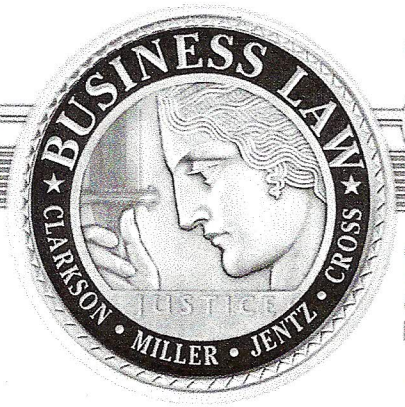


CHAPTER 10

Nature and Terminology

The noted legal scholar Roscoe Pound once said that "[t]he social order rests upon the stability and predictability of conduct, of which keeping promises is a large item."[1] Contract law deals with, among other things, the formation and keeping of promises. A **promise** is a person's assurance that the person will or will not do something.

Like other types of law, contract law reflects our social values, interests, and expectations at a given point in time. It shows, for example, to what extent our society allows people to make promises or commitments that are legally binding. It distinguishes between promises that create only *moral* obligations (such as a promise to take a friend to lunch) and promises that are legally binding (such as a promise to pay for merchandise purchased). Contract law also demonstrates which excuses our society accepts for breaking certain types of promises. In addition, it indicates which promises are considered to be contrary to public policy—against the interests of society as a whole—and therefore legally invalid. When the person making a promise is a child or is mentally incompetent, for example, a question will arise as to whether the promise should be enforced. Resolving such questions is the essence of contract law.

1. R. Pound, *Jurisprudence*, Vol. 3 (St. Paul, Minn.: West Publishing Co., 1959), p. 162.

An Overview of Contract Law

Before we look at the numerous rules that courts use to determine whether a particular promise will be enforced, it is necessary to understand some fundamental concepts of contract law. In this section, we describe the sources and general function of contract law. We also provide the definition of a contract and introduce the objective theory of contracts.

Sources of Contract Law

The common law governs all contracts except when it has been modified or replaced by statutory law, such as the Uniform Commercial Code (UCC),[2] or by administrative agency regulations. Contracts relating to services, real estate, employment, and insurance, for example, generally are governed by the common law of contracts.

Contracts for the sale and lease of goods, however, are governed by the UCC—to the extent that the UCC has modified general contract law. The relationship between general contract law and the law governing sales and leases of goods will be explored in detail in Chapter 20. In the discussion of general contract law that follows, we indicate in footnotes the areas in which the UCC has significantly altered common law contract principles.

The Function of Contract Law

The law encourages competent parties to form contracts for lawful objectives. Indeed, no aspect of modern life is entirely free of contractual relationships. Even ordinary consumers in their daily activities

2. See Chapters 1 and 20 for further discussions of the significance and coverage of the UCC. The UCC is presented in Appendix C at the end of this book.

acquire rights and obligations based on contract law. You acquire rights and obligations, for example, when you purchase a DVD or when you borrow funds to buy a house. Contract law is designed to provide stability and predictability, as well as certainty, for both buyers and sellers in the marketplace.

Contract law deals with, among other things, the formation and enforcement of agreements between parties (in Latin, *pacta sunt servanda*—"agreements shall be kept"). By supplying procedures for enforcing private contractual agreements, contract law provides an essential condition for the existence of a market economy. Without a legal framework of reasonably assured expectations within which to make long-run plans, businesspersons would be able to rely only on the good faith of others. Duty and good faith are usually sufficient to obtain compliance with a promise, but when price changes or adverse economic factors make compliance costly, these elements may not be enough. Contract law is necessary to ensure compliance with a promise or to entitle the innocent party to some form of relief.

Definition of a Contract

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."[3] Put simply, a contract is a legally binding agreement between two or more parties who agree to perform or to refrain from performing some act now or in the future. Generally, contract disputes arise when there is a promise of future performance. If the contractual promise is not fulfilled, the party who made it is subject to the sanctions of a court (see Chapter 18). That party may be required to pay damages for failing to perform the contractual promise; in limited instances, the party may be required to perform the promised act.

The Objective Theory of Contracts

In determining whether a contract has been formed, the element of intent is of prime importance. In contract law, intent is determined by what is called the **objective theory of contracts,** not by the personal or subjective intent, or belief, of a party. The theory is that a party's intention to enter into a legally binding agreement, or contract, is judged by outward, objective facts as interpreted by a *reasonable* person, rather than by the party's own secret, subjective intentions. Objective facts include (1) what the party said when entering into the contract, (2) how the party acted or appeared (intent may be manifested by conduct as well as by oral or written words), and (3) the circumstances surrounding the transaction. We will look further at the objective theory of contracts in Chapter 11, in the context of contract formation.

3. *Restatement (Second) of Contracts,* Section 1. The *Restatement of the Law of Contracts* is a nonstatutory, authoritative exposition of the common law of contracts compiled by the American Law Institute in 1932. The *Restatement,* which is now in its second edition (a third edition is being drafted), will be referred to throughout the following chapters on contract law.

SECTION 2 Elements of a Contract

The many topics that will be discussed in the following chapters on contract law require an understanding of the basic elements of a valid contract and the way in which a contract is created. The topics to be covered in this unit on contracts also require an understanding of the types of circumstances in which even legally valid contracts will not be enforced.

Requirements of a Valid Contract

The following list briefly describes the four requirements that must be met before a valid contract exists. If any of these elements is lacking, no contract will have been formed. (Each requirement will be explained more fully in subsequent chapters.)

1. *Agreement.* An agreement to form a contract includes an *offer* and an *acceptance.* One party must offer to enter into a legal agreement, and another party must accept the terms of the offer.
2. *Consideration.* Any promises made by the parties to the contract must be supported by legally sufficient and bargained-for *consideration* (something of value received or promised, such as money, to convince a person to make a deal).
3. *Contractual capacity.* Both parties entering into the contract must have the contractual *capacity* to do so; the law must recognize them as possessing characteristics that qualify them as competent parties.
4. *Legality.* The contract's purpose must be to accomplish some goal that is legal and not against public policy.

Defenses to the Enforceability of a Contract

Even if all of the above-listed requirements are satisfied, a contract may be unenforceable if the following requirements are not met. These requirements typically are raised as *defenses* to the enforceability of an otherwise valid contract.

1. *Genuineness of assent.* The apparent consent of both parties must be genuine. For example, if a contract was formed as a result of fraud, undue influence, mistake, or duress, the contract may not be enforceable.
2. *Form.* The contract must be in whatever form the law requires; for example, some contracts must be in writing to be enforceable.

SECTION 3 Types of Contracts

There are many types of contracts. In this section, you will learn that contracts can be categorized based on legal distinctions as to formation, performance, and enforceability.

Contract Formation

As you can see in Exhibit 10–1, three classifications, or categories, of contracts are based on how and when a contract is formed. We explain each of these types of contracts in the following subsections.

Bilateral versus Unilateral Contracts

Every contract involves at least two parties. The **offeror** is the party making the offer. The **offeree** is the party to whom the offer is made. Whether the contract is classified as *bilateral* or *unilateral* depends on what the offeree must do to accept the offer and bind the offeror to a contract.

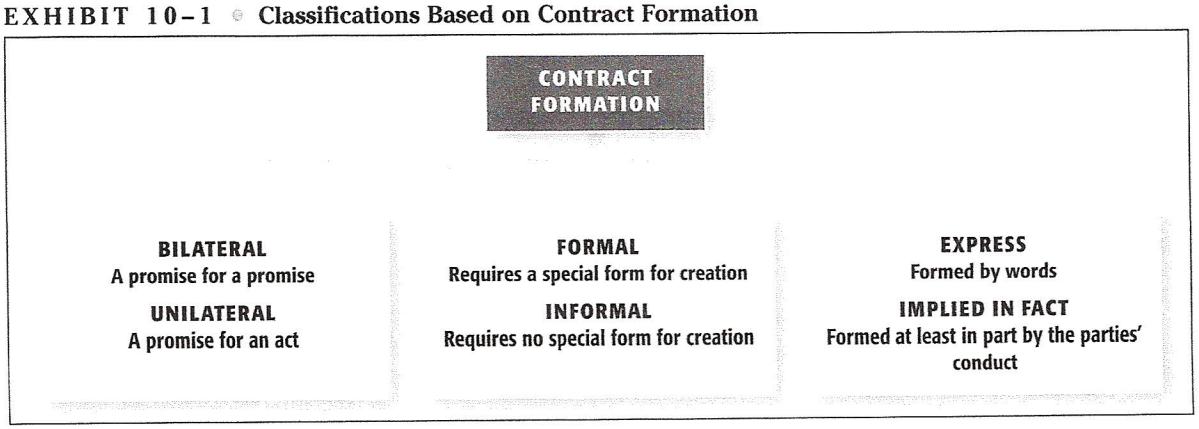
Bilateral Contracts. If the offeree can accept simply by promising to perform, the contract is a **bilateral contract.** Hence, a bilateral contract is a "promise for a promise." No performance, such as payment of funds or delivery of goods, need take place for a bilateral contract to be formed. The contract comes into existence at the moment the promises are exchanged.

For example, Javier offers to buy Ann's digital camcorder for $200. Javier tells Ann that he will give her the funds for the camcorder next Friday, when he gets paid. Ann accepts Javier's offer and promises to give him the camcorder when he pays her on Friday. Javier and Ann have formed a bilateral contract.

Unilateral Contracts. If the offer is phrased so that the offeree can accept the offer only by completing the contract performance, the contract is a **unilateral contract.** Hence, a unilateral contract is a "promise for an act."[4] In other words, the time of contract formation in a unilateral contract is not the moment when promises are exchanged but the moment when the contract is *performed.* A classic example of a unilateral contract is as follows: O'Malley says to Parker, "If you carry this package across the Brooklyn Bridge, I'll give you $20."

4. Clearly, a contract cannot be "one sided," because, by definition, an agreement implies the existence of two or more parties. Therefore, the phrase *unilateral contract,* if read literally, is a contradiction in terms. As traditionally used in contract law, however, the phrase refers to the kind of contract that results when only one promise is being made (the promise made by the offeror in return for the offeree's performance).

EXHIBIT 10–1 • Classifications Based on Contract Formation



Only on Parker's complete crossing with the package does she fully accept O'Malley's offer to pay $20. If she chooses not to undertake the walk, there are no legal consequences.

Contests, lotteries, and other competitions involving prizes are examples of offers to form unilateral contracts. If a person complies with the rules of the contest—such as by submitting the right lottery number at the right place and time—a unilateral contract is formed, binding the organization offering the prize to a contract to perform as promised in the offer.

Can a school's, or an employer's, letter of tentative acceptance to a prospective student, or a possible employee, qualify as a unilateral contract? That was the issue in the following case.

CASE 10.1 Ardito v. City of Providence

United States District Court, District of Rhode Island, 2003. 263 F.Supp.2d 358.

Background and Facts In 2001, the city of Providence, Rhode Island, decided to begin hiring police officers to fill vacancies in its police department. Because only individuals who had graduated from the Providence Police Academy were eligible, the city also decided to conduct two training sessions, the "60th and 61st Police Academies." To be admitted, an applicant had to pass a series of tests and be deemed qualified by members of the department after an interview. The applicants judged most qualified were sent a letter informing them that they had been selected to attend the academy if they successfully completed a medical checkup and a psychological examination. The letter for the applicants to the 61st Academy, dated October 15, stated that it was "a conditional offer of employment." Meanwhile, a new chief of police, Dean Esserman, decided to revise the selection process, which caused some of those who had received the letter to be rejected. Derek Ardito and thirteen other newly rejected applicants—who had all completed the examinations—filed a suit in a federal district court against the city, seeking a halt to the 61st Academy unless they were allowed to attend. They alleged that, among other things, the city was in breach of contract.

IN THE LANGUAGE OF THE COURT
***ERNEST C. TORRES*, Chief District Judge.**

* * * *

* * * [T]he October 15 letter * * * *is a classic example of an offer to enter into a unilateral contract.* The October 15 letter expressly stated that it was a "conditional offer of employment" and the message that it conveyed was that the recipient would be admitted into the 61st Academy if he or she successfully completed the medical and psychological examinations, requirements that the city could not lawfully impose unless it was making a conditional offer of employment. [Emphasis added.]

Moreover, the terms of that offer were perfectly consistent with what applicants had been told when they appeared [for their interviews]. At that time, [Police Major Dennis] Simoneau informed them that, if they "passed" the [interviews], they would be offered a place in the academy provided that they also passed medical and psychological examinations.

The October 15 letter also was in marked contrast to notices sent to applicants by the city at earlier stages of the selection process. Those notices merely informed applicants that they had completed a step in the process and remained eligible to be considered for admission into the academy. Unlike the October 15 letter, the prior notices did not purport to extend a "conditional offer" of admission.

The plaintiffs accepted the city's offer of admission into the academy by satisfying the specified conditions. Each of the plaintiffs submitted to and passed lengthy and intrusive medical and psychological examinations. In addition, many of the plaintiffs, in reliance on the City's offer, jeopardized their standing with their existing employers by notifying the employers of their anticipated departure, and some plaintiffs passed up opportunities for other employment.

CASE CONTINUES

CASE 10.1 CONTINUED * * * *

The city argues that there is no contract between the parties because the plaintiffs have no legally enforceable right to employment. The city correctly points out that, even if the plaintiffs graduate from the Academy and there are existing vacancies in the department, they would be required to serve a one-year probationary period during which they could be terminated without cause * * * .That argument misses the point. The contract that the plaintiffs seek to enforce is not a contract that they will be appointed as permanent Providence police officers; rather, it is a contract that they would be admitted to the Academy if they passed the medical and psychological examinations.

Decision and Remedy *The court issued an injunction to prohibit the city from conducting the 61st Police Academy unless the plaintiffs were included. The October 15 letter was a unilateral offer that the plaintiffs had accepted by passing the required medical and psychological examinations.*

What If the Facts Were Different? *Suppose that the October 15 letter had used the phrase "potential offer of employment" instead of using the word "conditional." Would the court in this case still have considered the letter to be a unilateral contract? Why or why not?*

The Legal Environment Dimension *Why did the court order the city to stop the 61st Police Academy unless the plaintiffs were included?*

A Problem with Unilateral Contracts. A problem arises in unilateral contracts when the **promisor** (the one making the promise) attempts to *revoke* (cancel) the offer after the **promisee** (the one to whom the promise was made) has begun performance but before the act has been completed. The promisee can accept the offer only on full performance, and under traditional contract principles, an offer may be revoked at any time before the offer is accepted. The present-day view, however, is that an offer to form a unilateral contract becomes irrevocable—cannot be revoked—once performance has begun. Thus, even though the offer has not yet been accepted, the offeror is prohibited from revoking it for a reasonable time period.

For instance, in the earlier example involving the Brooklyn Bridge, suppose that Parker is walking across the bridge and has only three yards to go when O'Malley calls out to her, "I revoke my offer." Under traditional contract law, O'Malley's revocation would terminate the offer. Under the modern view of unilateral contracts, however, O'Malley will not be able to revoke his offer because Parker has undertaken performance and walked all but three yards of the bridge. In these circumstances, Parker can finish crossing the bridge and bind O'Malley to the contract.

Formal versus Informal Contracts Another classification system divides contracts into formal contracts and informal contracts. **Formal contracts** are contracts that require a special form or method of creation (formation) to be enforceable. *Contracts under seal* are a type of formal contract that involves a formalized writing with a special seal attached.[5] In the past, the seals were often made of wax and impressed on the paper document. Today, the significance of the seal in contract law has lessened, though standard-form contracts still sometimes include a place for a seal next to the signature lines. *Letters of credit,* which are frequently used in international sales contracts, are another type of formal contract. As will be discussed in Chapter 22, letters of credit are agreements to pay contingent on the purchaser's receipt of invoices and bills of lading (documents evidencing receipt of, and title to, goods shipped).

Informal contracts (also called *simple contracts*) include all other contracts. No special form is required (except for certain types of contracts that must be in writing), as the contracts are usually based on their substance rather than their form. Typically, businesspersons put their contracts in writing to ensure that there is some proof of a contract's existence should problems arise.

5. The contract under seal has been almost entirely abolished under such provisions as UCC 2–203 (Section 2–203 of the Uniform Commercial Code). In sales of real estate, however, it is still common to use a seal (or an acceptable substitute).

Express versus Implied-in-Fact Contracts

Contracts may also be categorized as *express* or *implied* by the conduct of the parties. We look here at the differences between these two types of contracts.

Express Contracts. In an **express contract,** the terms of the agreement are fully and explicitly stated in words, oral or written. A signed lease for an apartment or a house is an express written contract. If a classmate calls you on the phone and agrees to buy your textbook from last semester for $45, an express oral contract has been made.

Implied-in-Fact Contracts. A contract that is implied from the conduct of the parties is called an **implied-in-fact contract** or an *implied contract.* This type of contract differs from an express contract in that the *conduct* of the parties, rather than their words, creates and defines the terms of the contract. (Note that a contract may be a mixture of an express contract and an implied-in-fact contract. In other words, a contract may contain some express terms, while others are implied.)

Requirements for Implied-in-Fact Contracts. For an implied-in-fact contract to arise, certain requirements must be met. Normally, if the following conditions exist, a court will hold that an implied contract was formed:

1. The plaintiff furnished some service or property.
2. The plaintiff expected to be paid for that service or property, and the defendant knew or should have known that payment was expected.
3. The defendant had a chance to reject the services or property and did not.

For example, suppose that you need an accountant to complete your tax return this year. You look through the Yellow Pages and find an accountant with an office in your neighborhood. You drop by the firm's office, explain your problem to an accountant, and learn what fees will be charged. The next day you return and give her administrative assistant all the necessary information and documents, such as canceled checks and W-2 forms. You then walk out the door without saying anything expressly to the accountant. In this situation, you have entered into an implied-in-fact contract to pay the accountant the usual and reasonable fees for her services. The contract is implied by your conduct and by hers. She expects to be paid for completing your tax return, and by bringing in the records she will need to do the work, you have implied an intent to pay her.

Disputes often arise between construction contractors and subcontractors. In the following case, the question was whether the subcontractor could receive extra compensation for work that was not listed in the parties' express contract based on the existence of an implied-in-fact contract.

CASE 10.2 Gary Porter Construction v. Fox Construction, Inc.

Court of Appeals of Utah, 2004. 2004 UT App. 354, 101 P.3d 371.
www.utcourts.gov/opinions[a]

Background and Facts The University of Utah contracted with Fox Construction, Inc., to build a women's gymnastics training facility on the university's campus. Fox subcontracted with Gary Porter Construction to do excavation and soil placement work, according to specific sections of the project's plans (the "Included Sections"), for $146,740. Later, Fox asked Porter to do additional work that had not been included in the subcontract (the "Excluded Sections"). Porter did all of the work, but Fox refused to pay more than the amount of the subcontract, claiming that the added work had been mistakenly excluded from it. Porter filed a suit in a Utah state court against Fox, alleging, among other things, breach of an implied-in-fact contract. The court granted Porter's motion for summary judgment. Fox appealed to a state intermediate appellate court.

a. In the "Court of Appeals" section, in the "By Date" row, click on "2004." In the list that opens, scroll to the name of the case and click on it to access the opinion. The Utah State Courts, through their Administrative Office of the Courts, maintain this Web site.

CASE CONTINUES

CASE 10.2 CONTINUED

IN THE LANGUAGE OF THE COURT
***BILLINGS,* Presiding Judge.**

* * * *

Porter argues that Fox owes additional compensation for work it did under the Excluded Sections based upon a contract implied in fact. To succeed on this claim, Porter must show that (1) Fox requested Porter to perform the work under the Excluded Sections, (2) Porter expected additional compensation from Fox for the work, and (3) Fox knew or should have known that Porter expected additional compensation. The facts provided by Porter satisfy all of these elements and are not properly controverted [opposed] by Fox.

In its [motion for summary judgment] Porter set forth the following facts * * * : (1) Jeff Wood, Fox's project manager, drafted the subcontract which contains only the Included Sections; (2) Fox repeatedly asked Porter to perform work outside the subcontract under the Excluded Sections; (3) Porter performed all work identified in the subcontract as well as the requested work under the Excluded Sections; (4) for months, Fox reviewed and paid * * * bills from Porter which identified the work performed, the costs of the work, and the specific section under which the work was done; (5) at times, Fox acknowledged that Porter was performing work outside the subcontract; and (6) the total cost of the work performed by Porter was $296,750.00, and the amount Fox paid Porter was $135,441.62, leaving a balance of $161,309.08.

The additional facts submitted by Fox do not create a material dispute regarding any of the three elements required for Porter's implied-in-fact contract claim. Fox does not dispute that it requested Porter to perform work under the Excluded Sections; and Fox provides no facts to dispute Porter's claim that Porter expected additional compensation for the work under the Excluded Sections. However, Fox does attempt to dispute the third element [in the first paragraph above]—whether Fox knew or should have known that Porter expected additional compensation.

* * * *

* * * [Floyd Cox, Fox's vice president, testified] that one Excluded Section, "section 2300, had been left out of the subcontract"; and Wood [testified] "that there was a section of specifications that was left out of the subcontract by mistake." Neither statement creates a material dispute over whether the Excluded Sections are part of the subcontract because they do not explain how the mistakes occurred despite ordinary diligence on the part of Fox. Also, because Fox presents no evidence that Porter should have known about Fox's mistake either when it entered into the subcontract or after performing, billing for, and being paid for work under the Excluded Sections, *as a matter of law, Fox should have known that Porter expected additional compensation for its work under the Excluded Provisions.* [Emphasis added.]

The facts set forth [by Fox] do not create a material dispute regarding whether (1) Fox requested Porter to perform the work under the Excluded Sections, (2) Porter expected additional compensation from Fox for the work, and (3) Fox knew or should have known that Porter expected additional compensation. Also, Fox does not dispute the amounts provided by Porter regarding the value of the work for which it was uncompensated. Therefore, the trial court did not err when it granted Porter's motion for summary judgment against Fox for $161,309.08.

Decision and Remedy *The state intermediate appellate court affirmed the lower court's summary judgment in favor of Porter. The appellate court concluded that Porter had met all of the requirements for establishing an implied-in-fact contract: Porter provided its services at Fox's request, expecting to be paid, which Fox knew or should have known.*

The Ethical Dimension *Should a court accept without proof a party's assertion that something was or was not done "by mistake"? Explain.*

The E-Commerce Dimension *Would the outcome of this case have been different if the parties had communicated via an e-mail system that limited the size of the documents that they could transmit to each other? Why or why not?*

Contract Performance

Contracts are also classified according to the degree to which they have been performed. A contract that has been fully performed on both sides is called an **executed contract.** A contract that has not been fully performed by the parties is called an **executory contract.** If one party has fully performed but the other has not, the contract is said to be executed on the one side and executory on the other, but the contract is still classified as executory.

For example, assume that you agree to buy ten tons of coal from the Northern Coal Company. Further assume that Northern has delivered the coal to your steel mill, where it is now being burned. At this point, the contract is executed on the part of Northern and executory on your part. After you pay Northern for the coal, the contract will be executed on both sides.

Contract Enforceability

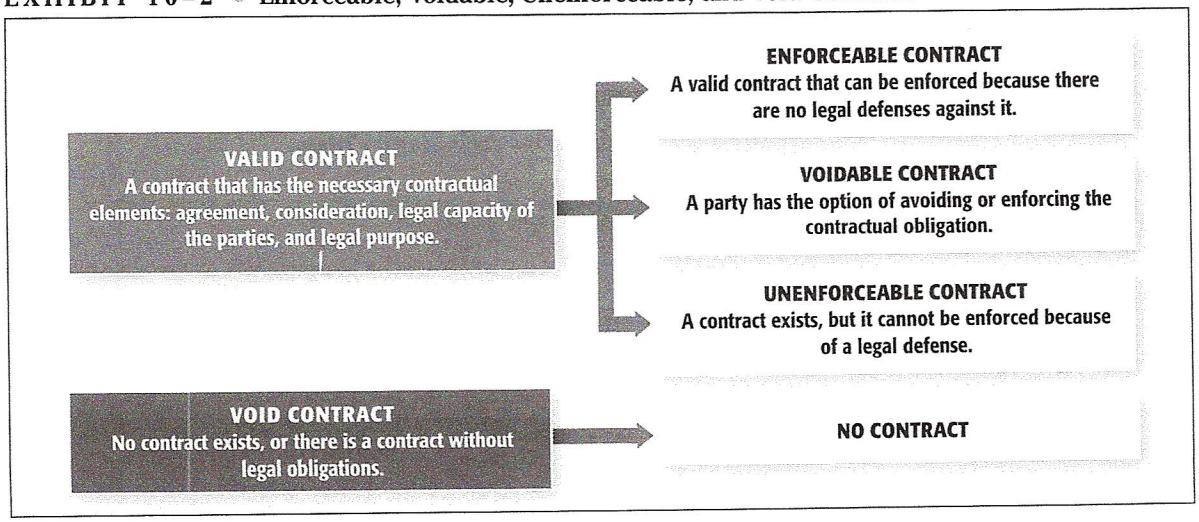
A **valid contract** has the elements necessary to entitle at least one of the parties to enforce it in court. Those elements, as mentioned earlier, consist of (1) an agreement consisting of an offer and an acceptance of that offer, (2) supported by legally sufficient consideration, (3) made by parties who have the legal capacity to enter into the contract, and (4) made for a legal purpose. As you can see in Exhibit 10–2, valid contracts may be enforceable, voidable, or unenforceable. Additionally, a contract may be referred to as a *void contract.* We look next at the meaning of the terms *voidable, unenforceable,* and *void* in relation to contract enforceability.

Voidable Contracts A **voidable contract** is a valid contract but one that can be avoided at the option of one or both of the parties. The party having the option can elect either to avoid any duty to perform or to *ratify* (make valid) the contract. If the contract is avoided, both parties are released from it. If it is ratified, both parties must fully perform their respective legal obligations.

As you will read in Chapter 13, contracts made by minors, insane persons, and intoxicated persons may be voidable. For example, contracts made by minors generally are voidable at the option of the minor (with certain exceptions). Additionally, contracts entered into under fraudulent conditions are voidable at the option of the defrauded party. Contracts entered into under legally defined duress or undue influence are also voidable (see Chapter 14).

Unenforceable Contracts An **unenforceable contract** is one that cannot be enforced because of certain legal defenses against it. It is not unenforceable because a party failed to satisfy a legal requirement of the contract; rather, it is a valid contract rendered unenforceable by some statute or law. For example, certain contracts must be in writing (see Chapter 15), and if they are not, they will not be enforceable except in certain exceptional circumstances.

EXHIBIT 10–2 • Enforceable, Voidable, Unenforceable, and Void Contracts



Void Contracts A **void contract** is no contract at all. The terms *void* and *contract* are contradictory. A void contract produces no legal obligations on any of the parties. For example, a contract can be void because one of the parties was adjudged by a court to be legally insane (and thus lacked the legal capacity to enter into a contract—see Chapter 13) or because the purpose of the contract was illegal. To review the various types of contracts, see *Concept Summary 10.1*.

Quasi Contracts

Quasi contracts, or contracts *implied in law*, are not actual contracts. Express contracts and implied-in-fact contracts are actual contracts formed by the words or actions of the parties. Quasi contracts, in contrast, are fictional contracts created by courts and imposed on parties in the interests of fairness and justice. Quasi contracts are therefore equitable, rather than contractual, in nature.

Usually, quasi contracts are imposed to avoid the *unjust enrichment* of one party at the expense of another. The doctrine of unjust enrichment is based on the theory that individuals should not be allowed to profit or enrich themselves inequitably at the expense of others. When the court imposes a quasi contract, a plaintiff may recover in ***quantum meruit,***[6] a Latin phrase meaning "as much as he or she deserves." *Quantum meruit* essentially describes the extent of compensation owed under a contract implied in law.

For example, suppose that a vacationing physician is driving down the highway and finds Potter lying unconscious on the side of the road. The physician renders medical aid that saves Potter's life. Although the injured, unconscious Potter did not solicit the medical aid and was not aware that the aid had been rendered, Potter received a valuable benefit, and the requirements for a quasi contract were fulfilled. In such a situation, the law will impose a quasi contract,

6. Pronounced *kwahn*-tuhm *mehr*-oo-wit.

CONCEPT SUMMARY 10.1
Types of Contracts

Aspect	Definition
FORMATION	1. *Bilateral*—A promise for a promise. 2. *Unilateral*—A promise for an act (acceptance is the completed performance of the act). 3. *Formal*—Requires a special form for creation. 4. *Informal*—Requires no special form for creation. 5. *Express*—Formed by words (oral, written, or a combination). 6. *Implied in fact*—Formed by the conduct of the parties.
PERFORMANCE	1. *Executed*—A fully performed contract. 2. *Executory*—A contract not fully performed.
ENFORCEABILITY	1. *Valid*—The contract has the necessary contractual elements: agreement (offer and acceptance), consideration, legal capacity of the parties, and legal purpose. 2. *Voidable*—One party has the option of avoiding or enforcing the contractual obligation. 3. *Unenforceable*—A contract exists, but it cannot be enforced because of a legal defense. 4. *Void*—No contract exists, or there is a contract without legal obligations.

and Potter normally will have to pay the physician for the reasonable value of the medical services rendered.

Limitations on Quasi-contractual Recovery

Although quasi contracts exist to prevent unjust enrichment, the party obtaining the enrichment is not held liable in some situations. Basically, a party who has conferred a benefit on someone else unnecessarily or as a result of misconduct or negligence cannot invoke the principle of quasi contract. The enrichment in those situations will not be considered "unjust."

For example, suppose that you take your car to the local car wash and ask to have it run through the washer and to have the gas tank filled. While it is being washed, you go to a nearby shopping center for two hours. In the meantime, one of the workers at the car wash has mistaken your car for the one that he is supposed to hand wax. When you come back, you are presented with a bill for a full tank of gas, a wash job, and a hand wax. Clearly, a benefit has been conferred on you. But this benefit has been conferred because of a mistake by the car wash employee. You have not been *unjustly* enriched under these circumstances. People normally cannot be forced to pay for benefits "thrust" on them.

When an Actual Contract Exists

The doctrine of quasi contract generally cannot be used when there is an *actual contract* that covers the matter in controversy. For example, Bateman contracts with Cameron to deliver a furnace to a building owned by Jones. Bateman delivers the furnace, but Cameron never pays Bateman. Jones has been unjustly enriched in this situation, to be sure. Bateman, however, cannot recover from Jones in quasi contract because Bateman had an actual contract with Cameron. Bateman already has a remedy—he can sue for breach of contract to recover the price of the furnace from Cameron. The court does not need to impose a quasi contract in this situation to achieve justice.

SECTION 5 Interpretation of Contracts

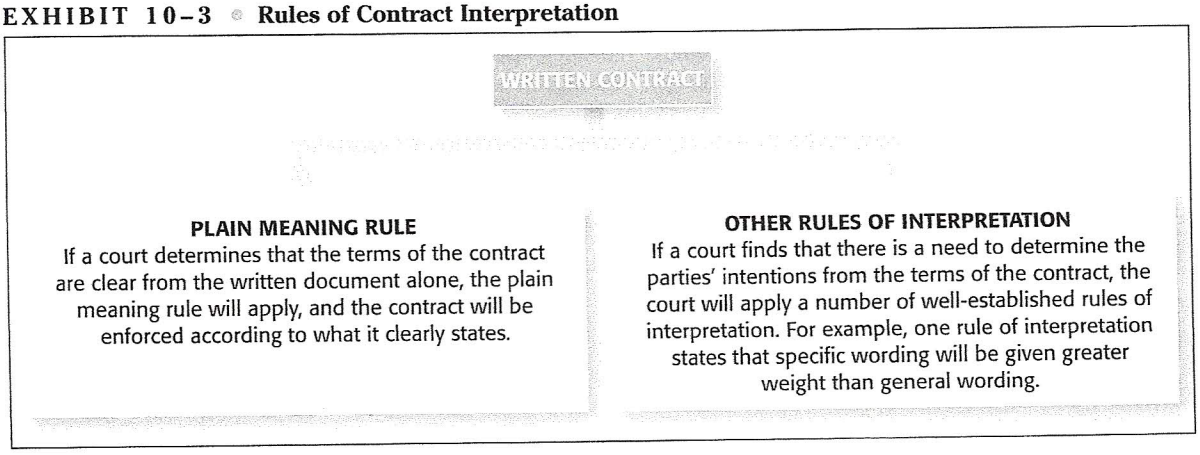
Sometimes, parties agree that a contract has been formed but disagree on its meaning or legal effect. One reason this may happen is that one of the parties is not familiar with the legal terminology used in the contract. To an extent, *plain language* laws (enacted by the federal government and a majority of the states) have helped to avoid this difficulty. Sometimes, though, a dispute may arise over the meaning of a contract simply because the rights or obligations under the contract are not expressed clearly—no matter how "plain" the language used.

In this section, we look at some common law rules of contract interpretation. These rules, which have evolved over time, provide the courts with guidelines for deciding disputes over how contract terms or provisions should be interpreted. Exhibit 10–3 provides a brief graphic summary of how these rules are applied.

The Plain Meaning Rule

When a contract's writing is clear and unequivocal, a court will enforce it according to its obvious terms. The meaning of the terms must be determined from

EXHIBIT 10–3 • Rules of Contract Interpretation



the face of the instrument—from the written document alone. This is sometimes referred to as the *plain meaning rule.*

Under this rule, if a contract's words appear to be clear and unambiguous, a court cannot consider *extrinsic evidence*—that is, any evidence not contained in the document itself. If a contract's terms are unclear or ambiguous, however, extrinsic evidence may be admissible to clarify the meaning of the contract. The admissibility of such evidence can significantly affect the court's interpretation of ambiguous contractual provisions and thus the outcome of litigation. The following case illustrates these points.

EXTENDED CASE 10.3 Wagner v. Columbia Pictures Industries, Inc.

California Court of Appeal, Second District, Division 7, 2007.
146 Cal.App.4th 586, 52 Cal.Rptr.3d 898.

***JOHNSON,* Acting P.J. [Presiding Judge]**

* * * *

Robert Wagner and Natalie Wood (the "Wagners") entered into an agreement with Spelling-Goldberg Productions (SGP) "relating to 'Charlie's Angels' (herein called the 'series')." The contract entitled the Wagners to 50 percent of the net profits SGP received as consideration "for the right to exhibit photoplays of the series and from the exploitation of all ancillary, music and subsidiary rights in connection therewith." SGP subsequently sold its rights and obligations with respect to the "Charlie's Angels" series to defendant Columbia Pictures [Industries, Inc.] Thirteen years later Columbia contracted to obtain the motion picture rights to the series from * * * the show's writers, Ivan Goff and Ben Roberts. In 2000 and 2003 Columbia produced and distributed two "Charlie's Angels" films based on the TV series.

Wagner contends the "subsidiary rights" provision in the agreement with SGP entitles him * * * to 50 percent of the net profits from the two "Charlie's Angels" films. * * *

Wagner brought this action [in a California state court] against Columbia for breach of contract * * * . Columbia answered and moved for summary [judgment] * * * . [T]he trial court granted that motion * * * . [Wagner appealed this judgment to a state intermediate appellate court.]

* * * *

Wagner introduced evidence of the history of the negotiations underlying the "Charlie's Angels" contract in support of his [contention].

This history begins with a contract the Wagners entered into with SGP to star in a television movie-of-the-week, "Love Song." As compensation for Wagner and Wood acting in "Love Song," SGP agreed to pay them a fixed amount plus one-half the net profits * * * .

* * * *

In the * * * "Love Song" contract net profits were not limited to monies received "for the right to exhibit the Photoplay." Instead they were defined as the net of "all monies received by Producer as consideration for the right to exhibit the Photoplay, and exploitation of all ancillary, music and subsidiary rights in connection therewith."

* * * *

Wagner's argument is simple and straightforward. The net profits provision in the "Love Song" agreement was intended to give the Wagners a one-half share in the net profits received by SGP "from all sources" without limitation as to source or time. * * * The "Charlie's Angels" agreement was based on the "Love Song" agreement and defines net profits in identical language. Therefore, the "Charlie's Angels" agreement should also be interpreted as providing the Wagners with a 50 percent share in SGP's income "from all sources" without limitation as to source or time. Since Columbia admits it stands in SGP's shoes with respect to SGP's obligations under the "Charlie's Angels" agreement, Columbia is obligated to pay Wagner * * * 50 percent of the net profits derived from the "Charlie's Angels" movies.

* * * *

The problem with Wagner's extrinsic evidence is that it does not explain the ["Charlie's Angels"] contract language, it contradicts it. *Under the parol evidence rule,*[a] *extrinsic evidence is not admis-*

a. As will be discussed in Chapter 15, the *parol evidence rule* prohibits the parties from introducing in court evidence of an oral agreement that contradicts the written terms of a contract.

CASE 10.3 CONTINUED

sible to contradict express terms in a written contract or to explain what the agreement was. The agreement is the writing itself. Parol evidence cannot be admitted to show intention independent of an unambiguous written instrument. * * * [Emphasis added.]

Even if the Wagners and SGP intended the Wagners would share in the net profits "from any and all sources" they did not say so in their contract. What they said in their contract was the Wagners would share in "all monies actually received by Producer, as consideration for the right to exhibit photoplays of the series, and from the exploitation of all ancillary, music and subsidiary rights in connection therewith." For a right to be "subsidiary" or "ancillary," meaning supplementary or subordinate, there must be a primary right to which it relates. The only primary right mentioned in the contract is "the right to exhibit photoplays of the series." Thus the Wagners were entitled to share in the profits from the exploitation of the movie rights to "Charlie's Angels" if those rights were exploited by Columbia as ancillary or subsidiary rights of its primary "right to exhibit photoplays of the series" but not if those rights were acquired by Columbia independently from its right to exhibit photoplays.

* * * *

To understand how the producer of a television series acquires the motion picture rights in the series it is necessary to understand the * * * Writers Guild of America Minimum Basic Agreement (MBA).[b]

* * * *

The contract between Goff and Roberts and SGP * * * stated: "The parties acknowledge that this agreement is subject to all of the terms and provisions of the applicable [MBA] * * * ."

Article 16B of the MBA entitled "Separation of Rights" provided * * * : "[Producer] shall own the exclusive film television rights in the literary material * * * Writer shall retain all other rights * * * including but not limited to * * * theatrical motion picture * * * rights."

* * * *

Despite the provision in the MBA conferring the motion picture rights in a teleplay on the writers of the teleplay the producer retained a "limited interest in such rights." As relevant here, this "limited interest" consisted of the right of first refusal should the writer decide to offer the movie rights for sale within five years from the date the writer delivered the teleplay to the producer. After the five-year period expired the producer could still purchase the movie rights but it had to do so on the open market and in competition with any other producer who wanted to purchase those rights.

Consequently, if Columbia had produced "Charlie's Angels" movies based on motion picture rights * * * SGP had acquired from Goff and Roberts under SGP's right of first refusal Columbia could be said to have "exploited" an ancillary or subsidiary right, i.e., movie-making, in connection with "the right to exhibit photoplays of the series," and the Wagners would be entitled to a share of the movies' profits.

However, * * * there is no evidence SGP ever acquired the motion picture rights to "Charlie's Angels" by exercising its right of first refusal or in any other way connected to its right to exhibit photoplays of the series.

* * * *

The judgment is affirmed.

QUESTIONS

1. How might the result in this case have been different if the court had admitted the Wagners' evidence of the "Love Song" contract?
2. Under what circumstance would the Wagners' evidence of the "Love Song" contract have been irrelevant and yet they would still have been entitled to a share of the profits from the "Charlie's Angels" movies?

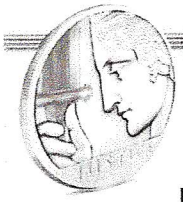
b. The Writers Guild of America is an association of screen and television writers that negotiates industrywide agreements with motion picture and television producers.

Other Rules of Interpretation

Generally, a court will interpret the language to give effect to the parties' intent as *expressed in their contract.* This is the primary purpose of the rules of interpretation—to determine the parties' intent from the language used in their agreement and to give effect to that intent. A court normally will not make or remake a contract, nor will it interpret the language according to what the parties *claim* their intent was when they made it. The courts use the following rules in interpreting contractual terms:

1. Insofar as possible, a reasonable, lawful, and effective meaning will be given to all of a contract's terms.
2. A contract will be interpreted as a whole; individual, specific clauses will be considered subordinate to the contract's general intent. All writings that are a part of the same transaction will be interpreted together.
3. Terms that were the subject of separate negotiation will be given greater consideration than standardized terms and terms that were not negotiated separately.
4. A word will be given its ordinary, commonly accepted meaning, and a technical word or term will be given its technical meaning, unless the parties clearly intended something else.[7]
5. Specific and exact wording will be given greater consideration than general language.
6. Written or typewritten terms will prevail over preprinted ones.
7. Because a contract should be drafted in clear and unambiguous language, a party who uses ambiguous expressions is held to be responsible for the ambiguities. Thus, when the language has more than one meaning, it will be interpreted against the party who drafted the contract.
8. Evidence of trade usage, prior dealing, and course of performance may be admitted to clarify the meaning of an ambiguously worded contract (these terms will be defined and discussed in Chapter 20). When considering custom and usage, a court will look at what is common to the particular business or industry and to the locale where the contract was made or is to be performed.

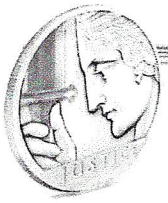
7. See, for example, *Citizens Communications Co. v. Trustmark Insurance,* 303 F.Supp.2d 197 (2004).



REVIEWING Nature and Terminology

Grant Borman, who was engaged in a construction project, leased a crane from Allied Equipment and hired Crosstown Trucking Company to deliver the crane to the construction site. Crosstown, while the crane was in its possession and without permission from either Borman or Allied Equipment, used the crane to install a transformer for a utility company, which paid Crosstown for the job. Crosstown then delivered the crane to Borman's construction site at the appointed time of delivery. When Allied Equipment learned of the unauthorized use of the crane by Crosstown, it sued Crosstown for damages, seeking to recover the rental value of Crosstown's use of the crane. Using the information presented in the chapter, answer the following questions.

1. What are the four requirements of a valid contract?
2. Did Crosstown have a valid contract with Borman concerning the use of the crane? If so, was it a bilateral or a unilateral contract? Explain.
3. What are the requirements of an implied-in-fact contract? Can Allied Equipment obtain damages from Crosstown based on an implied-in-fact contract? Why or why not?
4. Should a court impose a quasi contract on the parties in this situation to allow Allied to recover damages from Crosstown? Why or why not?



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QUESTIONS AND CASE PROBLEMS

10-1. Suppose that Everett McCleskey, a local businessperson, is a good friend of Al Miller, the owner of a local candy store. Every day on his lunch hour, McCleskey goes into Miller's candy store and spends about five minutes looking at the candy. After examining Miller's candy and talking with Miller, McCleskey usually buys one or two candy bars. One afternoon, McCleskey goes into Miller's candy shop, looks at the candy, and picks up a $1 candy bar. Seeing that Miller is very busy, he waves the candy bar at Miller without saying a word and walks out. Is there a contract? If so, classify it within the categories presented in this chapter.

10-2. QUESTION WITH SAMPLE ANSWER

Janine was hospitalized with severe abdominal pain and placed in an intensive care unit. Her doctor told the hospital personnel to order around-the-clock nursing care for Janine. At the hospital's request, a nursing services firm, Nursing Services Unlimited, provided two weeks of in-hospital care and, after Janine was sent home, an additional two weeks of at-home care. During the at-home period of care, Janine was fully aware that she was receiving the benefit of the nursing services. Nursing Services later billed Janine $4,000 for the nursing care, but Janine refused to pay on the ground that she had never contracted for the services, either orally or in writing. In view of the fact that no express contract was ever formed, can Nursing Services recover the $4,000 from Janine? If so, under what legal theory? Discuss.

- For a sample answer to Question 10–2, go to Appendix I at the end of this text.

10-3. Burger Baby restaurants engaged Air Advertising to fly an advertisement above the Connecticut beaches. The advertisement offered $1,000 to any person who could swim from the Connecticut beaches to Long Island across Long Island Sound in less than a day. At 10:00 A.M. on Saturday, October 10, Air Advertising's pilot flew a sign above the Connecticut beaches that read: "Swim across the Sound and Burger Baby pays $1,000." On seeing the sign, Davison dived in. About four hours later, when he was about halfway across the Sound, Air Advertising flew another sign over the Sound that read: "Burger Baby revokes." Davison completed the swim in another six hours. Is there a contract between Davison and Burger Baby? Can Davison recover anything?

10-4. Bilateral versus Unilateral Contracts. D.L. Peoples Group (D.L.) placed an ad in a Missouri newspaper to recruit admissions representatives, who were hired to recruit Missouri residents to attend D.L.'s college in Florida. Donald Hawley responded to the ad, his interviewer recommended him for the job, and he signed, in Missouri, an "Admissions Representative Agreement," which was mailed to D.L.'s president, who signed it in his office in Florida. The agreement provided, in part, that Hawley would devote exclusive time and effort to the business in his assigned territory in Missouri and that D.L. would pay Hawley a commission if he successfully recruited students for the school. While attempting to make one of his first calls on his new job, Hawley was accidentally shot and killed. On the basis of his death, a claim was filed in Florida for workers' compensation. (Under Florida law, when an accident occurs outside Florida, workers' compensation benefits are payable only if the employment contract was made in Florida.) Was this admissions representative agreement a bilateral or a unilateral contract? What are the consequences of the distinction in this case? Explain. [*D.L. Peoples Group, Inc. v. Hawley*, 804 So.2d 561 (Fla.App. 1 Dist. 2002)]

10-5. Interpretation of Contracts. East Mill Associates (EMA) was developing residential "units" in East

Brunswick, New Jersey, within the service area of the East Brunswick Sewerage Authority (EBSA). The sewer system required an upgrade to the Ryder's Lane Pumping Station to accommodate the new units. EMA agreed to pay "fifty-five percent (55%) of the total cost" of the upgrade. At the time, the estimated cost to EMA was $150,000 to $200,000. Impediments to the project arose, however, substantially increasing the cost. Among other things, the pumping station had to be moved to accommodate a widened road nearby. The upgrade was delayed for almost three years. When it was completed, EBSA asked EMA for $340,022.12, which represented 55 percent of the total cost. EMA did not pay. EBSA filed a suit in a New Jersey state court against EMA for breach of contract. What rule should the court apply to interpret the parties' contract? How should that rule be applied? Why? [*East Brunswick Sewerage Authority v. East Mill Associates, Inc.*, 365 N.J.Super. 120, 838 A.2d 494 (A.D. 2004)]

10-6. CASE PROBLEM WITH SAMPLE ANSWER

In December 2000, Nextel South Corp., a communications firm, contacted R. A. Clark Consulting, Ltd., an executive search company, about finding an employment manager for Nextel's call center in Atlanta, Georgia. Over the next six months, Clark screened, evaluated, and interviewed more than three hundred candidates. Clark provided Nextel with more than fifteen candidate summaries, including one for Dan Sax. Nextel hired Sax for the position at an annual salary of $75,000. Sax started work on June 25, 2001, took two weeks' vacation, and quit on July 31 in the middle of a project. Clark spent the next six weeks looking for a replacement, until Nextel asked Clark to stop. Clark billed Nextel for its services, but Nextel refused to pay, asserting, among other things, that the parties had not signed an agreement. Nextel's typical agreement specified payment to an employment agency of 20 percent of an employee's annual salary. Clark filed a suit in a Georgia state court against Nextel to recover in *quantum meruit*. What is *quantum meruit?* What should Clark have to show to recover on this basis? Should the court rule in Clark's favor? Explain. [*Nextel South Corp. v. R. A. Clark Consulting, Ltd.*, 266 Ga.App. 85, 596 S.E.2d 416 (2004)]

- **To view a sample answer for Problem 10–6, go to this book's Web site at academic.cengage.com/blaw/clarkson, select "Chapter 10," and click on "Case Problem with Sample Answer."**

10-7. Contract Enforceability. California's Subdivision Map Act (SMA) prohibits the sale of real property until a map of its subdivision is filed with, and approved by, the appropriate state agency. In November 2004, Black Hills Investments, Inc., entered into two contracts with Albertson's, Inc., to buy two parcels of property in a shopping center development. Each contract required that "all governmental approvals relating to any lot split [or] subdivision" be obtained before the sale but permitted Albertson's to waive this condition. Black Hills made a $133,000 deposit on the purchase. A few weeks later, before the sales were complete, Albertson's filed with a local state agency a map that subdivided the shopping center into four parcels, including the two that Black Hills had agreed to buy. In January 2005, Black Hills objected to concessions that Albertson's had made to a buyer of one of the other parcels, told Albertson's that it was terminating its deal, and asked for a return of its deposit. Albertson's refused. Black Hills filed a suit in a California state court against Albertson's, arguing that the contracts were void. Are these contracts valid, voidable, unenforceable, or void? Explain. [*Black Hills Investments, Inc. v. Albertson's, Inc.*, 146 Cal.App.4th 883, 53 Cal.Rptr.3d 263 (4 Dist. 2007)]

10-8. A QUESTION OF ETHICS

*International Business Machines Corp. (IBM) hired Niels Jensen in 2000 as a software sales representative. In 2001, IBM presented a new "Software Sales Incentive Plan" (SIP) at a conference for its sales employees. A brochure given to the attendees stated, "[T]here are no caps to your earnings; the more you sell, * * * the more earnings for you." The brochure outlined how the plan worked and referred the employees to the "Sales Incentives" section of IBM's corporate intranet for more details. Jensen was given a "quota letter" that said he would be paid $75,000 as a base salary and, if he attained his quota, an additional $75,000 as incentive pay. In September, Jensen closed a deal with the U.S. Department of the Treasury's Internal Revenue Service that was worth over $24 million to IBM. Relying on the SIP brochure, Jensen estimated his commission to be $2.6 million. IBM paid him less than $500,000, however. Jensen filed a suit in a federal district court against IBM, contending that the SIP brochure and quota letter constituted a unilateral offer that became a binding contract when Jensen closed the sale. In view of these facts, consider the following questions.* [Jensen v. International Business Machines Corp., *454 F.3d 382 (4th Cir. 2006)*]

(a) Would it be fair to the employer in this case to hold that the SIP brochure and the quota letter created a unilateral contract if IBM did not intend to create such a contract? Would it be fair to the employee to hold that no contract was created? Explain.

(b) The "Sales Incentives" section of IBM's intranet included a clause providing that "[m]anagement will decide if an adjustment to the payment is appropriate" when an employee closes a large transaction. Jensen's quota letter stated, "[The SIP] program does not constitute a promise by IBM to make any distributions under it. IBM reserves the right to adjust the program terms or to cancel or otherwise modify the program at any time." How do these statements affect your answers to the above questions? From an ethi-

cal perspective, would it be fair to hold that a contract exists despite these statements?

10-9. SPECIAL CASE ANALYSIS

Go to Case 10.3, *Wagner v. Columbia Pictures Industries, Inc.*, 146 Cal.App.4th 586, 52 Cal.Rptr.3d 898 (2 Dist. 2007), on pages 226–227. Read the excerpt and answer the following questions.

(a) **Issue:** The dispute between the parties to this case centered on which contract and asked what question?
(b) **Rule of Law:** What rule concerning the interpretation of a contract and the admission of evidence did the court apply in this case?
(c) **Applying the Rule of Law:** How did the intent of the contracting parties and the language in their contract affect the application of the rule of law?
(d) **Conclusion:** Did the court resolve the dispute in the plaintiff's favor? Why or why not?

10-10. VIDEO QUESTION

Go to this text's Web site at **academic.cengage.com/blaw/clarkson** and select "Chapter 10." Click on "Video Questions" and view the video titled *Bowfinger*. Then answer the following questions.

(a) In the video, Renfro (Robert Downey, Jr.) says to Bowfinger (Steve Martin), "You bring me this script and Kit Ramsey and you've got yourself a 'go' picture." Assume for the purposes of this question that their agreement is a contract. Is the contract bilateral or unilateral? Is it express or implied? Is it formal or informal? Is it executed or executory? Explain your answers.
(b) What criteria would a court rely on to interpret the terms of the contract?
(c) Recall from the video that the contract between Bowfinger and the producer was oral. Suppose that a statute requires contracts of this type to be in writing. In that situation, would the contract be void, voidable, or unenforceable? Explain.

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The 'Lectric Law Library provides information about contract law, including a definition of a contract and the elements required for a contract. Go to

lectlaw.com/def/c123.htm

Scroll down to the "Other Assorted Items" section and click on "Contracts."

You can keep abreast of recent and planned revisions of the *Restatements of the Law*, including the *Restatement (Second) of Contracts*, by accessing the American Law Institute's Web site at

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Legal Research Exercises on the Web

Go to **academic.cengage.com/blaw/clarkson**, the Web site that accompanies this text. Select "Chapter 10" and click on "Internet Exercises." There you will find the following Internet research exercises that you can perform to learn more about the topics covered in this chapter.

Internet Exercise 10–1: Legal Perspective
Contracts and Contract Provisions

Internet Exercise 10–2: Management Perspective
Implied Employment Contracts

Internet Exercise 10–3: Historical Perspective
Contracts in Ancient Mesopotamia