case of a breach and, if that amount is not excessive, the court will award the amount stipulated (called stipulated or liquidated damages) rather than the amount of the actual damages. If the amount of stipulated damages is found to be excessive by the court, it considers the amount a penalty designed to coerce performance and will not allow the stipulated amount. In that case, the court will ignore the amount provided in the contract, as if it were silent on the issue, and assess damages itself. On the other hand, the court will generally view the stipulated amount as reasonable, rather than an excessive penalty, if it is an honest estimate of probable loss. In deciding whether the amount is reasonable (an honest estimate), the court looks at whether it is difficult to foresee actual damages or whether a single sum is set as liquated damages for a variety of obligations that would have greatly varying actual losses.

Contracts may also contain attorney fees clauses that allow the prevailing party to recover reasonable attorney fees and costs associated with any legal action required to enforce the contract.

X. Time

Most states have adopted statutes to insure that an injured party files a cause of action within a reasonable time. These laws are called Statutes of Limitations, and they specify various time limits within which to file an action (depending on the state and the kind of action). The Statute of Limitations under North Carolina law generally imposes a limit of three years within which to file an action upon a contract.
Laches is the neglect to assert a right within a reasonable time and which operates to the detriment of the opposing party. The court of equity does not aid a party who fails to protect his own right, and thus laches acts as a bar to that party’s ability to bring suit. This is the common law equivalent of the statute of limitations.