

12: Contracts

10.1 Introduction

LEARNING OBJECTIVES

1. Explain what constitutes a contract.
2. Understand how a contract is formed.
3. Know the defenses to performance of a contract.
4. Understand breach of contract and its consequences.
5. Identify remedies for breach of contract.

Although businesses tend to use the terms “agreement” and “contract” interchangeably, legally the terms have very different meanings. An **agreement** is a mutual understanding between two or more parties about their rights and duties toward each other. A **contract** is a legally enforceable agreement between two or more parties. All contracts are agreements, but not all agreements are contracts.

When contracts are broken, or breached, the injured party can seek damages. In contracts, this usually means an amount that would make that party whole again.

Generally speaking, contracts are a form of **private law**, because the terms of the contract are binding on the parties to the contract but not anyone else. Parties may enter into contracts for whatever they wish and under any terms that they agree on. In other words, parties may assent to agreements even if those agreements represent bad bargains.

Contracts may restrict parties’ future activity. For example, a non-compete clause in an employment contract may be enforceable in the future against an employee after termination of employment.

However, contracts that are illegal or against public policy are not enforceable.

Contract law performs three significant economic functions:

1. It helps individuals and businesses exchange goods and services efficiently.
2. It reduces the costs of economic transactions because parties do not need to negotiate a variety of rules and terms with each separate transaction.
3. It alerts the parties to problems that have arisen in the past, making it easier to avoid potential pitfalls.

Counselor’s Corner We live in a world of contracts, which are the bread and butter of business transactions. However, many consumers, employees, and small businesses are afraid to read and understand contracts. That fear allows others to take advantage of them. Take the time to read contracts provided to you. Ask questions about anything you don’t understand *before* you sign. Have the courage to revise and edit contracts to ensure your interests are protected. Or even write your own. It’s not hard and the more you do it, the more confidence you will have to negotiate business transactions and protect your interests. ~Darnell T., attorney

10.2 Contract Elements

There are three required elements of a contract: offer, acceptance, and consideration. It is important to note that some states and legal scholars expand this list to include whether the subject matter is legal, whether the parties have capacity to enter into a contract, and whether the law requires the contract to be in writing to be enforceable. However, these are best understood as defenses to contract formation, especially in light of the fact that the only elements that all states agree on are offer, acceptance, and consideration.

Offer

All contracts start when an individual or business proposes a deal. It might involve buying or selling goods, performing services, or making an exchange. An **offer** is a conditional promise to do or refrain from doing something now or in the future. In other words, it is willingness to enter into a contract.

Offers can be formal or informal. In some industries, such as retail and restaurants, offers are often posted on menus, signs, and advertisements. For example, a sign hanging above a cash register listing menu items and their prices is the restaurant’s offer to sell customers those items at those prices.

There are not a lot of legal requirements about what an offer must contain, but there are some things that cannot be a legal offer:

| Type of Invalid Offers | Definition | Example |
|------------------------|---|--|
| Illusory Promise | No offer exists because there is no duty to perform | "If I decide to buy a new car, I'll give you my old one." |
| Pre-existing Duty | A party cannot leverage an existing duty to get more out of someone else | "I agree to teach you business law for \$100 even though you have already paid tuition for the course." |
| Forbearance | An offer cannot be a promise not to pursue a legal claim that is known to be invalid (Note: if the claim is valid, then forbearance may be a valid offer) | "I know the accident was completely my fault but I promise not to sue you." |
| Past Consideration | An offer cannot be based on past actions | I paint your house. Two months later you say that you will pay me \$500 for doing it. If you change your mind and decide not to pay me, I cannot enforce your promise because it was in consideration of a past event. |

Once made, offers can be terminated in a number of ways. An offer that has been properly communicated continues to exist until it:

1. Is rejected;
2. Is replaced by a counteroffer;
3. Lapses or expires;
4. Is revoked; or
5. Is terminated by operation of law.

Unless it states a specific time, an offer remains open for a reasonable time. A **lapsed offer** is an offer that is no longer valid because a reasonable time to accept it has expired. An expired coupon is an example of a lapsed offer.

Acceptance

To constitute an agreement, there must be an acceptance of the offer. Legally, **acceptance** is an implied or express act that shows willingness to be bound by the terms of an offer. To be effective, both parties must understand and agree to be bound by the contract.

Acceptance can be both express or implied. Express acceptance occurs when a party states that they accept the offer. Acceptance may be implied based on the parties' conduct. For example, a retailer offers to sell a product to consumers for the price listed on the shelf. A consumer may accept that offer by handing the cashier the item and money to pay for it. The consumer does not need to say anything to complete the transaction. But the consumer must do *something* to accept. Silence, without more (such as handing over payment), is not acceptance. This is because silence may be evidence that the consumer either does not know about the offer or has rejected it.

A common problem in the business community is knowing what constitutes acceptance and what is negotiation. If an acceptance changes, adds, or modifies terms of the offer, it is a **counter-offer** and no contract is formed. The original party may decide to accept, reject, or propose another offer as a result. Although this sounds straightforward, with today's fast-paced communications, parties may respond to part of an offer, negotiate various parts of the contract simultaneously, or agree to terms in installments. As a result, there may be confusion about what the full terms of a contract are.

Offer and acceptance form **mutual assent**, which is also called "meeting of the minds." This is the parties' intention to enter into a binding contract on the terms they agreed upon. If parties do not agree on the essential terms, then there can be no meeting of the minds to enter into a contract. This is the basis for many of the defenses to contract formation.

Consideration

Consideration is the bargained-for exchange of something of value that shows the parties intend to be bound by the contract. There are two elements to consideration:

1. Something of value

2. Is exchanged between the parties.

The “something” that is promised or delivered must be a legal detriment. A **legal detriment** is giving up a legal or property right.

Consideration may be concurrent or a promise to perform in the future. However, it cannot be “past consideration” based on something that has occurred before the formation of the current contract. In other words, an act or promise made before the current contract is not adequate consideration because it was not given in exchange for the current promise.

When bargained-for consideration is not present, a court may validate a promise based on promissory estoppel. **Promissory estoppel** is the principle that a promise made without consideration may nonetheless be enforced to prevent injustice if the promisor should have reasonably expected the promisee to rely on the promise, and the promisee actually relied on the promise to his or her detriment. Promissory estoppel is an equitable doctrine used as a substitute for consideration that allows the imposition of contractual liability to prevent unfairness.

To establish promissory estoppel, a party must show:

1. A definite promise;
2. The party making the promise should have expected that the other party would rely on the promise;
3. A reasonable person would have relied on the promise;
4. The party relied on the promise and it resulted in a substantial detriment; and
5. Basic justice and fairness require that the promise be enforced.

10.3 Types of Contracts

Bilateral and Unilateral Contracts

In a **bilateral contract**, both parties make a promise of performance. These contracts are also called mutual or reciprocal contracts. Bilateral contracts are the most common form of contracts. They include ordering food in a restaurant, buying gas for vehicles, purchasing goods and services, etc.

A **unilateral contract**, on the other hand, is a contract where one party makes a promise that the other party can accept only by doing something. For example, a business offers a reward for information leading to the arrest of a thief. A person cannot collect the reward money by promising to give information—he or she must perform under the contract by providing the information.

Express and Implied Contracts

An **express contract** is a contract in words (orally or in writing) in which the terms are spelled out directly. The parties to an express contract, whether written or oral, clearly intend to make a legally enforceable agreement. For example, an agreement to buy a car for \$1,000 and to take title next Monday is an express contract.

An **implied contract** is a contract that is inferred from the parties’ actions. Although no discussion of terms took place, an implied contract exists if it is clear from the conduct of the parties that they have an agreement. A delicatessen patron who asks for a “turkey sandwich to go” has made a contract and is obligated to pay when the sandwich is made. By ordering the food, the patron is implicitly agreeing to the price, whether posted or not.

Quasi-contract: Contract Implied in Law

Both express and implied contracts embody an actual agreement of the parties. A **quasi-contract**, by contrast, is an obligation imposed by law to avoid unjust enrichment of one person at the expense of another. In fact, a quasi-contract is not a contract at all. It is a judicial remedy in which the court decides what a contract should look like between the parties to prevent injustice. For example, a carpenter mistakenly believes a homeowner hired him to repair her porch, when it was actually the neighbor who hired him. One morning the carpenter arrives and begins work. Rather than stop him, the homeowner lets him proceed, excited to get her porch fixed for free. Although no contract exists because there was no offer, acceptance or consideration, the law will imply a contract between the carpenter and homeowner for the value of the work.

Enforceability

A contract that is fully enforceable and reflects the parties’ intent is **valid**. Conversely, an **unenforceable contract** is a contract where the parties intend to form a valid bargain but the court declares that it cannot be enforced for legal reasons. For example,

Ramesh owes Jai money, but Jai has waited too long to collect it and the statute of limitations has run out. The contract for repayment is unenforceable and Jai is out of luck unless Ramesh makes a new promise to pay or actually pays part of the debt.

An agreement that is lacking one of the legal elements of a contract is **void** because it never was a contract. In other words, it is not legally enforceable because it is not a contract at all. An agreement that is illegal is also void. For example, a promise to commit a crime in return for payment is void because neither side can enforce the agreement in court.

By contrast, a **voidable contract** is a contract that can be annulled. It is a contract that is unenforceable by one party but enforceable by the other. For example, a minor may “avoid” a contract with an adult; meaning the adult may not enforce the contract against the minor if the minor refuses to carry out the bargain. The adult must comply if the minor wishes the contract to be performed. A contract may be voidable by both parties if they are both minors. Usually, the parties to a voidable contract are entitled to be restored to their original position.

A voidable contract remains a valid contract until it is voided. Thus, a contract with a minor remains in force unless the minor decides he does not wish to be bound by it. When minors become adults, they have two choices:

1. **Ratify** the contract—that is, agree to be bound by it; or
2. **Disaffirm** the contract—that is, disavow or avoid it.

Ratification may be explicit or implicit. For example, by continuing to make payments or retaining goods for an unreasonable period of time, a party may ratify the contract. If a party has not disaffirmed the contract while still a minor, she may do so within a reasonable time after becoming an adult.

Degree of Completion

An **executory contract** is a contract that has yet to be completed. Most executory contracts are enforceable. If some, but not all, of the terms of the contract have been performed, the contract is called **partially executed**. A contract that has been completed or carried out fully by both parties is called an **executed contract**.

10.4 Performance and Breach of Contract

Performance simply means undertaking the legal duties imposed by the terms of the contract.

But how do we know whether the contract terms have been performed? Sometimes it’s easy to determine. For instance, if someone offers to sell his scooter for four hundred dollars, a purchaser agrees, and they exchange the scooter for the money, then the contract has been fully performed. A contract was formed, the parties performed their obligations under it (known as **complete performance**), and they are subsequently discharged from further duties arising under the contract. Complete performance results in an executed contract.

When a party fails to perform under the terms of the contract without a legally justifiable reason, the party is in **breach of contract**. Not all breach of contract situations give rise to litigation. Some breaches are minor and may be overlooked by parties, especially if there is a long-term business relationship between them. Others may be major and give rise to significant issues between the parties.

In a service contract, the standard used to judge performance is **substantial performance**. This means that the performing party acted in good faith and conveyed enough benefit to the other party under the contract that any breach may be remedied by money damages. A **material breach** in a service contract occurs when a party has not substantially performed under the terms of the contract. A **minor breach** occurs when the party has substantially performed but has not strictly performed.

Performance to the standard of **personal satisfaction** can be enforced if the contract expressly requires it. This means that contract performance is evaluated subjectively, either by one party to the contract or by a third-party beneficiary specified in the contract. If the subject of the contract is something for which approval is dependent on someone’s subjective opinion, like personal taste, then assessment can be made on a subjective standard providing this standard is clearly specified in the contract. These contracts often occur in the entertainment industry, as well as the building of custom homes.

Conditions

A **condition** is an act or event (other than the lapse of time) that must occur before performance under a contract becomes due. Conditions determine when a party must perform.

| Type of Condition | Description |
|------------------------|--|
| Condition precedent | A condition must occur before a party's performance is required |
| Concurrent condition | Each party's performance is dependent on the other party's performance |
| Subsequent condition | A condition follows the duty to perform that completely eliminates or discharges a duty to perform |
| Constructive condition | Equitable doctrine that serves as an implied-in-law condition to prevent injustice |

A **condition precedent** is an act or event that must occur before a duty of immediate performance of a promise arises. For example, an inspection of property is a condition precedent to the sale of a home.

A **concurrent condition** occurs when mutually dependent conditions must be performed at the same time by the parties. For example, delivery of goods and payment in a cash sale are concurrent conditions.

A **subsequent condition** is an event that discharges a duty of performance that becomes absolute. They are rare and tend to occur in the insurance industry. For example, an insurance company may require notice within thirty days of a claim. The insurance company does not have a duty to pay until the insured gives notice. Notice is the subsequent condition that triggers the insurance company's performance.

A **constructive condition** is a condition contained in an essential contractual term that, though omitted by the parties from their agreement, a court has supplied as being reasonable in the circumstances. It is an equitable doctrine that serves to imply conditions to prevent injustice.

10.5 Defenses to Contracts

A party may have a valid reason for **breaching**, or not performing, a contract. These reasons are known as defenses to contract. Many of the defenses to contracts go to the heart of whether an agreement ever existed. In other words, if a party does not voluntarily consent or there was no "meeting of the minds," then a valid contract was never formed.

Illegality

Illegal contracts are unenforceable because they are void. There are two common types of illegalities: (1) statutory violations, and (2) violations of public policy. An example of a statutory violation is where a company in the US wants to avoid import regulations and quotas by purchasing Cuban cigars through an intermediary in Mexico. If the US buyer pays the Mexican intermediary for the cigars but does not receive them, the buyer cannot sue the intermediary for breach of contract. The law will not provide a remedy to someone who intends to violate the law.

Examples of violations of public policy often occur in an employment context. An employer that tries to bind its employees to unreasonable non-compete agreements violates the public policy of freedom to work. Another common example is contracts with professionals who do not maintain a current license in their field. If they are not legally licensed for the work they perform, they are not entitled to payment for their services. Here, the public policy is that the law does not want to encourage a black market for services outside of government regulation.

Incapacity

If someone lacks mental capacity to understand the terms of the agreement, there cannot be a true meeting of the minds to form a contract. **Capacity** is the mental state of mind sufficient to understand that a contract is made and its legal consequences.

Incapacity can be permanent, such as from mental illness, physical illness, or insanity. Incapacity may also be temporary, such as being intoxicated, under the influence of drugs, or underage (i.e. under eighteen years old).

Undue Influence

Undue influence occurs when one party overpowers the free will of another by use of superior power or influence. In other words, it is unfair persuasion. Undue influence is not a normal level of persuasion. Rather, it occurs when a party agrees to a contract that they would not have otherwise consented to without the unreasonable pressure of the other party. For example, an elderly person who is isolated from others due to poor health and living conditions may be lonely and eager for company. If a caretaker exerted

influence over the elder to the extent that he or she could no longer exercise free will, then undue influence occurs. Contracts and transactions in which elders transfer most or all of their wealth to others are frequently reviewed for undue influence.

Duress

Duress occurs when there is a threat to a person, family or property. Economic pressure may constitute duress if it is wrongful and oppressive. Cases involving duress often occur in emergency situations. For example, when someone is required to sign legal paperwork in an emergency room before receiving medical treatment for themselves or their children.

If a person enters into a contract under duress, he or she is able to get out of the contract after the emergency situation is over. Duress essentially overcomes a person's free will to voluntarily choose to enter into the contract.

Unconscionability

Unconscionability occurs when the contract contains markedly unfair terms against the party with less bargaining power or sophistication than the party who created the terms and induced the other party to sign it. Common cases involving unconscionability claims occur when one party is an experienced business dealer, while the other party is an average consumer. If the business dealer uses a very small font and inserts terms into the contract in a way that intentionally misleads the consumer into signing on unfair terms, then the contract may be deemed unconscionable.

Statute of Frauds

The **Statute of Frauds** requires certain contracts to be in writing and signed to be enforceable. The Statute of Frauds originated in England in 1677 to prevent fraud when one party tries to claim a contract existed when it did not. The Statute of Frauds requires a written contract for:

1. Real property interests;
2. Marriage;
3. Payment of another's debt;
4. Contracts that cannot be completely performed within one year;
5. Contracts for the sale of goods of five hundred dollars or more; and
6. Acting as another's executor/administrator.

Statute of Limitations

The **statute of limitations** is an affirmative defense that can be raised by a defendant to argue that a lawsuit is being brought too late. This means that if a dispute arises under a contract, then the plaintiff must bring a lawsuit concerning that dispute within a certain time period. States have different statutes of limitations. If a contract has a choice of law provision, then that state's statute of limitations will apply to disputes related to the contract.

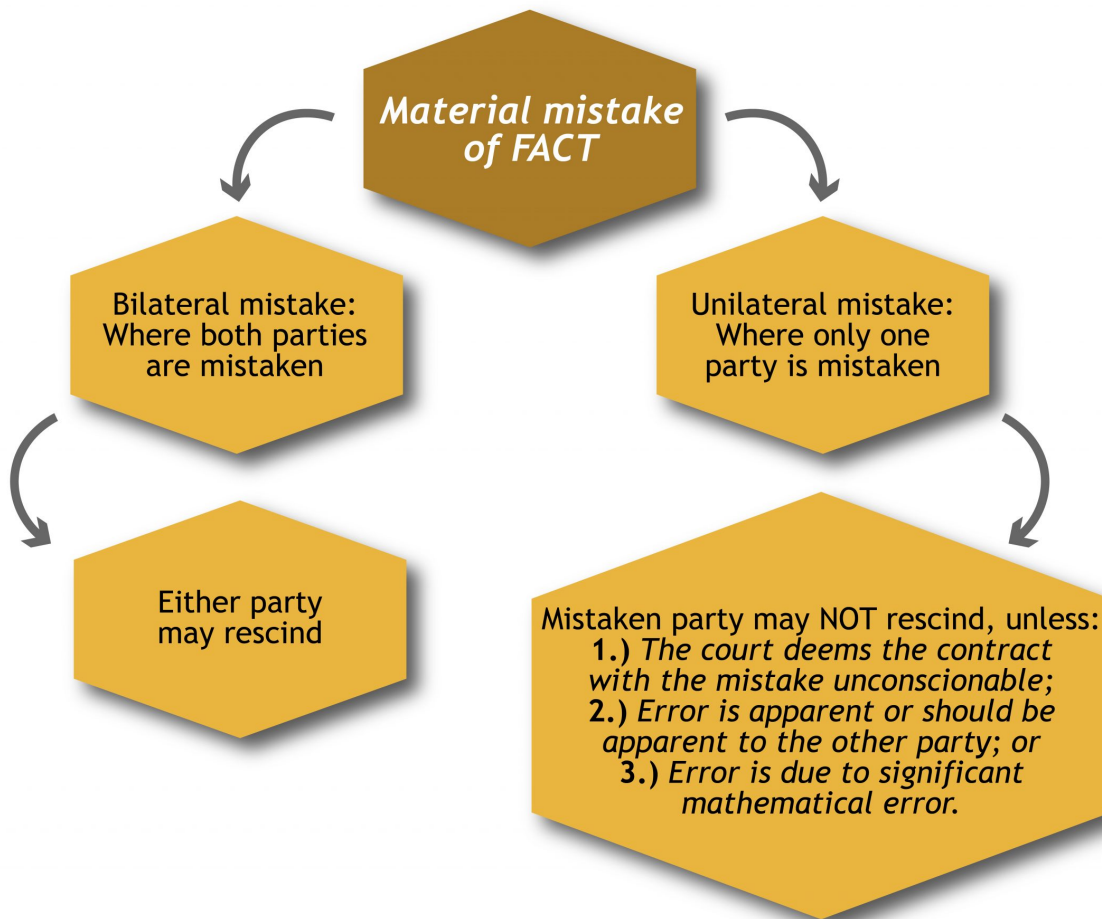
Mistake

In the context of contracts, a **mistake** is the situation in which the parties did not mean the same thing or when one or both parties formed untrue conclusions about the subject matter of the contract. In other words, a mistake is an erroneous belief.

Mutual mistake refers to something that is a mistake by both parties that relates to an essential term of the contract. For example, a contract to buy property that is not actually owned by the seller would be a mutual mistake, if the seller believed in good faith that he owned the property. When mutual mistakes occur, either party may rescind the contract.

Unilateral mistake occurs when only one party is laboring under a mistake. Mistake does not mean bad bargaining. Courts will not step in to save parties from bad bargaining absent evidence of undue influence or unconscionability. In general, parties cannot rescind the contract when unilateral mistakes occur except when the mistake makes the contract unconscionable, the error is apparent to the other party, or when significant mathematical errors occur.

Figure 10.1 Types of Mistakes Affecting Contracts and Their Remedies



Misrepresentation and Fraud

Misrepresentation and fraud are also defenses to contract. **Misrepresentation** is when a party makes a false statement that induces the other party to enter into the contract. **Fraud** is a closely related concept, and it simply means that one party has used deception to acquire money or property. Fraud may also be a basis for criminal charges, depending on the circumstances leading to the contract.

Commercial impracticability

Commercial impracticability is a defense that can be used when fulfilling a contract has become extraordinarily difficult or unfair for one party. For example, a sales contract relating to the sale of goods destroyed by a natural disaster would fall under this defense. It becomes impossible for the seller to deliver goods that no longer exist, and would be unfair to enforce damages against the seller for breach of contract. This is also called **frustration of purpose** or **impossibility** in some jurisdictions.

Bankruptcy

Sometimes a party to a contract files for **bankruptcy** protection. The bankruptcy court will determine which debts the bankrupt party must pay and which are dischargeable. Contract obligations are suspended temporarily through the bankruptcy court's automatic stay. In other words, the debt does not have to be paid during the course of the bankruptcy. At the conclusion of the bankruptcy, if the contract obligation is determined to be a dischargeable debt, then the debt will not have to be paid.

10.6 Assignment, Delegation, and Third Party Beneficiaries

Contracts are by law assignable and delegable. This means that the rights conveyed by the contract may be transferred to another party by **assignment**, unless an express restriction on assignment exists within the contract, or unless an assignment violates public policy. Likewise, the duties imposed on a party may be transferred to another party by **delegation**, unless the contract expressly restricts delegation, there is a substantial interest in personal performance by the original party to the contract, or if delegation would violate public policy.

As a general rule, a party may assign contract rights without the consent of the other party. This is common in the construction industry where a general contractor may assign rights and delegate duties to subcontractors for specific work that needs to be performed under the main contract. For example, the general contractor may delegate the duty to perform electrical work to an electrician, as well as assign the right to be paid for the work performed.

In delegation and assignment, the original contracting party is not “off the hook” if it transfers its duties or rights to another party. For instance, a subtenant assumed the rights and duties imposed on the original tenant in a lease. If the subletting tenant does not pay the rent, the original tenant is still liable.

The way to excuse oneself from legal liability under a contract is through novation. **Novation** is essentially a new contract that transfers all rights and duties to a new party to the contract and releases the previous party from any further obligation. It is the procedure in which one party is dismissed completely from the contract because a third party is substituted. In this situation, the dismissed party no longer has any liability under the original contract. To be effective, all parties must agree to the novation.

Third Party Beneficiaries

Assignment and delegation under a contract should not be confused with rights of third party beneficiaries. A **third party beneficiary** is someone who is not a party to the contract but stands to benefit from it. Life insurance policies are a classic example of contracts with third party beneficiaries. The insurance company and the insured are parties to the contract. But the person who receives payment upon the death of the insured is the third party beneficiary.

Third party beneficiaries can either be intended or incidental. An **intended beneficiary** is someone who the parties intend to receive the benefit of the contract. For example, the named beneficiary of a life insurance policy. The **beneficiary** does not need to know about the contract to have his or her rights vest.

An **incidental beneficiary** is someone who benefits from a contract but was not intended by the parties to benefit. For example, if a business pays for a professional to landscape its property, the neighbors are incidental beneficiaries to the landscaping contract. They benefit from the improved appearance and property values, but the business did not enter the contract with an intent to benefit them. Incidental beneficiaries do not have a legally enforceable interest in the contract.

10.7 Parol Evidence Rule

Courts often must interpret the meaning of a contract. When the contract is written, courts will look within the “four corners” of the document and apply the contract as written. **The Parol Evidence Rule** is the principle that a writing intended by the parties to be a final embodiment of their agreement cannot be modified by evidence that adds to, varies, or contradicts the writing. This rule usually prevents a party from introducing evidence of negotiations that occurred before or while the agreement was being reduced to its final written form.

However, there are several important exceptions that allow oral statements to be admitted:

1. Subsequent modifications;
2. Evidence of intentional misrepresentations by a party;
3. Correcting errors in drafting;
4. Clarifying ambiguities and filling in gaps; and
5. Supplements to a partially integrated contract.

As a result of the parol evidence rule, businesses should do their due diligence to ensure any written contracts fully and adequately include the essential terms of their agreement.

10.8 Remedies

The four main remedies for breach of contract are damages, specific performance, rescission, and restitution. The purpose of contract remedies is to compensate the non-breaching party for the losses suffered. In other words, remedies must put the non-breaching party in the position it would have been in if there had been no breach.

Damages

Damages are the money paid by one party to another to discharge a legal liability.

| Types of Monetary Damages | Purpose |
|---------------------------|---|
| Compensatory | To make the non-breaching party “whole” as if breach did not occur |
| Consequential | To cover indirect but foreseeable losses flowing from the breach |
| Incidental | To cover direct losses flowing from the breach & to avoid further loss |
| Nominal | To recognize legal breach although no actual damages resulted |
| Punitive | To punish and deter future wrongful behavior; only available if breach itself is a tort |
| Liquidated | To allow parties to determine value of contract in case of breach |

Compensatory Damages

Compensatory damages are paid to compensate the non-breaching party for the loss suffered as a result of the breach. It is the general category of damages awarded to make the party whole. Compensatory damages include out-of-pocket losses and costs associated with the loss of the bargain. They are the primary damages in contract breach cases and are a direct, foreseeable result of the breach of contract.

Consequential Damages

A basic principle of contract law is that a person injured by breach of contract is not entitled to compensation unless the breaching party, at the time the contract was made, had reason to foresee the loss as a probable result of the breach.

Consequential damages are damages that flow as a foreseeable but indirect result of the breach of contract. For example, a roofer takes longer to fix a leaky roof than specified in a contract. The delay results in a retailer remaining closed for an additional week until the roof is repaired. The loss of sales from that week are consequential damages.

Consequential damages often include:

- Loss of profits due to the interruption of normal business practices;
- Loss of customers due to delays or cancellations; and
- Cost of replacement goods or services.

Incidental Damages

Incidental damages are damages that are paid to the non-breaching party in an attempt to avoid further loss on account of the breach. These damages include additional costs incurred by the non-breaching party after the breach in a reasonable attempt to avoid further loss, even if that attempt was unsuccessful.

For example, an electrician contracts to install light fixtures in a warehouse within seven days. The electrician enters into a purchase agreement with a supplier to buy the fixtures which are to be delivered within three days. On the fifth day, the supplier notifies the electrician that it cannot fill the order, breaching the contract. Because he cannot fulfill his contract with another supplier in time, the electrician breaches his contract with the warehouse and has to refund the warehouse its money. The losses incurred by the electrician to the warehouse are a direct result of the supplier’s breach of contract, and are incidental damages.

Incidental costs often include:

- Inspection of items;
- Transportation or care of items;
- Expenses or commissions incurred in connection with incident or delay of items; and
- Storing of defective items until the supplier can retrieve them.

The difference between incidental and consequential damages is the cause of the expense or loss. Incidental damages are the direct result of one party’s breach of contract. Consequential damages are more indirect, being incurred not as a result of the breach itself, but due to the end result of the breach.

Nominal Damages

If the breach of contract caused no actual loss, the non-breaching party may be awarded nominal damages. **Nominal damages** are a token amount of money paid when the breach has caused no actual loss. Nominal damages are often awarded symbolically by juries when they find legal liability but believe the breach was minor or could have been accommodated in another way. For example, a buyer could have purchased the same commodity at the same price without spending any extra time or money.

Punitive Damages

Punitive damages are awarded to a non-breaching party in excess of any loss suffered to punish the breaching party. Punitive damages are awarded when the defendant acted willfully and maliciously, and the purpose is to deter similar future bad conduct. Punitive damages are not usually available for breach of contract claims, unless the breach of contract itself constitutes a tort. In other words, punitive damages may be available when the contract breach itself is fraudulent or malicious. Punitive damages have been awarded against insurance companies that have refused to honor disability payments and that have acted in bad faith in denying legitimate claims.

Liquidated Damages

Liquidated damages are damages agreed upon by parties to a contract to be paid in the event of a breach. Because the parties are often in the best position to know the value of their contract, they can negotiate a fixed sum or method to calculate damages in the event of a breach. To be enforceable, liquidated damage provisions must apply equally to all parties, be negotiated fairly at the time the contract is executed, and must bear a reasonable relation to the probable damage in case of a breach.

Equitable Remedies for Breach of Contract

Equitable remedies involve a request for relief that does not include money damages. Equitable remedies are useful for when money does not provide adequate relief to the non-breaching party.

| Equitable Remedy | Purpose | Description |
|----------------------|--|--|
| Specific Performance | The object of the contract is unique & the loss cannot be easily compensated through money | Party must perform under terms of contract |
| Rescission | Contract was executed based on mutual mistake or fraud | Parties are put back into position they were in before contract was made |
| Restitution | Parties must return any benefit received | Benefit or item unjustly obtained is returned |

Specific Performance

Specific performance is a judicial order directing a party to deliver the exact property (real or personal) under the terms of a contract. Specific performance is an alternative remedy to damages and may be issued at the discretion of the court. Specific performance is granted when money damages are not an adequate remedy. For example, sale of specific real property (real estate is always unique), artwork, antiques, and heirlooms.

To warrant specific performance, a contract must be clear, definite, complete, and free from fraud and duress.

Specific performance is generally not available for service contracts. This is because ordering someone to perform a contract against their will is a type of involuntary servitude banned by the Thirteenth Amendment of the US Constitution. However, courts have occasionally entered injunctions prohibiting entertainers from performing at alternative venues until they perform at the venue under their original contract. These cases are in response to unethical forum shopping in the entertainment industry, and are very limited in nature.

Rescission

Rescission occurs when one party seeks to undo a contract and return to the position it was in before the contract was made. Rescission often occurs when fraud and mutual mistake occur and enforcing the contract would be unjust. Rescission may also be available when one party materially breaches the contract to such an extent that requiring the other party to perform would be unjust.

A party seeking rescission must notify the other party within a reasonable time after discovery of the facts that are the basis for rescission. The reason is that restoring the parties to their pre-contractual positions is easiest before too much time and performance has passed. Failure to rescind a contract in a timely manner may be held to affirm the contract or waive a breach of contract.

Restitution

Restitution is restoring property to the original owners. In other words, parties must return any benefit received under the contract. Therefore, only to the extent that the injured party conferred a benefit on the other party may the injured party be awarded restitution. Restitution often follows rescission of a contract. The purpose of restitution is to prevent a party from being unjustly enriched when a contract has been legally annulled.

10.9 Concluding Thoughts

Contracts are a fundamental part of business. It is important to understand how contracts are formed, performed, and executed in order to be successful. This understanding also includes understanding what performance is required, what defenses are available when someone breaches a contract, and what remedies are available in the event of a breach.

12: Contracts is shared under a [not declared](#) license and was authored, remixed, and/or curated by LibreTexts.