This chapter will explain what elements are essential to having a valid and enforceable contract, as well as how contracts can be breached and how those differences can be resolved.
Objectives

At the end of this chapter, the student will be able to:

- List the terms describing contracts
- Identify and define the essential elements of a valid contract
- List and describe the ways of discharging a contract
- Explain a breach and list the methods of resolution

Contract

A contract is a legally enforceable agreement to do (or not do) a specific thing.

A contract in which one or both parties have agreed not to do some specific thing is called a contract to forbear.

For instance, a lessor may promise not to lease to a competitor if the lessee will renew a lease.

Creation of Contracts

Contracts may be expressed and be created by declaring intentions orally or in writing. Implied contracts are created by behavior of the parties.

For example, when you go into a restaurant and order a meal, you imply that you will pay the bill.

A standard purchase offer agreed to by both buyer and seller, meanwhile, is expressed.
Executed and Executory

A contract which is in the process of being fulfilled is called an executory contract.

Once it is fully performed or completed, it is executed.

The Uniform Commercial Code is a body of law that codifies all law relating to commercial transactions to make states' laws uniform. The UCC covers primarily personal property transactions and oral contracts that are enforceable under the UCC.

Unilateral and Bilateral

Contracts can be unilateral or bilateral

- A unilateral contract is one that results when there is only one party making a promise.

  The best example of a unilateral contract is a posted reward. If you publish an article in the paper promising a reward to anyone returning your lost glove, you are the only one to have made a promise. Anyone reading the article is not bound to do anything. You, however, must perform in accordance with your promise if someone does return your glove.

- A bilateral contract consists of an exchange of promises. In a typical real estate contract, the buyer promises to buy and the seller promises to sell. A bilateral contract is basically an "I will do this and you will do that" agreement.
Options

An option is a unilateral contract which involves either the right to buy or the right to lease real estate. The owner or lessor is called the optionor; the prospective buyer or lessee is the optionee.

In an option, the optionor grants the optionee an irrevocable and exclusive right to buy or lease the optionor's property at a fixed price within a specified period of time. For the option to be enforceable it must be in writing and signed by the optionor. Also, the optionee must pay the optionor a valuable consideration. Although it is customary for option money to be applied to the purchase price (or rent) when the option is exercised, it is always a matter of negotiations. Option money purchases "time" and does not provide the optionee with an interest in the property.

An option could be used to give a buyer more time to resolve questions involving financing or zoning.

The optionee assumes no obligation with an option other than payment of the consideration. Should he choose to exercise his right, the optionor is obligated to sell or lease at a fixed price. If not exercised within the time period specified, the option expires and all option money is forfeited.

Statute of Frauds

The Statute of Frauds is based on the original English Statute for Prevention of Frauds and Perjuries of 1677. The Statute of Frauds requires that all contracts for the sale of land or any interest exceeding one year be in writing and signed by the parties to be enforceable.

Real estate transactions are governed under the Statute of Frauds because, for one reason, no two parcels of land are exactly alike. When a deed is in writing, there is no chance of error and this is important because there is no substitute for a particular parcel of real estate. Leases for one year or less are not required to be in writing in order to be enforceable.
Validity of Contracts

Depending on the circumstances, a contract can be described as either:

- **Valid**: A valid contract complies with all the essential elements, and is binding and enforceable on both parties.
- **Void**: A void contract is one that has no legal force or effect because it does not meet the essential elements of a contract.

  For example, one of the essential conditions in order for a contract to be valid is that it be for a legal purpose; thus, a contract to commit a crime is void.

- **Voidable**: A voidable contract is one that seems on the surface to be valid but may be rescinded, or disaffirmed, by the party who might be injured if the contract were to be enforced; in some cases, this may be both parties. A voidable contract will be considered by the courts to be a valid contract if the party who has the option to disaffirm the agreement does not do so within a reasonable period of time.

- **Unenforceable**: An unenforceable contract has all the elements of a valid contract; however, neither party can sue the other to force performance.

  For example, if a buyer has promised to obtain an FHA loan to purchase a property but is later found to be ineligible, he or she cannot be forced to perform because it is impossible. An oral real estate contract would also be unenforceable.

### Legal Effects of Contracts

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<thead>
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<th>Legal Effect</th>
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<td>Void</td>
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Essential Elements

In order for a contract to be legally valid, and hence binding and enforceable, the following five requirements must be met:

- Legally competent parties
- Mutual agreement
- Lawful objective
- Consideration or cause
- Contract in writing when required by law

If these considerations are met, any party to the contract may, if the need arises, call upon a court of law to either enforce the contract as written or award monetary damages for nonperformance. In reality, a properly written contract seldom ends in court because each party knows it will be enforced as written.

It is the poorly written contract or the contract that borders between enforceable and unenforceable that ends in court. A judge must then decide if a contract actually exists and the obligations of each party.

*Using the courts, however, is an expensive and time-consuming method of interpreting an agreement. It is much better to have a correctly prepared contract in the first place.*

Who is Legally Competent?

In order for a contract to be legally enforceable, all parties entering into it must be legally competent. In deciding competency, the law provides a mixture of objective and subjective standards.

Those standards include:

- Minors
- Intoxication
- Unsound Mind
Minors

Minors: The most objective standard is that of age. A person must reach the age of **majority** to be legally capable of entering into a contract. **Minors do not have contractual capability.**

In most states, including Virginia, the age for entering into legally binding contracts is **18 years**. The purpose of majority laws is to protect minors from entering into contracts that they may not be old enough to understand. **Most contracts made with minors, except those for necessities, such as food and clothing, are voidable** by the minor at the minor's option, and remain voidable at the minor's option for a reasonable time after attaining the age of majority. However, if the adult was unaware of the minor's status, the contract may be at the option of either party.

Intoxication

Intoxication: If there was a deliberate attempt to intoxicate a person for the purpose of approving a contract, the intoxicated person, upon sobering up, can call upon the courts to cancel the contract. If the contracting party was voluntarily drunk to the point of incompetence, when he is sober he may ratify or deny the contract if he does so promptly.

However, some courts look at the matter strictly from the standpoint of whether the intoxicated person had the capability of formulating the intent to enter into a contract. Obviously, there are some fine and subjective distinctions here, and a judge may interpret them differently than the parties to the contract. These points also apply to a person who contracts while high on marijuana or other legal or illegal drugs.

Unsound Mind

Unsound Mind: People of unsound mind who have been declared incompetent by a judge may not make a valid contract, and any attempt to do so results in a void contract.

The solution is to contract through the person appointed to act on behalf of the incompetent. **If a person has not been judged legally incompetent but nonetheless appears incapable of understanding the transaction in question, the contract may be voidable** at the option of the court or the court-appointed guardian. **If a person is judged to have been lucid upon**
entering into a contract, the contract remains even though he/she is later declared incompetent.

Mutual Agreement

The requirements of mutual agreement (also called mutual consent, or mutual assent, or meeting of the minds) means that there must be agreement to the provisions of the contract by the parties involved. **In other words, there must be a mutual willingness to enter into a contract.**

- The existence of mutual agreement is evidenced by the words and acts of the parties indicating that there is a valid offer and an unqualified acceptance.
- In addition, there must be "reality of consent" meaning there is no fraud, misrepresentation or mistake, and the agreement must be genuine and freely given.

Lawful Objective

To be enforceable, a contract must call for a lawful objective. This is because a court of law cannot be called upon to enforce a contract that requires that a law be broken. Such a contract is void, or if already in operation, it is unenforceable in a court of law.

*For example, a debt contract requiring an interest rate in excess of that allowed by state law would be void. If the borrower had started repaying the debt and then later stopped, the lender would not be able to look to the courts to enforce collection of the balance. Contracts contrary to good morals and general public policy are also unenforceable.*

Consideration

For an agreement to be enforceable it must be supported by consideration. The purpose of requiring consideration is to demonstrate that a bargain has been struck between the parties to the contract. The size, quantity, nature or amount of what is being exchanged is irrelevant as long as it is present.
Consideration is usually something of value such as:

- A promise to do something
- Money
- Property
- Personal services.

For example, there can be an exchange of a promise for a promise, money for a promise, money for property, goods for services, and the like. Forbearance also qualifies as consideration.

In a typical offer to purchase a home, the consideration is the mutual exchange of promises by the buyer and seller to obligate themselves to do something they were not previously required to do. In other words, the seller agrees to sell on the terms agreed and the buyer agrees to buy the property on those same terms. **The earnest money the buyer may put down is not the consideration necessary to make the contract valid.** Rather, earnest money is a tangible indication of the buyer's intent and may become a source of compensation (damages) to the seller in the event the buyer does not carry out his promises.

A contract fails to be legally binding if present consideration is lacking from any party to the contract. The legal philosophy is that a person cannot promise to do something of value for someone else without receiving in turn some form of consideration.

Stated another way, each party must give up something, i.e., each must suffer a detriment.

For example, if Sam agrees to convey title to his farm in the future in appreciation for Louise having cared for his dog when he was on vacation, there would be no present consideration on Sam’s part. Since natural love and affection is not present consideration, it is not adequate to support contracts although it is sufficient to support the consideration in a deed.

**Written and Signed**

The purpose of requiring that a contract be written and signed is to prevent perjury and fraudulent attempts to seek legal enforcement of a contract that never existed.
It is not necessary that a contract be a single formal document. It can consist of a series of signed letters or memoranda as long as essentials of a valid contract are present. Note that the requirements for a written contract relate only to the enforceability of the contract.

Thus, if Mr. Colby orally agrees to sell his land to Mr. Conan and they carry out the deal, neither can come back after the contract was performed and ask the court to rescind the deal because the agreement to sell was oral.

The most common real estate contract that does not need to be in writing to be enforceable is a month-to-month rental agreement that can be terminated by either landlord or tenant on one-month notice. Nonetheless, most are in writing because people tend to forget oral promises. While the unhappy party can go to court, the judge may have a difficult time determining what oral promises were made, particularly if there were no witnesses other than the parties to the agreement. Hence, it is advisable to put all important contracts in writing and for each party to recognize the agreement by signing it.

A written contract will supersede an oral one. Thus, if two parties orally promise one thing and then write and sign something else, the written document will prevail. This has been the basis for many complaints against overzealous real estate agents who make oral promises that do not appear anywhere in the written sales contract. Typed information supersedes preprinted information and handwritten information supersedes both preprinted and typed information in a contract.

Under certain circumstances, the parol evidence rule permits oral evidence to complete an otherwise incomplete or ambiguous written contract. However, the application of this rule is quite narrow. If a contract is complete and clear in its intent, the court presumes that what the parties put into writing is what they agreed upon.

Offer and Acceptance
Offer and acceptance requires that one party (the offeror) make an offer to another party (the offeree). The offeree must then communicate to the offeror that he accepts. The means of communication may be spoken or written or an action that implies acceptance. Notification of acceptance given to the offeror is often called delivery.

Upon receiving an offer, the offeree has three options:

- To agree to it. If he agrees, he must agree to every item in the offer.
- To reject it. An offer is considered by law to be rejected if the offeree either rejects it outright or makes a change in the terms.
- Make a counteroffer. If the offeree makes any changes, it is called a counteroffer and, although it would appear the offeree is only amending the offer before he will accept it, in reality, the offeree has rejected it and is making an offer of his own. This now makes him the offeror.

If the offeree does not wish to accept the offer nor make a counteroffer, how is the offer terminated? When nothing is said as to how long the offer is to remain open, the courts will permit a reasonable amount of time, depending on the situation. An offer is terminated by the death of either party and an offer may be withdrawn at anytime up until the moment of acceptance.

Remember, an offer is not considered accepted until the offeror has been so notified.

A written offer, mailed to the offeree, is considered accepted and delivered when it is placed back in the mail.

Power of Attorney

An individual can give another person the power to act on his behalf: for example, to buy or sell land or sign a lease. The document that accomplishes this is called a power of attorney. The person holding the power of attorney is called an attorney-in-fact. With regard to real estate, a power of attorney must be in writing because the real estate documents to be signed must be in writing.

Any document signed with a power of attorney should be executed as
follows:

"Paul Jones, principal, by Samuel Smith, his attorney-in-fact." If the attorney-in-fact is to convey title to land, then the power of attorney must be acknowledged by the principal and recorded. This requirement is in accordance with the "equal dignities rule" which stipulates that when a contract is required to be in writing, the authority of the agent must also be in writing, be acknowledged, and have "equal dignity."

Corporations

Corporations are considered legally competent parties. However, the individual contracting on behalf of the corporation must have authority from the board of directors.

Some states also require that the corporate seal be affixed to contracts.

- A partnership can contract either in the name of the partnership or in the name of any of its general partners.
- Executors and administrators with court authorization can contract on behalf of estates, and trustees on behalf of trusts.

Fraud, Misrepresentation, and Mistake

Mutual agreement requires that there be no fraud, misrepresentation or mistake in the contract if it is to be valid.

- Fraud: A fraud is an act intended to deceive for the purpose of inducing another to part with something of value. It can be as blatant as knowingly telling a lie or making a promise with no intention of performance.

For example, you are showing your apartment and a prospective tenant asks if there is frequent bus service nearby. There isn't, but you say, "yes," as you sense this is important and want to rent the apartment. The prospective tenant rents the apartment, relying on this
information from you, and moves in. The next day he calls and says there is no public transportation and wants to break the rental agreement immediately. Because mutual agreement was lacking, the tenant can rescind (cancel) the contract and get his money back.

Fraud can also result from failing to disclose important information, thereby inducing someone to accept an offer.

For example, on the day you show your apartment to a prospective tenant the weather is dry. But you know that during every rainstorm the tenant’s automobile parking stall becomes a lake of water 6 inches deep. This would qualify as a fraud if the prospective tenant was not made aware of the problem before agreeing to the rental contract. Once again, the law will permit the aggrieved party to rescind the contract. However, the tenant does not have to rescind the contract. If he likes the other features of the apartment enough, he can elect to live with the flooded parking stall. In other words, the lease contract is voidable.

**Misrepresentation**

**Misrepresentation: Innocent misrepresentation** differs from fraud (intentional misrepresentation) in that the party providing the wrong information is not doing so to deceive another for the purpose of reaching an agreement.

To illustrate, suppose that over the past year you have observed that the city buses stop near your apartment building. If you tell a prospective tenant that there is bus service, only to learn the day after the tenant moves in that service stopped last week, this is innocent misrepresentation. Although there was no dishonesty involved, the tenant still has the right to rescind the contract.
Mistake, as applied in contract law, has a very narrow meaning. It does not include innocent misrepresentation nor does it include ignorance, inability or poor judgment. If a person enters into a contract that he later regrets because he did not investigate it thoroughly enough, or because it did not turn out to be beneficial, the law will not grant relief to him on the grounds of mistake, even though he may now consider it to be a "mistake" to have made the contract in the first place.

Mistake as used in contract law arises from ambiguity in negotiations and mistake of material fact.

For example, you offer to sell your mountain cabin to an acquaintance. He has never seen your cabin, and you give him instructions on how to get there to look at it. He returns and accepts your offer. However, he made a wrong turn and the cabin he looked at was not your cabin. A week later he discovers his error. The law considers this ambiguity in negotiations. In this case the buyer, in his mind, was purchasing a different cabin from the one the seller was selling; therefore, there is no mutual agreement and any contract signed is void.
Intent

Mutual agreement also requires that the parties express **contractual intent**.

Contractual intent means that **their intention is to be bound by the agreement, thus precluding jokes or jests from becoming valid contracts**. Contractual intent in real estate purchase agreements is usually evidenced by an **earnest money** deposit which indicates the purchaser is in "*earnest.*" Earnest money is not the consideration required to create a valid contract.

The last requirement of mutual agreement is that the offer and acceptance be genuine and freely given. **Duress** (use of force), **menace** (threat of violence) or **undue influence** (unfair advantage) cannot be used to obtain agreement.

*The law permits a contract made under any of these conditions to be revoked by the aggrieved party.*

Discharge of Contracts

Most contracts are discharged by being **fully performed** by the contracting parties in accordance with the contract terms.

However, alternatives are open to the parties of the contract. They include:

- Assignment
- Novation
- Supervening Illegality

Assignment

A person can sell or otherwise assign the contract to another party. Unless prohibited by the contract; rights, benefits, and obligations under a contract can be assigned to someone else; however **personal duties cannot always be assigned**.

*For example, a listing contract creating an agency relationship is personal in nature, so the listing broker cannot assign the contract to another broker.*
without the principal’s consent.

There can be assignments of mortgages, sales contracts, contracts for deeds, leases and options. The original party to the contract, however, still remains ultimately liable for its performance.

Note, too, that an assignment is a contract in itself and must meet all the essential contract requirements to be enforceable. A common example of an assignment occurs when a lessee wants to move out and sells his lease to another party.

**Novation**

A contract can also be performed by novation. Novation is the substitution of a new contract replacing an old agreement between the same or new parties.

For example, novation occurs when the buyer assumes the seller's loan, and the lender releases the seller from the loan contract.

With novation, the departing party is released from the obligation to complete the contract.

Novation also requires consideration and other essentials of a valid contract.

**Supervening Illegality**

If the objective of a contract becomes legally impossible to accomplish, the law will consider the contract discharged through supervening illegality.

For example, a new legislative statute may forbid what the contract originally intended.

If the parties mutually agree to cancel their contract before it is executed, this, too, is a form of discharge.

For instance, you sign a five-year lease to pay $900 per month for an office. Three years later you find a better location and want to move. Meanwhile, rents for similar offices in your building have increased to $1,000 per month.
Under these conditions, your landlord might be happy to agree to cancel your lease.

If one of the contracting parties dies, a contract is considered discharged if it calls for some specific act that only the deceased person could have performed. In other words, contracts for services are usually terminated by the death of one of the parties. Likewise, a contract for services, such as property management, can be terminated should title be transferred and the new owner decides to cancel.

**Enforceable Against the Estate**

If there is a valid purchase contract and one party dies, the contract is usually enforceable against the estate because the estate has the authority to carry out the deceased's affairs. The contract must include offer and acceptance to be binding. If an offer was made, but not accepted, the offer is subject to negotiation with the estate.

Similarly, if a person mortgages his or her property and dies, the estate must continue the payments or lose the property.

**Uniform Vendor and Purchaser Risk Act**

Under the Uniform Vendor and Purchaser Risk Act, if neither possession nor title has passed and there is material destruction to the property, the seller cannot enforce the contract and the purchaser is entitled to his money back.

If damage is minor and promptly repaired by the seller, the contract would still be enforceable. If either title or possession has passed and destruction occurs, the purchaser is not relieved of his duty to pay the price, nor is he entitled to a refund of money already paid.

**Breach of Contract**

When one party fails to perform as required by a contract and the law does not recognize the reason for failure to be a valid excuse, there is a breach of contract.

The wronged or innocent party has six alternatives:
Accept partial performance
Rescind the contract unilaterally
Sue for specific performance
Sue for money damages
Accept liquidated money damages
Mutually rescind the contract

The **statute of limitations** limits by law the amount of time a wronged party has to seek the aid of a court in obtaining justice. The aggrieved party must start legal proceedings within a certain period of time or the courts will not help him. The amount of time varies from state to state and by type of legal action involved. However, time limits of 3 to 7 years are typical for breach of contract.

**Partial Performance**

Partial performance may be acceptable to the innocent party because there may not be a great deal at stake or because the innocent party feels that the time and effort to sue would not be worth the rewards.

*Suppose that you contracted with a roofing repairman to fix your roof for $400. When he was finished, you paid him. A week later, you discover a spot that he had agreed to fix, but missed. After many futile phone calls, you accept the breach and consider the contract discharged because it is easier to fix the spot yourself than to keep pursuing the repairman.*

**Unilaterally Rescind**

Under certain circumstances, the innocent party can **unilaterally rescind** a contract. That is, the **innocent party can take the position that if the other party is not going to perform his obligations, then the innocent party will not either.**

**Sue for Specific Performance**

A lawsuit for **specific performance is an action in court by the innocent party to force the breaching party to carry out the remainder of the contract according to the precise terms, price, and conditions agreed**
upon.

For example, you make an offer to purchase a parcel of land and the seller accepts, a written contract is prepared and signed by both of you. If you carry out all your obligations under the contract, but the seller has a change of mind and refuses to deliver title to you, you may bring a lawsuit against the seller for specific performance. In reviewing your suit, the court will determine if the contract is valid and legal, if you carried out your duties under the contract, and if the contract is just and reasonable. If you win your lawsuit, the court will force the seller to deliver title to you as specified in the contract.

**Sue for Monetary Damages**

If the damages to the innocent party can be reasonably expressed in terms of money, the innocent party can sue for monetary damages.

For example, a seller's refusal to convey title as per the contract has required that you live in a hotel and eat in restaurants. You can sue the seller to recover the money damages suffered as a result of his/her breach of contract.

**Accept Liquidated Money Damages**

Accept liquidated money damages: The parties to a contract may decide in advance the amount of damages to be paid in the event either party breaches the contract.

An example is an offer to purchase real estate that includes a statement to the effect that, once the seller accepts the offer, if the buyer fails to complete the purchase, the seller may keep the buyer's deposit (the earnest money) as liquidated damages. If a broker is involved, seller and broker usually agree to divide the damages, thus compensating the seller for damages and the broker for time and effort.

Another case of liquidated damages occurs when a builder promises to finish a building by a certain date or pay the party that hired him or her a certain number of dollars per day until it is completed. This impresses upon the builder the need for prompt completion and compensates the property owner for losses due to the delay.
Mutual Rescission

Specific performance, money damages, and liquidated damages are all designed to aid the innocent party in the event of a breach of contract.

However, as a practical matter, the time and cost of pursuing a remedy in a court of law may sometimes exceed the benefits to be derived. Moreover, there is the possibility the judge for your case may not agree with your point of view. Therefore, even though you are the innocent party and feel you have a legitimate case that can be pursued in the courts, you may find it more practical to agree with the other party (or parties) to simply rescind (i.e., cancel or annul) the contract. To properly protect everyone involved, the agreement to cancel must be in writing and signed by the parties to the original contract.

Properly executed, mutual rescission relieves the parties to the contract from their obligations to each other.

In Review

- A contract is a legally enforceable agreement to do (or not do) a specific thing.
- Contracts may be expressed or implied. Expressed contracts are created by declaring intentions orally or in writing. Implied contracts are created by behavior of the parties.
- Contracts can also be unilateral or bilateral. A unilateral contract is one that results when there is only one party making a promise. A bilateral contract consists of an exchange of promises.
- Depending on the circumstances, a contract can be described as valid, void, voidable, or unenforceable.
- Five requirements must be met for a contract to be legally valid. It must be made between legally competent parties, there must be mutual agreement, there must be lawful objective, there must be consideration or cause, and the contract must be in writing when required by law.
- Most contracts are discharged by being fully performed by the contracting parties in accordance with the contract terms. However, alternatives are open to the parties of the contract. They include:
assignment, which entails a person selling or otherwise assigning a contract to another party, and novation, which is when a new contract replaces an existing agreement.

- When one party to a contract fails in its obligations, it is a breach of contract. The wronged or innocent party has several options to make itself whole. They include: accept partial performance, rescind the contract unilaterally, sue for specific performance, sue for monetary damages, accept liquidated money damages, or mutually rescind the contract.