

## 12.1: Contracts

**What you'll learn to do: list and describe the elements of a legally enforceable contract, and explain the consequences of breach of contract**

The contract is probably the most familiar legal concept in American society because it's so central to deeply held convictions about the nature of our political, economic, and social life. In this section you'll learn what contracts are and why they're so central to business.

### Learning Objectives

- Identify the four elements of a legally enforceable contract
- Explain the legal remedies for breach of contract

What Is a Contract?

A **contract** is a voluntary arrangement between two or more parties that is enforceable as a binding legal agreement.

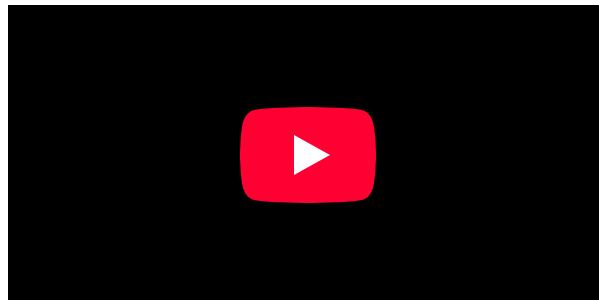
A contract arises when the parties concur that there is an agreement. Formation of a contract generally requires an offer, acceptance, consideration, and a mutual intent to be bound. Each party to a contract must have capacity to enter the agreement. Minors, intoxicated persons, and those under a mental affliction may have insufficient capacity to enter a contract.

A contract may be oral or written, and the lack of a writing does not automatically make the contract void. English law and later U.S. law, however, recognized that oral contracts were subject to fraudulent claims by unscrupulous parties, and so developed the "Statute of Frauds" requiring that certain types of contracts be put into writing in order to be enforceable.

Under U.S. law, a contract must have four essential elements in order to be valid:

1. Offer and Acceptance
2. Consideration
3. Competent Parties
4. Legal Purpose

The following video explains these requirements in greater detail.





## Breaches of Contracts

We speak of contracts as being either enforceable (legally binding) or unenforceable. An enforceable contract creates legal obligations, and the failure to comply with them creates a breach of contract.

When a party fails to live up to its obligations under the contract, he is said to have breached the agreement or to be in **breach of contract**. In the case of a breach of contract, the party that has suffered as a result of the breach may be granted one or more of the following remedies:

1. **Specific Performance.** In some circumstances a court will order a party to perform his or her promise under the contract. In this case, the court will make an order of what is called “specific performance,” requiring that the contract be performed. There may be circumstances in which it would be unjust to permit the defaulting party simply to buy out the injured party with damages—for example, if an art collector purchased a rare painting and the vendor refused to deliver, the collector’s damages would be equal to the sum paid, but that wouldn’t exactly be just, since the contract stipulated receipt of the painting.
2. **Damages.** Damages may be general or consequential. **General damages** are those damages that naturally flow from a breach of contract. **Consequential damages** are those damages that, although not naturally flowing from a breach, are naturally supposed by both parties at the time of contract formation. An example would be when someone rents a car to get to a business meeting, but when that person arrives to pick up the car, it isn’t there. General damages would be the cost of renting a different car. Consequential damages would be the business lost if that person were unable to get to the meeting, if both parties knew the reason the party was renting the car. However, there is still a duty to mitigate the losses. The fact that the car wasn’t there doesn’t give the party a right not to attempt to rent another car.
3. **Discharge of Duties.** There are some instances when, after the breach, both parties are relieved of their obligations under the contract. Let’s say you enter into a contract to purchase a house, but the house is destroyed by a tornado before you can complete the purchase. In this case, the court may decide that since the house is no longer there, the best remedy is to discharge the contract and relieve both parties of their obligation to perform under the contract.

Since almost every exchange in business creates some form of contract, it is essential that business owners as well as consumers understand the fundamental principles of contracts and contract laws.

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