



# A DEAL'S A DEAL

CONTRACT LAW

# WHY DO WE NEED CONTRACT LAW?

- In a market economy, work is done, goods are distributed, and specialization of labor and production is coordinated through contracts.

## FOR EXAMPLE

- People want a way to transport themselves.
- Ford creates subcompacts cars and SUVs.
- If the cars are attractive and the price is competitive, people will contract to buy them.
- Ford meets this demand by hiring workers, buying raw steel and finished tires, advertising the cars on TV, franchising to local dealers to sell its cars, and entering into a thousand other contracts.
- This system of production and distribution is organized through the interaction of many contracts.

# WHY DO WE NEED CONTRACT LAW?

- Contract law has two special functions in making an open, democratic society possible:
  - 1) It provides a dispute resolution mechanism for exchanges; and
  - 2) It demonstrates society's commitment to freedom and autonomy



# WHY DO WE NEED CONTRACT LAW?

- Lawyers are often inclined to overstate the importance of contract law.
- Contract law is important, but when we look at the entire landscape of contracting in society, we see that contract law is only a small part of the picture.

# WHY DO WE NEED CONTRACT LAW?



Most agreements are made and performed with no trouble.



And even when trouble does occur in a contract, contract law is a remedy of last resort.



For example, if a dispute arises between Ford and one of its suppliers, neither of them will immediately resort to calling their lawyers.



The supplier wants to protect its reputation and the prospect of future sales to Ford, and Ford wants to keep its assembly line moving.



So, the parties will usually just get on the phone and try to work things out.

# WEAKNESSES IN THE FREEDOM OF CONTRACT

- In the classic case, *Hurley v. Eddingfield*, a doctor in the small town of Mace, Indiana, was the Burks' family doctor.
- Charlotte Burk went into labor and became seriously ill. Her family asked that Eddingfield come and help Charlotte, but he refused to come.
- Even when a messenger told him that Charlotte was seriously ill and she and her baby were in danger of dying, he refused to come help her “without any reason whatsoever,” as the court said.

# WEAKNESSES IN THE FREEDOM OF CONTRACT

- Charlotte and her baby unfortunately died because of the lack of medical treatment, and her heirs sued Eddingfield.
- The Indiana Supreme Court held that Eddingfield had no duty as a licensed doctor to come to Charlotte's aid.
- And the court didn't even consider that Eddingfield, as the Burks' family doctor, had a duty as a matter of contract law to come and help his patient.

# WEAKNESSES IN THE FREEDOM OF CONTRACT

- Because contract law is based on consent, no one can be compelled to enter into a contract against his will, not even the only doctor available to treat a dying patient whom he had previously treated.



# FREEDOM OF CONTRACT IS NOT AN ABSOLUTE PRINCIPLE

- Of course, things have changed a little bit since 1901.
- Federal law today requires hospitals to treat patients in certain circumstances, including women in labor.
- Many other laws also require people to enter into contracts, whether they want to or not, thereby limiting their freedom to contract.
- For example, a prejudiced employer may refuse to hire blacks, Muslims, or women, but civil rights law prevents him from discriminating in this way.

# CONTRACT LAW IS ONLY PARTIALLY ABOUT CHOICE

- Suppose that Eddingfield repeatedly treated Burk and her family, and over time they thought of each other as “my doctor” and “my patient.”
- Then we could assume that there was a relationship of family doctor and patient here.
- Can we then assume from this that Eddingfield has agreed to come when called in emergencies?

# CONTRACT LAW IS ONLY PARTIALLY ABOUT CHOICE

- The parties to a contract may be bound to a particular term—providing service in an emergency—even if they did not actually agree to it or never thought about it specifically.
- Eddingfield might not have intended to provide emergency services, and Birk may not have thought about the issue in advance.
- But when the emergency arises, we could still hold the doctor liable for failing to respond.

# CONTRACT LAW IS ONLY PARTIALLY ABOUT CHOICE

- The basis of liability for the doctor flows from our sense of the relationship itself.
- Each of us determines what we think the right answer should be based on evidence about the typical doctor-patient relationship, our own experience with doctors, and our sense of what kinds of duties people should owe to each other.
- And the right answer rests on a decision about what is best for the interests of society as a whole.

# HOW DO YOU MAKE A CONTRACT?



- You can make a contract almost any way you want!

# HOW DO YOU MAKE A CONTRACT



- We look to see whether a **reasonable person** would be justified in believing that a person has **made a promise**.
- There are two elements to a promise: 1) commitment to 2) a future course of action.
- When you promise to do something, you are saying that you **really** will do it, not that you will do it if you feel like it when the time comes, or you will do it unless you change your mind.

# MAKING A CONTACT

- If someone says, “I promise to pay \$5,000 for your car” and then the other person says “I agree to sell you my car for that price”; has a contract been formed?

# MAKING A CONTRACT

- Yes! It is reasonable to believe that both parties are committed to buying the car.

# MAKING A CONTRACT

- At an auction, the auctioneer says, “We have this lovely Picasso. We will start the bidding at \$20 million.” If you raise your hand, has a contract been formed?

# MAKING A CONTRACT

- Likely yes. It is possible to make a contract by implication or with no words at all. You may have just obligated yourself to pay \$20 million for the painting.

# MAKING A CONTRACT

- Proceeding from the idea that contract formation is about the **manifestation of assent**, we look to see if the parties have demonstrated their consent to enter into a contract.

# MAKING A CONTRACT

- An employee is working under an employment contract that expires on December 15<sup>th</sup>.
- In early December, the president of the company offers to renew the employee's contract for another year.
- The president and the employee discuss the employee's duties, salary, health benefits, vacation, and sick leave, and incorporate their understanding into a written document.
- They both sign the agreement and shake hands.
- Has a contract been formed?

# MAKING A CONTRACT



- Yes. This may have been an obvious example...
- Here, the contract is formed at the moment they both sign the document.

# MAKING A CONTRACT

- Suppose that you have been looking for a car, and you see a car parked on the side of the road with a “for sale” sign.
- You text the number on the sign, asking them if they are still selling the car.
- The seller replies in a text saying, “I will sell you the car for \$5,000.”
- Has a contract been formed?

# MAKING A CONTRACT



No.



Here, no contract was formed because this type of contract formation occurs through **offer** and **acceptance**.



One party must initiate the agreement process and the other party completes it (and forms a contract) by accepting it.



Here, you could accept the offer by texting back, “I will buy it.”

# MAKING A CONTRACT

- Suppose Embry, the manager of the samples department of a company, had an employment contract with the company that was set to expire on December 15.
- McKinney, the president of the company, had put off Embry whenever he tried to raise the issue of contract renewal.
- Finally, on December 23, Embry went to McKinney and said that he would quit then and there unless they agreed on a contract for another year.

# MAKING A CONTRACT

- McKinney asked Embry how his department was getting along, and Embry said they were very busy, as it was the height of the season for getting salespeople on the road to see customers.
- McKinney then said, “Go ahead, you’re all right. Get your men out and don’t let that worry you.”
- Embry, assuming he had a new contract for a year, worked until February 15. He was then fired.
- **Was a contract formed?**

# MAKING A CONTRACT

- Perhaps.
- The law says that if Embry was **reasonable** in believing that McKinney was making a promise, we will protect his **reasonable expectation**.
- **The test for contract formation** is not whether someone actually intended to make a promise, but whether their words and conduct, as reasonably understood by the person to whom they were directed, were sufficient to ***imply a promise***

# MAKING A CONTRACT

(We call the person who makes a promise the ***promisor*** and the person to whom the promise is made the ***promisee***.)

We look at contract formation through an ***objective lens*** and not a ***subjective*** one. In other words, we focus on objective, observable factors such as words and conduct, rather than the actual state of mind of the promisor.

# MAKING A CONTRACT

- For example, let's say that you are sitting at a table playing your Nintendo Switch.
- Someone you know (only vaguely) approaches you and asks to buy the Switch for \$200.
- You say, sarcastically, “Yes, of course. I would *love* to sell my Switch I just bought for the same price I paid for it for just a few weeks ago.”
- Has a **contract been formed?**

# MAKING A CONTRACT



- Probably.
- As we talked about earlier, the person that hears the promise has no way of determining the subjective state of mind of the person making the promise.
- Therefore, if what the promisee hears sounds like a promise in the circumstances, she is entitled to believe that a promise is being made.

# MAKING A CONTRACT

- Same set of facts as earlier. Except this time, the person offers to pay you \$10 for your relatively new Switch.
- You agree, sarcastically.
- Has a contract been formed?

# MAKING A CONTRACT

Probably not.

The key here is **reasonableness**.

The purpose of the objective theory of contract is to protect the **reasonable expectations** of the person to whom the promise is directed.

If we look at the circumstances, we can probably determine that the other person would not be entitled to rely on that promise.

For example: you do not know this person; they are offering you a price far below the market value; and you responded with a sarcastic tone of voice.



# DOES A CONTRACT HAVE TO BE IN WRITING TO BE ENFORCEABLE?

Usually, a contract does not have to be in writing.

As long as the parties sufficiently indicate that they intend to make a contract, oral promises are sufficient.

# DOES A CONTRACT HAVE TO BE IN WRITING TO BE ENFORCEABLE?

- However, there are some contracts that must be in writing to be enforceable. These are promises governed by the Statute of Frauds.
- The list of contracts required by the statute to be in writing varies from jurisdiction to jurisdiction, but there are a few that are commonly on the list:
  - 1) A contract to pay someone else's debt
  - 2) A contract that is not to be performed within one year of the time that it is made
  - 3) A contract for the sale of goods for \$500 or more.

# DOES A CONTRACT HAVE TO BE IN WRITING TO BE ENFORCEABLE?



- To enforce these types of contracts, a plaintiff must produce a writing signed by the other party that contains evidence of the contract.

# ARE CONTRACTS ALWAYS ENFORCEABLE?

- Consider this hypothetical:
- Uncle agrees to sell and Nephew agrees to buy Uncle's car for \$5,000.
- Is this contract enforceable? (I.e., can Nephew bring Uncle to court and force him to sell the car for \$5,000?)



# ARE CONTRACTS ALWAYS ENFORCEABLE?

- Yes.
- Uncle and Nephew have exercised their freedom of contract in an obvious manifestation of assent, so we are inclined to enforce the promise.

# ARE CONTRACTS ALWAYS ENFORCEABLE?

- Next, consider the following hypothetical:
- Uncle promises to give Nephew the car on Nephew's next birthday.
- If Uncle later changes his mind, is the contract enforceable? (I.e., can Nephew take Uncle to court and force him to hand over the car?)

# ARE CONTRACTS ALWAYS ENFORCEABLE?

- Probably not.
- Here, we have a manifestation of assent. But is it enough?
- Although we have a promise, it is a promise to make a gift, not a promise to enter into a bargain.
- This presents a problem because it is often hard to determine if the gift promise was made seriously.

# ARE CONTRACTS ALWAYS ENFORCEABLE?

- This is where the **doctrine of consideration** comes into play.
- Any promise supported by consideration is enforceable, whereas any promise not supported by consideration is unenforceable.
- Even though Uncle's promise was made freely, he receives nothing for it in return for his promise, so it is not legally binding.
- Note: once Uncle gives the car, he cannot demand it back; although a promise to make a gift is unenforceable under contract law, an executed gift is a binding transaction.

# WHAT IS CONSIDERATION ANYWAY?

- Consider the following:
- Uncle promised to give Nephew \$5,000 if Nephew refrained from smoking or drinking until his 21<sup>st</sup> birthday.
- Is this contract enforceable?

# WHAT IS CONSIDERATION ANYWAY?

- Yes!
- Even though Uncle gets no economic value from Nephew's performance (i.e., not smoking or drinking until he is 21), the promise is still supported by consideration.
- Here, the consideration is Uncle's interest in his Nephew's health or moral fiber, and it could be reason enough for courts to enforce the exchange.
- Additionally, even though Nephew is not harmed by agreeing to the promise, he still gives something up.
  - Uncle gets: a healthy Nephew
  - Nephew gives up: his "freedom" to smoke and drink

# WHAT HAPPENS IF YOU BREACH A CONTRACT

- The consequence of a breach is that the injured party (can be the promisee or the promisor) is entitled to a legal remedy for breach of contract.
- Usually, when a promise is broken, the injured party's expectation is the usual measure of contract damages. (i.e., the injured party gets a sum of money to put them in the place they would be had the contract been performed as promised)
- In other situations, however, the court may order the other party to do what they promised to do.

# THE CASE OF THE HAIRY HAND

- The case involved a young boy named George Hawkins whose hand was badly scarred. A surgeon named Edward R. B. McGee promised that an operation, which entailed the grafting of skin from Hawkins's chest onto his hand, would leave Hawkins with a 100% good hand. Instead, the operation left Hawkins with, well . . . a hairy hand.

# THE CASE OF THE HAIRY HAND

- Hawkins sued McGee. In resolving the matter, the Supreme Court of New Hampshire declared that the proper measure of damages for breach of contract in cases like this was the difference between the value of the contract as fully performed and the actual value of what the non-breaching party got, plus any reasonably foreseeable incidental damages.
- In other words, Hawkins was entitled to the difference in value between a 100% good hand and a hairy hand.
- The money that Hawkins received were called **expectation damages**. (I.e., the monetary difference between a “normal” hand a hairy one.)

## LET'S LOOK AT SOME MORE EXAMPLES

- A farmer agrees to sell a truckload of pumpkins to the owner of a roadside produce stand for \$100.
- When the farmer fails to deliver the pumpkins, the stand owner buys a substitute truckload of pumpkins for \$120.
- **What is the farmer required to pay? \$100 or \$20?**

## EXAMPLES

- Here, the farmer would be required to pay \$20.
- The stand owner expected to get a truckload of pumpkins for \$100. If the farmer pays the stand owner \$20, then that would satisfy the owner's expectation.

## EXAMPLES

- A farmer agrees to sell a truckload of pumpkins to the owner of a roadside produce stand for \$100.
- When the farmer fails to deliver the pumpkins, the stand owner buys a substitute truckload of pumpkins for \$90.
- **What is the farmer required to pay? \$10 or \$0?**

## EXAMPLES

- Here, the farmer would be required to pay \$0.
- The stand owner expected to get a truckload of pumpkins for \$100. Because the stand owner was able to get the pumpkins for \$10 less than the agreed price, the stand owner is in a better position than if the farmer actually delivered the pumpkins.

## EXAMPLES

- Let's say that the stand owner refused to accept the pumpkins once the farmer delivered them.
- The farmer is able to resell the pumpkins for \$90.
- What does the stand owner have to pay the farmer? \$100 or \$10?

## EXAMPLES

- Here, the stand owner would have to pay the farmer \$10.
- The owner must pay \$10 because it will put the farmer in the same position that he would have been if the promise had been performed: no pumpkins in his truck and \$100 in his pocket.