

UNDERSTANDING LIABILITY UNDER CONTRACT

I. REVIEW OF BASIC CONTRACT PRINCIPLES

A. Contracts

1. Definitions

A contract can be defined as an agreement made upon sufficient consideration either to do, or to refrain from doing, a particular lawful act. A contract has been defined as an agreement, obligation, or legal tie by which a party binds itself, or becomes bound, expressly or impliedly, to pay a sum of money or to perform or omit to do some certain act or thing. Also, a contract has been variously defined as a private, voluntary allocation by which two or more parties distribute specific entitlements and obligations. Another definition is a promise or a set of promises, the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty. A contract is not a law, nor does it make law. It is an agreement plus the law that makes the ordinary contract an enforceable obligation.

2. Contract Types

There are two basic types of contracts: express and implied. An express contract may be either oral or in writing. An implied contract, on the other hand, may be implied in fact, by the words and conduct of the parties, or implied in law. An implied in law contract is one made for the parties by the courts to assure that one party to an obligation receives what his actions merit and the other party to the obligation is not unjustly enriched.

3. The Five Requirements of a Valid Contract

(a) The Necessary Elements

The elements of a valid contract have been variously stated by courts at different times as: (1) parties competent to contract, (2) a proper or lawful subject matter, (3) the

exchange of consideration, (4) the mutuality of agreement or assent on both sides, and (5) the mutuality of obligation.

A contract is made at the time the last act necessary to its formation is done. It is usually completed at the place where the offer is accepted. Thus, if a contract is made by telephone, it is made where the acceptor speaks. While the existence of a contract is a question of fact, whether a certain or undisputed state of facts establishes a contract is a question of law for the courts.

(b) Competent Parties and Lawful Subject Matter

To form a contract it is necessary that there is a party capable of contracting and a party capable of being contracted with on the other side. In other words, to enter into a valid, legal agreement, the parties must have the capacity to do so. No one can be bound by a contract who does not have legal capacity to incur at least voidable contractual duties. Each case involving competency to contract must be decided on its own facts. *Brown v. United Missouri Bank, N.A.*, 78 F.3d 382 (8th Cir. 1996) (applying Missouri law).

(c) Consideration

No contract will exist without sufficient consideration. Consideration may be a benefit to the promisor or a loss or detriment to the promisee. It may take the form of a right, an interest, or profit accruing to one party, or some forbearance, detriment, or responsibility given, suffered, or undertaken by the other party. It may also consist of the creation, modification, or destruction of a legal relationship. Consideration is, in effect, the price of the bargain and the price paid for a promise. It is something given in exchange for a promise. Consideration is what distinguishes a contract from a gift.

(d) Mutual Assent

There must be mutual assent or a meeting of the minds on all negotiated terms between the parties and on all the essential elements in terms of the contract to form a binding contract. *Dougan v. Rossville Drainage District*, 270 Kan. 468, 15 P.3d 338 (2000). In some jurisdictions, the parties must also have a present intent to be bound by their agreements. It is not necessary that the assent of both parties be given at the same time. Also, it is not necessary that communication of the assent be simultaneous. The omission of a material element from a contract renders the contract unenforceable because there has been no meeting of the minds of the parties. A valid contract requires a manifestation of mutual assent to the bargained-for exchange.

For example, a subcontractor may supply pricing to a general contractor for the general contractor's bid to the owner. The general contractor then advises the subcontractor that he is the low bidder. The general contractor asks for a bond and a liquidated damage provision. The subcontractor attends the preconstruction conference, submits a schedule of values, and obtains an insurance certificate; however, he does not start work. The general contractor and subcontractor thereafter cannot agree on whether the subcontractor will provide a bond or agree to a liquidated damage provision. One might argue that these are material elements to the contract and, therefore, no agreement has been formed.

4. The Requirements of Offer and Acceptance

(a) Offer

A valid offer identifies the bargained-for exchange between the parties and creates a power of acceptance in the party to whom the offer is made. The formation of a contract generally requires both an offer and an acceptance. *Hyken v. Travelers Insurance Co.*, 678 S.W.2d 454 (Mo. App. 1984). However, the words used by parties in negotiating for a contract

derive their primary importance from the standpoint of whether they express and achieve mutual assent, rather than whether they constitute an offer and acceptance. Although manifestation of mutual assent to an exchange ordinarily takes the form of an offer or proposal by one party followed by an acceptance by the other party, a manifestation of mutual assent may be made even though neither offer nor acceptance can be identified and even though the moment of formation of the contract cannot be determined.

(1) Price Quotes

Whether a communication naming a price is a quotation or an offer to contract depends upon the intention of the owner as it is manifested by the facts and circumstances of each particular case. Generally, a price quotation or proposal is not an offer to contract, but is an invitation to enter into negotiations or a preliminary solicitation of an offer. *Nordyne, Inc. v. International Controls & Measurements Corp.*, 262 F.3d 843 (8th Cir. 2001) (applying Missouri law). However, a price quotation, if detailed enough, can amount to an offer to contract, creating the power of acceptance in the person to whom it is offered if it reasonably appears from the price quotation that assent to the quote is all that is needed to ripen the offer into a contract. *Nordyne, Inc., supra*. Factors that are relevant in determining whether a price quotation is an offer include the extent of prior inquiry, the completeness of the terms of the suggested bargain, and the number of persons to whom the price quotation is communicated. *Nordyne, Inc., supra*.

(b) Acceptance

To constitute a contract, there must be an acceptance of the offer as noted above. Until the offer is accepted, both parties have not assented to the terms and, therefore, there is no mutual assent.

Acceptance is defined as a manifestation of assent to the terms of the offer made by the offeree in a manner invited or required by the offer. Whether an offer has been accepted is a

question of fact. The effect of acceptance is to convert the offer into a binding contract. *Tebeau v. Ridge*, 261 Mo. 547, 170 S.W. 871 (1914).

(c) Delivery

Delivery is ordinarily essential to the validity and operation of a contract; however, neither manual transfer nor any particular form of ceremony is necessary to constitute good delivery, which may be by acts without words, words without acts, or by both words and acts. *Wilkie v. Elmore*, 395 S.W.2d 168 (Mo. 1965). Although physical delivery is frequently the only method by which acceptance is to be expressed, it is not an absolute necessity unless so intended by the parties. If the parties understand that the contract has been executed and is in operation, it will be considered as delivery. In the absence of direct evidence, the delivery of a contract is presumed where the concurrent acts of the parties recognize the contract's obligations. Delivery of a contract is largely a matter of intention of the parties, and such delivery may be actual or constructive.

5. Formal Requisites

(a) Oral Contracts

An oral contract is ordinarily no less binding than one that is reduced to writing; however, a statute may require certain contracts to be in writing, and an oral or parol contract is unenforceable where a statute so requires.

(b) Written Contracts

The principal statute that is raised in this connection is the "statute of frauds." This statute applies to contracts specified within the statute that are required to be in writing and, absent a writing, are found not to exist. For example, Section 432.010, *et seq.*, R.S.Mo. (assignment of wages and certain leases); Section 400.2-201, R.S.Mo. (sale of goods for greater than \$500.00);

K.S.A. § 33-101, *et seq.* (*i.e.*, land leases exceeding one year in length); and K.S.A. § 84-2-201 (sale of goods over \$500.00).

Where the parties indicate a definite intention not to be bound until a written agreement has been made, such an agreement will be a prerequisite to the formation of a contract. Except for some contracts, the form of which may be closely regulated by statute, no particular form is necessary to create a promise or covenant and all that is essential is that, from a fair interpretation of the language, it appears that the parties have agreed to do or refrain from doing certain acts in question.

(c) Multiple Writings

A contract may be stated upon several different writings that are construed together. Indeed, a complete contract may be gathered from letters, writings, and presumably, e-mails between the parties, where they in fact relate to the subject matter of the contract and are so connected with each other that they may be fairly said to constitute one document relating to the contract.

(d) Partly Written and Partly Oral Contracts

In the absence of a statute requiring that a contract be in writing or evidenced by a writing, a valid contract may be partly written and partly oral. A verbal acceptance of a written offer will form a valid contract that is partly written and partly oral. The rule that all preliminary negotiations and agreements are to be deemed merged into the final settled instrument executed by the parties does not prevent a contract from being partly oral and partly in writing. This rule does not apply, however, where it appears from an inspection of the documents themselves that it was intended to express the full and complete agreement and intention of the parties.

6. Definiteness and Certainty

To be enforceable, an agreement or contract must be “definite and certain” as to its terms and requirements. Or, on the other hand, it must contain provisions that are capable by themselves of being reduced to certainty, even if there are some formal imperfections in the contract. To have a valid contract, all terms should be definitely agreed upon, and the failure to agree to even one essential term means there is no agreement to be enforced. The test for the enforceability of an agreement is whether both parties have manifested an intention to be bound by its terms and whether the terms are sufficiently definite to be specifically enforced by a court; however, an agreement to the essential terms of a contract does not mean that the terms must be set out in the plainest language. It does not follow that parties must share identical, subjective, opinions as to the meaning of the terms.

Generally, an agreement to agree is unenforceable. This is because its terms are so indefinite that it fails to show a mutual intent to create an enforceable obligation. The parties’ obligations must be identified so that the adequacy of performance can be ascertained. A letter of intent, for example, often runs afoul of this rule.

An agreement will be rendered unenforceable if its terms are not reasonably certain. The trier of fact determines whether an agreement has been made and what the terms of the agreement are. Ambiguity will exist if a contract is reasonably susceptible to more than one interpretation. No enforceable contract comes into being when parties leave a material term for future negotiation, creating a mere agreement to agree; however, it is not required that all terms of agreement be precisely specified, and the presence of undefined and unspecified terms will not necessarily preclude the formation of a binding contract. In determining whether the mistake has a material effect on the agreed exchange of performances, account is taken of any relief by way of reformation, restitution, or otherwise.

More simply stated, to be binding a contract must generally be sufficiently definite to permit a determination by a court of a breach and the application of a remedy.

Mutual expressions of agreement may fail to consummate a contract for the reason that they are not complete, due to some essential term or terms not being agreed upon. *Wilkinson v. Shoney's, Inc.*, 269 Kan. 194, 4 P.3d 1149 (2000). However, even if a contract is ambiguous, it should not be held void for uncertainty if there is a possibility of giving meaning to the agreement. *Lindsey v. Jewels by Park Lane, Inc.*, 205 F.3d 1087 (8th Cir. 2000). Once a trial court determines that a contract is ambiguous, it is for a jury to determine the true meaning of the contract terms.

7. Ambiguities

If the terms are not definite and certain, then an ambiguity exists in the contract. In such case, the court will gather, if possible, the intention of the parties from the contract as a whole or, as is often stated, from the “four corners” of the contract.

Accordingly, the fundamental and cardinal rule in the construction or interpretation of a contract is that the intention of the parties is to be ascertained by the fact finder. *Liggatt v. Employers Mutual Casualty Co.*, 273 Kan. 915, 46 P.3d 1120 (2002), and *Berman v. Berman*, 701 S.W.2d 781 (Mo. App. 1985). If only one reasonable meaning can be ascribed to the contract when viewed in context, that meaning necessarily reflects the parties’ intent. To determine the intentions of the parties to a contract, the court will look not only to the written contract, but also to any extrinsic evidence regarding the parties’ intent at the time the contract was made.

If the language used by the parties is plain, complete and unambiguous, the intention of the parties must be gathered from that language, and from that language alone. *Liggatt, supra*, and *Needles v. Kansas City*, 371 S.W.2d 300 (Mo. 1963). This is true no matter what the actual

or secret intentions of the parties may have been. Presumptively, the intent of the parties to a contract is expressed by the natural and ordinary meaning of the language used. Only when the contract language is ambiguous may a court turn to extrinsic evidence of the contracting parties' intent.

8. Mistakes Between the Parties

In general, a mistake can be defined as a belief that is not in accord with the actual facts. A mistake in a contract is an unintentional act or omission arising from ignorance, surprise, or a misplaced confidence.

Mutual mistake is a defense to contract formation while a unilateral mistake is not. Mutual mistake results when both parties to a contract share a common assumption about a vital existing fact upon which they based their bargain or agreement and that assumption turns out to be false. Because of the mistake, a quite different exchange of values occurs from the exchange of values the parties contemplated. Under the doctrine of mutual mistake, a contract can be reformed (altered) or rendered voidable if it can be shown that the parties were both mistaken about a basic fact that is material to the agreement; however, only if avoidance is just and reasonable and will not unfairly prejudice the rights of an innocent third party will a contract be reformed. Reformation is the appropriate remedy when the mistake is one as to expression, while avoidance is the proper remedy where a mistake goes to a basic assumption on which the contract was made and when it has a material effect on the agreed exchange of performances.

If partial performance has occurred on one side, the mutual mistake doctrine does not automatically cancel all remaining obligations on the other side and thereby allow the nonperforming party simply to retain the benefit conferred by the partial performance. On the contrary, the doctrine permits the court to grant relief only on such terms as justice requires. The doctrine of mutual mistake is limited to cases in which both parties were reasonable in their

inconsistent interpretations of the contract and in which neither party is more at fault than the other. Moreover, a mutual mistake of fact cannot lie as to a future event. Mutual mistakes must concern past or present facts, not unexpected facts that occur after the document is executed.

9. Changes or Modifications

Parties to a contract are not forever locked into its terms. Accordingly, parties to an existing contract may, by mutual assent, modify its terms. This is so provided the modification does not violate law or public policy and provided there is consideration for the new agreement or that the new agreement satisfies a statute or is made under circumstances making consideration unnecessary. Accordingly, it is entirely acceptable for the parties to a contract to modify or waive their rights under it and engraft new terms upon it. *Holyfield v. Harrington*, 84 Kan. 760, 115 P. 546 (1911); *Shutt v. Chris Kaye Plastics Corp.*, 962 S.W.2d 887 (Mo. 1998). Further, the parties to a contract are ordinarily as free to change it after making it as they were to make it in the first instance, notwithstanding provisions in it designed to hamper that freedom or regardless of contractual provisions to the contrary. *Twin River Construction Co., Inc. v. Public Water District No. 6*, 653 S.W.2d 682 (Mo. App. 1983).

A valid modification of a contract must satisfy all of the criteria essential for a valid original contract. *Zumwinkel v. Leggett*, 345 S.W.2d 89 (Mo. 1961). This includes offer acceptance and consideration. One party to a contract may not unilaterally alter its terms. Modification of a contract requires the mutual assent of both parties to the contract. *Fast v. Kahan*, 206 Kan. 682, 481 P.2d 958 (1971); *Rimer v. Hubbert*, 439 S.W.2d 5 (Mo. App. 1969). Mutual assent is a requisite element in effecting a contractual modification, as it is in the initial creation of a contract. *Meyer v. Diesel Equipment Co., Inc.*, 1 Kan. App. 2d 574, 570 P.2d 1374 (1977). A request, suggestion, or proposal for an alteration or modification to a contract that is made after an unconditional acceptance of an offer and not assented to by the opposite party does

not affect the contract then in full force and effect by reason of the acceptance. The minds of the parties must meet as to any proposed modification.

The original contract may provide for methods and procedures for modification; this is not unusual. The contract's method of modification is not an exclusive method – the parties may waive the method of modifying the contract (and may waive any other right under a contract).

There is some confusion in the cases as to the necessity of consideration for the modification of a contract and some authority dispensing with it, at least under certain circumstances. *Holyfield v. Harrington*, 84 Kan. 760, 115 P. 546 (1911). Nevertheless, many courts support the general principle that a contract modification must be supported by valid consideration. *Parkhurst v. Investors Syndicate*, 128 Kan. 7, 23 P.2d 589 (1933). This is generally true unless: (1) The modification can be supported on principles of estoppel or waiver, such as where it has been acted upon by the parties until it would work a fraud or injury to refuse to carry it out, or (2) a statute makes the consideration unnecessary.

Although a simple contract completely reduced to writing cannot be contradicted, changed, or modified by parol or oral evidence of what was said and done either prior to or at the time it was made, by the rules of common law it may be appropriate for the parties to add written provisions (prior to any breach of the contract) to waive, dissolve, or abandon the contract or to add to it, change it, or modify it, or any of its terms. *Coonrod & Walz Construction Co, Inc. v. Motel Enterprises, Inc.*, 217 Kan. 63, 535 P.2d 971 (1975); *George F. Robertson Plastering Co. v. Magidson*, 271 S.W.2d 538 (Mo. 1954). Therefore, extrinsic evidence may be relied on to establish that the parties modified their agreement after its execution. Moreover, a course of dealing is sufficient to establish modification of a contract if the circumstances surrounding the parties' conduct are sufficient to support a finding of a mutual intention that the modification is

effective, and if such intention is shown by clear, unequivocal, and convincing evidence (either direct or implied).

The rule followed by the courts generally is that unless a contract is required by law to be in writing, the contract can be modified orally as well, even though it provides that it can be modified only in writing. Such a stipulation in the original contract may become inoperative because of modification or rescission, waiver or estoppel, or an independent contract. Some jurisdictions, however, have statutes providing that a written contract containing a provision against oral modification cannot be changed or altered by an executory agreement unless it is in writing.

Finally, where possible, a modification agreement should be construed in connection with the original contract. All circumstances surrounding the negotiations held prior to the execution of the modification should be examined. The modification of a contract results in the establishment of a new agreement between the parties which *pro tanto* supplants the affected provisions of the original agreement, while leaving the balance of the agreement intact. Although the effect of the modification is the production of a new contract, it consists not only of the new terms agreed upon, but of as many of the terms of the original contract as the parties have not abrogated by their modification agreement.

II. STANDARD FORM AGREEMENTS

The use of standard form agreements when drafting construction contracts is recommended because construction contracts have become very complicated. The provisions in the standard forms are generally recognized and accepted within the industry, and they have been tailored by use and experience to coordinate obligations for various responsibilities. Forms are available from the American Institute of Architects (AIA), the Engineering Joint Contract Documents Committee (EJCDC), and the Associated General Contractors (AGC), just to name a

few. The AIA documents are frequently used in building construction and projects overseen by architects. The EJCDC documents are used more frequently for heavy and highway construction such as roads, dams, bridges and tunnels, where the designer is more likely to be an engineer rather than an architect. The AGC forms are frequently used and are considered reasonably balanced. They do not, however, enjoy the same popularity as the AIA documents, which are generally thought to be more evenly balanced in terms of the rights and liabilities of the parties.

Regardless of the standard form that is used by the parties, the forms need to be reviewed and individual provisions or terms negotiated in order to tailor the terms and scope of the services and work to the subject project. Automatic tailoring is not recommended unless specific requirements of the project mandate it.

III. RECOGNIZING LIABILITY EXPOSURE UNDER CONTRACT AND DEFENSES TO CONTRACT LIABILITY CLAIMS

A. Introduction

Two basic questions must be asked: (i) whether a present duty to perform has arisen (*i.e.*, is there an absolute promise *or* have all conditions been met or excused); and (ii) whether the duty to perform has been discharged. If a present duty to perform has arisen and has not been discharged, nonperformance will be a contractual breach.

B. When Has A Contracting Party's Duty To Perform Become Absolute?

1. Distinction Between Promise and Condition

(a) Definitions

A *promise* is a commitment to do or refrain from doing something. It may be conditional or unconditional. A *condition* is an event the occurrence or nonoccurrence of which will create, limit, or extinguish the absolute duty to perform; it is a promise modifier.

(b) Interpretation of Provision as Promise or Condition

It is not always clear whether a contract provision is a promise or a condition. The basic test is the “*intent of the parties*,” as judged by the words of the agreement, the prior practices of the parties, and custom in the business. In doubtful situations, the courts prefer a promise, since a promise will support the contract.

(c) Condition or Promise

A provision may be a promise for one party *and* a condition for the other, as in an exchange where the second party’s duty to pay is conditioned on the first party’s performance of its promise. A provision may also be both a promise and a condition for the same party, as where a party is under a duty to reasonably ensure that a condition comes about (*e.g.*, to secure financing).

2. Classification of Conditions

(a) According to Time of Occurrence

A condition *precedent* is one that must occur before an absolute duty of performance arises in the other party. Conditions *concurrent* are those that are capable of occurring together, as where property is tendered in exchange for cash. A condition *subsequent* is one that cuts off an already existing duty of performance.

(b) Express, Implied, and Constructive Conditions

Express conditions are those expressed in the contract. *Implied* conditions (called “implied in fact” conditions) are those to be inferred from evidence of the parties’ intention. *Constructive* conditions (called “implied in law” conditions) are those read into a contract by the court *without regard to the parties’ intention* in order to ensure that the parties receive what they bargained for. Constructive conditions may relate to the time of performance, *i.e.*, which party performs first.

3. Have the Conditions Been Excused?

A duty of performance becomes absolute when conditions are either *performed* or *excused*. Conditions may be excused in several ways:

(a) Excuse of Condition by Failure to Cooperate

A party who wrongfully prevents a condition from occurring will no longer be given the benefit of it.

(b) Excuse of Condition by Actual Breach

An actual, material breach by one party excuses the other's duty of counterperformance. (A minor breach might suspend the duty, but will not excuse it.)

(c) Excuse of Condition by Anticipatory Repudiation

Anticipatory repudiation must be unequivocal, not just an expression of doubt. It applies *only if* there are *executory* (unperformed) *duties on both sides* of a bilateral contract. (If the nonrepudiating party has nothing further to do at the time of repudiation – he has performed his part of the contract – he must wait until the time originally set for performance; the repudiator may change his mind up to that time.) Anticipatory repudiation gives the nonrepudiating party four alternatives:

- (1) **Treat the contract as totally repudiated and *sue immediately*;**
- (2) ***Suspend his own performance* and wait until the performance is due to sue;**
- (3) **Treat the repudiation as an *offer to rescind and treat the contract as discharged*; or**
- (4) ***Ignore* the repudiation and urge performance.**

Repudiation may be retracted until the nonrepudiating party has accepted the repudiation or detrimentally relied on it.

(d) Excuse of Condition by Prospective Inability or Unwillingness to Perform

A party might have reasonable grounds to believe the other party will be unable or unwilling to perform when performance is due.

(i) Distinguish from Anticipatory Repudiation

Prospective inability to perform merely *raises doubts* about performance; thus, it does not meet the unequivocal requirement of anticipatory repudiation.

(ii) What Conduct Will Suffice?

Conduct is judged according to a reasonable person standard.

(iii) Effect of Prospective Failure

The innocent party may *suspend* its own performance until it receives adequate assurances of performance. If these are not forthcoming, it may treat the failure as a repudiation.

(iv) Retraction

Retraction is possible, but may be ineffective if the other party has changed its position in reliance on the prospective failure.

(e) Excuse of Condition by Substantial Performance

Where a party has almost completely performed its duties, but has breached in some minor way, the rule of substantial performance avoids forfeiture of a return performance.

(i) Application

The rule is generally applied only where *constructive* conditions are involved; applying it to express conditions might defeat the express intent of the parties that performance be perfect. Substantiality of performance is judged by the same standards as materiality of breach. (*See* VIII.B.1., *infra.*) The rule is usually *not* applied if the breach was *willful*.

(ii) Damages Offset

The substantially performing party may be required to pay damages to compensate the other party for the incomplete performance.

(iii) Applicability of Substantial Performance to Sale of Goods

Although the U.C.C. sets forth a “perfect tender rule,” it is subject to exceptions, such as the provision for a seller’s right to cure defective tender.

(f) Excuse of Condition by Divisibility of Contract

Where a party performs one of the units of a divisible contract, it is entitled to the agreed equivalent for that unit even though it fails to perform the other units.

(i) What Is a Divisible Contract?

Three tests must be met to find that a contract is divisible:

- 1) The performance of each party is divided into two or more parts under the contract;
- 2) The number of parts due from each party is the same; and
- 3) The performance of each part by one party is the agreed equivalent of the corresponding part by the other party.

(ii) Installment Contracts

Under the U.C.C., a contract that authorizes or requires delivery in separate lots is an installment contract. The buyer may declare a total breach only if defects in an installment are such as to substantially impair the value of the *entire contract*.

(g) Excuse of Condition by Waiver or Estoppel

(i) Estoppel Waiver

A party may “waive” a condition by indicating that he will not insist on it; however, such a waiver may be retracted at any time unless the other party relies on the waiver and changes its

position to her detriment. Upon such detrimental reliance, the waiving party is estopped from asserting the condition.

(ii) Election Waiver

If a condition is broken, the party who was to have its benefit may either terminate its liability or continue under the contract. If it chooses the latter, it is deemed to have waived the condition.

(iii) Conditions that May Be Waived

If no consideration is given for the waiver, the condition must be one that is ancillary or collateral to the main purpose of the contract; otherwise, the waiver amounts to a gift and is thus not enforceable.

(iv) Right to Damages for Failure of Condition

Waiving a condition does *not* waive one's right to damages for the other's defective performance.

(h) Excuse of Condition by Impossibility, Impracticability, or Frustration

Conditions may be excused by impossibility, impracticability, or frustration of purpose according to the tests described under discharge. (*See C.4., infra.*)

C. Has The Duty To Perform Been Discharged?

Once it is established that there is an immediate duty to perform (either because the duty is unconditional or the condition has been satisfied or excused), that duty must be discharged.

1. Discharge by Performance or Tender of Performance

The duty may be discharged by complete performance or tender of performance, assuming the tendering party possesses the present ability to perform.

2. Discharge by Condition Subsequent

The duty may be discharged by occurrence of a condition subsequent.

3. Discharge by Illegality

The duty may be discharged by supervening illegality of the subject matter.

4. Discharge by Impossibility, Impracticability, or Frustration

(a) Discharge by Impossibility

The duty may be discharged by impossibility (measured by an *objective standard* – nobody could perform according to the terms of the contract). This impossibility must arise after the contract was entered into. A party who has rendered part performance prior to the impossibility may recover in quasi-contract. Impossibility examples include: (i) *death or physical incapacity* of a person necessary to effectuate the contract; (ii) a subsequently enacted law rendering the contract subject matter *illegal*; and (iii) *subsequent destruction of the contract's subject matter* or means of performance, as long as the promisor was not at fault and it is truly impossible to fulfill the terms of the contract at any price.

(b) Discharge by Impracticability

Modern courts will also discharge a duty because of impracticability (subjective test). Impracticability requires that a party encounter *extreme and unreasonable* difficulty or expense that was *not anticipated*. A mere change in the difficulty or expense due to normal risks that could have been anticipated (*e.g.*, increase in price of raw materials) will *not* warrant discharge by impracticability.

(c) Discharge by Frustration of Purpose

A duty may also be discharged by frustration of purpose. This requires (i) a *supervening event*; (ii) that was *not reasonably foreseeable* at the time of entering into the contract; (iii) that

completely or almost completely *destroys the purpose* of the contract; and (iv) the purpose was understood *by both parties*.

5. Discharge by Rescission

(a) Mutual Rescission

Duties may be discharged by mutual rescission, *i.e.*, where both parties expressly agree to it. The contract to be rescinded must be *executory on both sides*. A mutual agreement to rescind will usually be enforced where a bilateral contract has been partially performed. Where the contract is unilateral, a contract to mutually rescind where only one party still has a duty to perform will be ineffective (unless there is an offer of new consideration by the nonperforming party, there are elements of promissory estoppel, or the original offeree manifests an intent to make a gift of the obligation owed it). Mutual rescission may be made *orally* unless the subject matter is within the Statute of Frauds or it involves a contract for the sale of goods requiring a rescission to be in writing.

(b) Unilateral Rescission

Rescission may be unilateral where only one of the parties to the contract desires to rescind it. In this case, that party must have adequate legal grounds (*e.g.*, mistake, misrepresentation, or duress).

6. Partial Discharge by Modification of Contract

A duty may be discharged partially by modification of the contract. There must be mutual assent to the modifying agreement. Generally, consideration is necessary, although courts will usually find it where *each party* has limited his right to enforce the original contract. Consideration is not necessary where the modification is only a correction, or for a modification of a contract for the sale of goods.

7. Discharge by Novation

A duty may be discharged by a novation, *i.e.*, a new contract substituting a new party for one of the parties to the original contract. Necessary elements are: (i) a previous valid contract; (ii) an agreement among all parties, including the new party; (iii) immediate extinguishment of contractual duties as between the original contracting parties; and (iv) a valid new contract.

8. Discharge by Cancellation

Duties may be discharged by cancellation of the original agreement.

9. Discharge by Release

Duties may be discharged by a release and/or covenant not to sue. The release must be in *writing* and supported by *new consideration* or *promissory estoppel* elements.

10. Discharge by Substituted Contract

There is a discharge by substituted contract where the parties to a contract enter into a second contract that expressly or impliedly *immediately* revokes the first contract.

11. Discharge by Accord and Satisfaction

(a) Accord

An accord is an agreement in which one party to a contract agrees to accept performance different from that originally promised. Generally, an accord requires consideration. Consideration less than that of the original contract will be sufficient if it is of a different type or is to be paid to a third party (*e.g.*, an accord agreement to exchange a \$500 TV set for a \$700 cash debt is valid).

(i) Effect

An accord does not discharge a contractual duty. It merely suspends the other party's right to enforce it.

(ii) Partial Payment of Original Debt

Payment of a smaller amount than is due on a claim is valid consideration if it is made in good faith and there is a *bona fide dispute* as to the claim. This is often accomplished by tendering a check conspicuously marked “payment in full.”

(b) Satisfaction

Satisfaction is the performance of the accord. It discharges both the accord and the original debt.

12. Discharge by Account Stated

Duties may be discharged by an account stated; *i.e.*, parties agree to an amount as a final balance due from one to the other as settlement of all previous transactions between them. It is necessary that there have been *more than one prior transaction*. A writing is required only if one or more of the original transactions was subject to the Statute of Frauds.

13. Discharge by Lapse

Duties may be discharged by the lapse of time if each party’s duty is a condition to the other’s duty and neither party performs its duty.

14. Discharge by Operation of Law

Duties may be discharged by operation of law (*e.g.*, the contractual duty of performance is merged in a court judgment for breach of the duty; discharge in bankruptcy bars any right of action on the contract).

15. Effect of Running of Statute of Limitations

Where the statute of limitations on an action has run, it is generally held that an action for breach of contract may be barred.

IV. DAMAGES AND QUANTUM MERUIT

A. Remedies For Breach

There are several remedies for breach of contract, *e.g.*, damages, specific performance, and rescission and restitution.

1. Damages

There are three kinds of damages: compensatory, nominal, and punitive. Most important for bar examination purposes are compensatory damages. The goal of compensatory damages is to put the nonbreaching party into *as good a position* as the party would have been in had the other party fully performed. There are two kinds of compensatory damages and the nonbreaching party may recover both: the “standard measure” (cost of a substitute) and consequential damages.

(a) Standard Measure of Damages

In most cases, the standard measure of damages will be expectation damages that would permit the plaintiff to buy a substitute. In cases where expectation damages are speculative, the plaintiff may recover reliance damages (*i.e.*, the cost it has incurred by performing).

(i) Construction Contracts

If a construction contract is breached by the *owner*, the builder will be entitled to profits that would have resulted from the contract plus any costs expended. (If the contract is breached after construction is completed, the measure is the full contract price plus interest.) If the contract is breached by the *builder*, the owner is entitled to the cost of completion plus reasonable compensation for the delay. Most courts allow the builder to offset or recover for work performed to date to avoid unjust enrichment of the owner. (If the breach is only late performance, the owner is entitled to damages incurred because of late performance.)

(ii) Contracts Calling for Installment Payments

If a contract calls for payments in installments and a payment is not made, there is only a partial breach. The aggrieved party is limited to recovering only the missed payment, not the entire contract price; however, the contract may include an acceleration clause making the entire amount due on any late payment, in which case the aggrieved party may recover the entire amount.

(b) Consequential Damages

Consequential damages are awarded in addition to the standard measure and will be given if a *reasonable person* would have foreseen at the time of entering into the contract that such damages would result from the breach. Note that the plaintiff bears the burden of proving the foreseeability of damages where “special circumstances” are involved (*i.e.*, whether those special circumstances were made clear to the other party at the time of contract formation).

(c) Punitive and Nominal Damages

Punitive damages are generally *not* awarded in commercial contract cases. Nominal damages (*e.g.*, \$1) may be awarded where a breach is shown but *no actual loss* is proven.

(d) Liquidated Damages

A liquidated damages provision will be valid if (i) damages were *difficult to ascertain at the time the contract was formed*, and (ii) the amount agreed upon was a *reasonable forecast* of compensatory damages. If these requirements are met, the plaintiff will receive the liquidated damages amount even though no actual money damages have been suffered. If the liquidated damages amount is unreasonable, the courts will construe this as a penalty and will not enforce the provision.

(e) Duty to Mitigate Damages

The nonbreaching party has a duty to mitigate damages. If it does not do so, its damages will be reduced by the amount that might have been avoided by mitigation. In employment contracts, the employee is under a duty to use reasonable diligence to find a like position. In sale of goods contracts, cover must be reasonable, in good faith, and without unreasonable delay. In construction and manufacturing contracts, mitigation requires the builder or manufacturer to cease work unless completion would decrease damages, *e.g.*, finishing partly manufactured goods.

2. Quasi-Contractual Relief

If there is no contractual relief available under the rules discussed in this outline, quasi-contractual relief might be proper.

(a) Failed Contract

Where quasi-contractual relief is used to remedy a failed contract, all that is necessary is that the failed contract *results in unjust enrichment of one of the parties*. Even the breaching party may be able to recover in quasi-contract, as long as the breach did not involve seriously wrongful or unconscionable conduct.

(b) Where No Contract Involved

Where there is no contractual relationship between the parties, quasi-contractual relief requires that:

- (1) One party has *conferred a benefit* on the other by rendering services or expending properties;**
- (2) The conferring party had a *reasonable expectation of being compensated*;**
- (3) The benefits were conferred at the express or implied *request of the other person*; and**

(4) *Unjust enrichment would result if the defendant were allowed to retain the benefits without compensating the plaintiff.*

The modern rule grants relief even though the defendant, in fact, received no benefit, as long as the plaintiff expended something on the defendant's behalf. The measure of relief is the benefit received by the defendant, or the detriment suffered by the plaintiff where the plaintiff has not breached the contract and where the benefits are difficult to measure, or where the benefit measure would achieve an unfair result. Relief may exceed the proposed contract price.