

7.1: General Perspectives on Contracts

Learning Objectives

By the end of this section, you will be able to:

- Understand the role of contract in society: it moves society from status to contract.
- Know the definition of a contract.
- Recognize the sources of contract law: the common law, the UCC, and the Convention on the International Sale of Goods—a treaty (the CISG).
- Understand some fundamental contract taxonomy and terminology.

The Role of Contract in Society

Contract is probably the most familiar legal concept in our society because it is so central to a deeply held conviction about the essence of our political, economic, and social life. In common parlance, the term is used interchangeably with agreement, bargain, undertaking, or deal; but whatever the word, it embodies our notion of freedom to pursue our own lives together with others. Contract is central because it is the means by which a free society orders what would otherwise be a jostling, frenetic anarchy. So commonplace is the concept of contract—and our freedom to make contracts with each other—that it is difficult to imagine a time when contracts were rare, an age when people's everyday associations with one another were not freely determined. Yet in historical terms, it was not so long ago that contracts were rare, entered into if at all by very few. In “primitive” societies and in the medieval Europe from which our institutions sprang, the relationships among people were largely fixed; traditions spelled out duties that each person owed to family, tribe, or manor. Though he may have oversimplified, Sir Henry Maine, a nineteenth-century historian, sketched the development of society in his classic book *Ancient Law*. As he put it:

(F)rom a condition of society in which all the relations of Persons are summed up in the relations of Family, we seem to have steadily moved towards a phase of social order in which all these relations arise from the free agreement of Individuals. . . . Thus the status of the Slave has disappeared—it has been superseded by the contractual relation of the servant to his master. . . . The status of the Female under Tutelage . . . has also ceased to exist. . . . So too the status of the Son under Power has no true place in the law of modern European societies. If any civil obligation binds together the Parent and the child of full age, it is one to which only contract gives its legal validity.... If then we employ Status, agreeably with the usage of the best writers, to signify these personal conditions [arising from ancient legal privileges of the Family] only, we may say that the movement of the progressive societies has hitherto been a movement *from Status to Contract*. Sir Henry Maine, *Ancient Law* (1869), 180–82.

This movement was not accidental. It went hand-in-glove with the emerging industrial order; from the fifteenth to the nineteenth centuries, as England, especially, evolved into a booming mercantile economy with all that that implies—flourishing trade, growing cities, an expanding monetary system, commercialization of agriculture, mushrooming manufacturing—contract law was created of necessity.

Contract law did not develop, however, according to a conscious, far-seeing plan. It was a response to changing conditions, and the judges who created it frequently resisted, preferring the quieter, imagined pastoral life of their forefathers. Not until the nineteenth century, in both the United States and England, did a full-fledged law of contracts arise together with modern capitalism.

Contract Defined

As usual in the law, the legal definition of “contract” is formalistic. The Restatement says: “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.” (*Restatement (Second) of Contracts*, Section 1) Similarly, the Uniform Commercial Code says: “‘Contract’ means the total legal obligation which results from the parties’ agreement as affected by this Act and any other applicable rules of law.” (Section 1-201(11)) A short-hand definition is: “A contract is a legally enforceable promise.”

Economic View of Contract Law

In *An Economic Analysis of Law* (1973), Judge Richard A. Posner (a former University of Chicago law professor) suggests that contract law performs three significant economic functions. First, it helps maintain incentives to individuals to exchange goods and services efficiently. Second, it reduces the costs of economic transactions because its very existence means that the parties need not go to the trouble of negotiating a variety of rules and terms already spelled out. Third, the law of contracts alerts the parties to

trouble spots that have arisen in the past, thus making it easier to plan the transactions more intelligently and avoid potential pitfalls.

Sources of Contract Law

There are four basic sources of contract law: the Constitution, federal and state statutes, federal and state case law, and administrative law. For our purposes, the most important of these, and the ones that we will examine at some length, are case law and statutes.

Case (Common) Law and the Restatement of Contracts

Because contract law was forged in the common-law courtroom, hammered out case by case on the anvil of individual judges, it grew in the course of time to formidable proportions. By the early twentieth century, tens of thousands of contract disputes had been submitted to the courts for resolution, and the published opinions, if collected in one place, would have filled dozens of bookshelves. Clearly this mass of case law was too unwieldy for efficient use. A similar problem had developed in the other leading branches of the common law. Disturbed by the profusion of cases and the resulting uncertainty of the law, a group of prominent American judges, lawyers, and teachers founded the American law Institute in 1923 to attempt to clarify, simplify, and improve the law. One of its first projects, and ultimately one of its most successful, was the drafting of the Restatement of the Law of Contracts, completed in 1932. A revision—the *Restatement (Second) of Contracts*—was undertaken in 1946 and finally completed in 1979.

The Restatements (others exist in the fields of torts, agency, conflicts of laws, judgments, property, restitution, security, and trusts) are detailed analyses of the decided cases in the field. These analyses are made with an eye to discerning the various principles that have emerged from the courts, and to the maximum extent possible, the Restatements declare the law as the courts have determined it to be. The Restatements, guided by a Reporter (the director of the project) and a staff of legal scholars, go through several so-called “tentative” drafts—sometimes as many as fifteen or twenty—and are screened by various committees within the American Law Institute before they are eventually published as final documents.

The *Restatement of Contracts* won prompt respect in the courts and has been cited in innumerable cases. The Restatements are not authoritative, in the sense that they are not actual judicial precedents, but they are nevertheless weighty interpretive texts, and judges frequently look to them for guidance. They are as close to “black letter” rules of law as exist anywhere in the American legal system for judge-made (common) law.

Statutory Law: The Uniform Commercial Code

Common law contract principles govern contracts for real estate and for services, obviously very important areas of law. But in one area the common law has been superseded by an important statute: the Uniform Commercial Code (UCC), especially Article 2, which deals with the sale of goods.

A Brief History

The UCC is a model law developed by the American law Institute and the National Conference of Commissioners on Uniform State Laws; it has been adopted in one form or another in all fifty states, the District of Columbia, and the American territories. It is the only “national” law not enacted by Congress.

Before the UCC was written, commercial law varied, sometimes greatly, from state to state. This first proved a nuisance and then a serious impediment to business as the American economy became nationwide during the twentieth century. Although there had been some uniform laws concerned with commercial deals—including the Uniform Sales Act, first published in 1906—few were widely adopted and none nationally. As a result, the law governing sales of goods, negotiable instruments, warehouse receipts, securities, and other matters crucial to doing business in an industrial, market economy was a crazy quilt of untidy provisions that did not mesh well from state to state.

Initial drafting of the UCC began in 1942 and was ten years in the making, involving the efforts of hundreds of practicing lawyers, law teachers, and judges. A final draft, promulgated by the Institute and the Conference, was endorsed by the American Bar Association and published in 1951.

Pennsylvania enacted the code in its entirety in 1953. It was the only state to enact the original version, because the Law Revision Commission of the New York State legislature began to examine it line by line and had serious objections. Three years later, in 1956, a revised code was issued. This version, known as the 1957 Official Text, was enacted in Massachusetts and Kentucky. In

1958, the Conference and the Institute amended the Code further and again reissued it, this time as the 1958 Official Text. Sixteen states, including Pennsylvania, adopted this version.

But in so doing, many of these states changed particular provisions. As a consequence, the Uniform Commercial Code was no longer so uniform. Responding to this development the American Law Institute established a permanent editorial board to oversee future revisions of the code. Various subcommittees went to work redrafting, and a 1962 Official Text was eventually published. Twelve more states adopted the code, eleven of them the 1962 text. By 1966, only three states and two territories had failed to enact any version: Arizona, Idaho, Louisiana, Guam, and Puerto Rico.

Meanwhile, non-uniform provisions continued to be enacted in various states, particularly in Article 9, to which 337 such amendments had been made. In 1971, a redraft of that article was readied and the 1972 Official Text was published. By that time, Louisiana was the only holdout. Two years later, in 1974, Louisiana made the UCC a truly national law when it enacted some but not all of the 1972 text (significantly, Louisiana has not adopted Article 2). One more major change was made, a revision of Article 8, necessitated by the electronics revolution that led to new ways of transferring investment securities from seller to purchaser. This change was incorporated in the 1978 Official Text, the version that remains current.

From this brief history, it is clear that the UCC is now a basic law of relevance to every business and business lawyer in the United States, even though it is not entirely uniform because different states have adopted it at various stages of its evolution—an evolution that continues still.

The Basic Framework of the UCC

The UCC embraces the Jaw of “commercial transactions,” a term of some ambiguity. A commercial transaction may seem to be a series of separate transactions; it may include, for example, the making of a contract for the sale of goods, the signing of a check, the endorsement of the check, the shipment of goods under a bill of Lading, and so on. However, the UCC presupposes that each of these transactions is a facet of one single transaction: the sale of and payment for goods. The Code deals with phases of this transaction from start to finish. These phases are organized according to the following “articles”:

- *Sales* (Article 2)
- *Commercial Paper* (Article 3)
- *Bank Deposits and Collections* (Article 4)
- *Letters of Credit* (Article 5)
- *Bulk Transfers* (Article 6)
- *Warehouse Receipts, Bills of Lading, and Other Documents of Title* (Article 7)
- *Investment Securities* (Article 8)
- *Secured Transactions; Sales of Accounts and Chattel Paper* (Article 9)

We now turn our attention to the sale—the first facet, and the cornerstone, of the commercial transaction. Sales law is a special type of contract law in that Article 2 applies only to the sale of goods, defined (Section 2-105) in part as “all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid. . . .” The only contracts and agreements covered by Article 2 are those relating to the present or future sale of goods.

In certain cases, the courts have difficulty in determining the nature of the object of a sales contract. The problem: How can goods and services be separated in contracts calling for the seller to deliver a combination of goods and services? This difficulty frequently arises in product liability cases in which the buyer sues the seller for breach of one of the UCC warranties. For example, you go to the hairdresser for a permanent and the shampoo gives you a severe scalp rash. May you recover damages on the grounds that either the hairdresser or the manufacturer breached an implied warranty in the sale of goods?

When the goods used are incidental to the service, the courts are split on whether the plaintiff should win. Compare *Epstein v. Giannattasio*, 197 A.2d 342 (Conn. 1963), in which the court held that no sale of goods had been made because the plaintiff received a treatment in which the cosmetics were only incidentally used, with *Newmark v. Gimbel's Inc.*, 258 A.2d 697 (N.J. 1969), in which the court said “[i]f the permanent wave lotion were sold . . . for home consumption . . . unquestionably an implied warranty of fitness for that purpose would have been an integral incident of the sale.” The New Jersey court rejected the defendant’s argument that by actually applying the lotion to the patron’s head the salon lessened the liability it otherwise would have had if it had simply sold her the lotion.

In two areas, state legislatures have taken the goods vs. services issue out of the courts’ hands and resolved the issue through legislation. One area involves restaurant cases, in which typically the plaintiff charges that he became ill because of tainted food.

UCC Section 2-314(1) states that any seller who is regularly a merchant of the goods sold impliedly warrants their merchantability in a contract for their sale. This section explicitly declares that serving food or drink is a sale, whether they are to be consumed on or off the premises.

The second type of case involves blood transfusions, which can give a patient hepatitis, a serious and sometimes fatal disease. Hospitals and blood banks obviously face large potential liability under the UCC provision just referred to on implied warranty of merchantability. Because medical techniques cannot detect the hepatitis virus in any form of blood used, hospitals and blood banks would be in constant jeopardy, without being able to take effective action to minimize the danger. Most states have enacted legislation specifically providing that blood supplies to be used in transfusions are a service, not goods, thus relieving the suppliers and hospitals of an onerous burden.

Three Basic Contract Types: Sources of Law

With this brief description of the UCC, it should now be clear that the primary sources of law for the three basic types of contracts are:

- Real estate: common law;
- Services: common law;
- Sale of goods: UCC (as interpreted by the courts).

Common law and UCC rules are often similar. For example, both require good faith in the performance of a contract. However, there are two general differences worth noting between the common law of contracts and the UCC's rules governing the sales of goods. First, the UCC is more liberal than the common law in upholding the existence of a contract. For example, in a sales contract (covered by the UCC), "open" terms—that is, those the parties have not agreed upon—do not require a court to rule that no contract was made. However, open terms in a *nonsales* contract will frequently result in a ruling that there is no contract. Second, although the common law of contracts applies to every person equally, under the UCC "merchants" occasionally receive special treatment. By "merchants" the UCC means persons who have special knowledge or skill who deal in the goods involved in the transaction.

The Convention on Contracts for the International Sale of Goods

A Convention on Contracts for the International Sale of Goods (CISG) was approved in 1980 at a diplomatic conference in Vienna. (A convention is a preliminary agreement that serves as the basis for a formal treaty.) The Convention has been adopted by several countries, including the United States.

The Convention is significant for three reasons. First, the Convention is a uniform law governing the sale of goods—in effect, an international Uniform Commercial Code. The major goal of the drafters was to produce a uniform law acceptable to countries with different legal, social and economic systems. Second, although provisions in the Convention are generally consistent with the UCC, there are significant differences. For instance, under the Convention, consideration (discussed below) is not required to form a contract and there is no Statute of Frauds (a requirement that some contracts be evidenced by a writing to be enforceable—also discussed below). Finally, the Convention represents the first attempt by the US Senate to reform the private law of business through its treaty powers, for the Convention preempts the UCC if the parties to a contract elect to use the CISG.

Basic Contract Taxonomy

Contracts are not all cut from the same die. Some are written, some oral; some are explicit, some not. Because contracts can be formed, expressed, and enforced in a variety of ways, a taxonomy of contracts has developed that is useful in lumping together like legal consequences. In general, contracts are classified along these dimensions: explicitness, mutuality, enforceability, and degree of completion. **Explicitness** is concerned with the degree to which the agreement is manifest to those not party to it. **Mutuality** takes into account whether promises are exchanged by two parties or only one. **Enforceability** is the degree to which a given contract is binding. **Completion** considers whether the contract is yet to be performed or the obligations have been fully discharged by one or both parties. We will examine each of these concepts in turn.

Explicitness

Express Contract

An express contract is one in which the terms are spelled out directly; the parties to an express contract, whether written or oral, are conscious that they are making an enforceable agreement. For example, an agreement to purchase your neighbor's car for \$500 and

to take title next Monday is an express contract.

Implied Contract

An implied contract is one that is inferred from the actions of the parties. Although no discussion of terms took place, an implied contract exists if it is clear from the conduct of both parties that they intended there be one. 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.

Contract Implied in Law: Quasi-contract

Both express and implied contracts embody an actual agreement of the parties. A quasi-contract, by contrast, is an obligation said to be “imposed by law” in order 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 fiction that the courts created to prevent injustice. Suppose, for example, that a carpenter mistakenly believes you have hired him to repair your porch; in fact, it is your neighbor who has hired him. One Saturday morning he arrives at your doorstep and begins to work. Rather than stop him, you let him proceed, pleased at the prospect of having your porch fixed for free (since you have never talked to the carpenter, you figure you need not pay his bill). Although it is true there is no contract, the law implies a contract for the value of the work.

Mutuality

The garden-variety contract is one in which the parties make mutual promises. Each is both promisor and promisee; that is, each pledges to do something and each is the recipient of such a pledge. This type of contract is called a bilateral contract. But mutual promises are not necessary to constitute a contract. Unilateral contracts, in which only one party makes a promise, are equally valid but depend upon performance of the promise to be binding. If Charles says to Fran, “I will pay you five dollars if you wash my car,” Charles is contractually bound to pay once Fran washes the car. Fran never makes a promise, but by actually performing she makes Charles liable to pay. A common example of a unilateral contract is the offer “\$50 for the return of my lost dog.” Frances never makes a promise to the offeror, but if she looks for the dog and finds it, she is entitled to the \$50.

Enforceability

Not every agreement between two people is a binding contract. An agreement that is lacking one of the legal elements of a contract is said to be void—that is, not a contract at all. An agreement that is illegal—for example, a promise to commit a crime in return for a money payment—is void. Neither party to a void “contract” may enforce it.

By contrast, a voidable contract is one that is unenforceable by one party but enforceable by the other. For example, a minor (any person under eighteen, in most states) may “avoid” a contract with an adult; the adult may not enforce the contract against the minor, if the minor refuses to carry out the bargain. But the adult has no choice if the minor wishes the contract to be performed. (A contract may be voidable by both parties if both are minors.) Ordinarily, the parties to a voidable contract are entitled to be restored to their original condition. Suppose you agree to buy your seventeen-year-old neighbor’s car. He delivers it to you in exchange for your agreement to pay him next week. He has the legal right to terminate the deal and recover the car, in which case you will of course have no obligation to pay him. If you have already paid him, he still may legally demand a return to the *status quo ante* (previous state of affairs). You must return the car to him; he must return the cash to you.

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 the minor reaches his majority, he may “ratify” the contract—that is, agree to be bound by it—in which case the contract will no longer be voidable and will thereafter be fully enforceable.

An unenforceable contract is one that some rule of law bars a court from enforcing. For example, Tom owes Pete money, but Pete has waited too long to collect it and the statute of limitations has run out. The contract for repayment is unenforceable and Pete is out of luck, unless Tom makes a new promise to pay or actually pays part of the debt. (However, if Pete is holding collateral as security for the debt, he is entitled to keep it; not all rights are extinguished because a contract is unenforceable.)

Degree of Completion

In medieval England, contract—defined as set of promises—was not an intuitive concept. The courts gave relief to one who wanted to collect a debt, for in such a case the creditor presumably had already given the debtor something of value, and the failure of the debtor to pay up was seen as manifestly unjust. But the issue was less clear when neither promise had yet been fulfilled. Suppose

John agrees to sell Humphrey a quantity of wheat in one month. On the appointed day, Humphrey refuses to take the wheat or to pay. The modern law of contracts holds that a valid contract exists and that Humphrey is required to pay John.

An agreement consisting of a set of promises is called an executory contract before either promise is carried out. Most executory contracts are enforceable. If one promise or set of terms has been fulfilled—if, for example, John had delivered the wheat to Humphrey—the contract is called partially executed. A contract that has been carried out fully by both parties is called an executed contract.

Key Takeaways

Contract is the mechanism by which people in modern society make choices for themselves, as opposed to being born or placed into a status as is common in feudal societies. A contract is a legally enforceable promise. The law of contract is the common law (for contracts involving real estate and services), statutory law (the Uniform Commercial Code for contract involving the sale or leasing of goods), and treaty law (the Convention on the International Sale of Goods). Contracts may be described based on the degree of their explicitness, mutuality, enforceability, and degree of completion.

Exercises

1. What did Sir Henry Maine mean when he wrote of society's movement "from status to contract?"
2. Are all promises "contracts"?
3. What is the source of law for contracts involving real estate? For contracts involving the sale of goods?
4. In contract taxonomy, what are the degrees of explicitness, mutuality, enforceability, and of completion?

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