CHAPTER THREE

Bars to a Contract

How to Know When It=s ANo Deal@

WHEN IS A CONTRACT NOT A CONTRACT? In the last chapter we discussed what you need to make a contract. Now we=ll consider what kinds of things could still prevent a legally-enforceable contract from being formed. These are often described as **contract defenses**. You should understand them because if one or more of them is present, and provable, you might be in much better shape if you=re having trouble with the terms of a Adeal@ you might have thought you were stuck with.

Illegality

Illegal contracts -- such as a Acontract@ on someone=s life -- are not enforceable. Courts will not help someone collect an illegal gambling debt, or payment for illegal drugs or prostitution. The law treats these contracts as if they never existed -- they are **unenforceable** or **void**. This is the contract defense of illegality.

Similarly, some contracts that are not specifically outlawed nonetheless will not be enforced if a court determines that enforcement would violate public policy. An example would be a contract to become a slave, which may not be prohibited by any specific statute but offends the law's view of what kinds of contracts society will permit.

There are some situations where a contract was legal when entered into, but the law changes

before it is executed by all parties. Generally speaking, the Constitution forbids lawmakers from passing laws that would impair the rights people bargain for in contracts, but there are many law books filled with exceptions to this general rule. Therefore, a contract is usually considered by courts in light of the law that applied at the time the contract was made -- *unless the change in the law involves a compelling public policy*.

The key, then, is whether the new law reflects an important public policy. Here's an example of a law that did not involve such a policy. A contract between a railroad and a property owner who leased a right-of-way to the railroad provided that the railroad was not responsible for any fire damage to the property caused by locomotives. Later, the state legislature required certain precautions against fire damaging an adjoining property. The court held that, even if that law would have made the contract illegal (because it didn't include the newly-required precautions), because it was passed after the contract was made the law did not affect the contract.

Typically, however, courts say that because of a change in *public policy* as a result of the change in the law, they will not enforce the old contract. Obviously, a contract to sell someone a slave could not be enforced after slavery became illegal; neither could you enforce a contract to purchase a banned assault rifle that was made before the ban went into effect. This works both ways: a contract that was illegal when made usually will not be enforced, even though it would be legal if entered into today. After World War II, one party wanted to enforce a contract that violated wartime price-controls. The court ruled that a contract that was so damaging to the public good when made (and when no change in the law was anticipated) should never be enforced. To do so would have been to provide an incentive to enter into illegal contracts in the hope that they will someday be enforceable -- a bad

prescription for effective public policy.

Remember that an illegal contract is different from an immoral contract. The courts will only enforce a moral code that the law (or "public policy") already reflects, such as laws against prostitution or stealing. You may feel that X-rated movies or fur coats are immoral, but as long as they're legal, they can be the subjects of enforceable contracts. What if it is illegal to gamble in your state, but you go on line and gamble over the Internet using your credit card? Chances are you will still have to pay your losses. The website operator may be in violation of local law, and you may be also. But your credit card agreement probably requires you to pay your gambling debts regardless, and until this area is regulated and controlled you must assume that when you put your money on the line, online, that you may never see it again – exactly the bargain you make whenever you gamble.

Sidebar

IS IT OR ISN'T IT A CONTRACT?

You now know that a contract has to be made between willing, competent parties. Also, the contract must concern a legal subject matter. The preceding chapter also discussed many aspects of consideration.

But applying these principles isn't always easy. Sometimes special protections in the law complicate matters. If successfully invoked, only one of these may be needed to provide a complete defense against someone claiming you owe him or her money or something else you supposedly

promised. It would prompt a court to resolve the dispute as if there never were a contract. Since the contract is void, neither party may enforce its terms in court against the other.

Other contracts are **voidable**, but not automatically **void**. What's the difference? A contract produced by fraud is not automatically void. People who are victimized by fraud may have the choice of asking a court to declare the contract void or to **reform** (rewrite) it. On the other hand, if they went along with the contract for a substantial period of time, they could lose their right to get out of it. This is called **ratification**, and is based on the idea that they have, by their actions, made it clear that they are able to live with the terms. A checklist of contract defenses appears in this chapter.

Duress

You don=t usually have to worry about being held to a contract that you Aentered into@ against your will. A contract that someone agrees to under duress is void. **Duress** is a threat or act that overcomes someone's free will. The classic case of duress is a contract signed by someone "with a gun to his head." That means *literally*. Since this kind of duress is very rare -- and often very hard to prove -- the defense of duress is rarely successful.

Duress is more than persuasion or hard selling. Persuasion in bargaining is perfectly legal. It also isn't duress when your friend says, "I would never pay that much for a Edsel if I had a choice." She does have a choice: buy a nice Taurus instead. But if she wants that mauve Edsel, she "has to" pay what the owner demands. In contrast, duress involves actual coercion, such as a threat of violence or imprisonment.

Besides being done by threats of physical violence, it may be duress to threaten to abuse the court system to coerce your agreement, i.e., to tell someone that AI=ll tie you up in litigation for ten years.@ There is also economic duress. That was alluded to earlier when the contractor demanded more money after his workers went on strike and you needed your house painted before you left the country. This isn't the same as "driving a hard bargain." Rather, the contractor had already made a deal. When the contractor threatened to withhold his part of the deal, he left you with no practical choice but to agree. The classic case is where the supplier of a necessary ingredient or material threatens, on short notice and at a critical time, not to deliver it -- in violation of an existing contract -- unless he or she gets more favorable terms. Courts have set aside contracts made under such economic duress.

A lawyer can tell you how to protect yourself, helping you determine whether you have assumed any obligation, and what legal rights you might have besides disavowing the contract. With duress, it's important to act quickly, since the courts are especially skeptical of a claim of duress made long after the danger has passed.

Undue Influence

There are other uses of unfair pressure, less severe than duress, that void a contract. One contract defense is called **undue influence**, which doesn't involve a threat. Rather, it's the unfair use of a relationship of trust to pressure someone into an unbalanced contract. Undue influence cases usually involve someone who starts out at a disadvantage, perhaps due to illness, age, or emotional vulnerability. The other person often has some duty to look out for the weaker one's interests.

An example would be an adult child who "persuades" his elderly, failing mother to sell him the

family homestead for a pittance. The sale contract would be unenforceable because of undue influence, regardless of whether the mother otherwise had the capacity to make a contract.

Fraud

A contract can be also be canceled by a court because of fraud. **Fraud** is when one person knowingly makes a material misrepresentation that the other person reasonably relied on and that disadvantaged that other person. A **material misrepresentation** is an untrue statement of "fact" that is important to the deal, "material" meaning it would affect the terms you'd agree to it if you knew the truth. In many states, this misrepresentation doesn't have to be made on purpose to make the contract voidable.

Consider our earlier example involving a car sale. You offered to sell your Edsel to a friend. Suppose you knew it had no transmission, and you knew she wanted it for the usual purpose of driving it. You told her it was working fine, and she relied on your statement. Then the contract you made may be set aside on the grounds of fraud.

Here, there is no issue of the statement being merely the seller's opinion, or exaggerated "sales talk" or puffery that people know not to believe literally. You didn't merely say it was a great car when really it was a mediocre car. Saying it's "great" is just an opinion, while fraud requires an outright lie, or a substantial failure to state a material fact about an important part of the contract. For that reason -- and because dishonest people often know well the fine line between fraud and puffing -- actual fraud that will invalidate a contract is a lot less common than people think.

Sidebar

WHEN SOMEONE FORCES YOU TO SIGN

Between the defenses of duress and undue influence, you should never have to fear a court holding you liable for a contract that someone forces you to sign. Both concepts are hard to define, though, and people often use them interchangeably. Also, their limits vary from one state to another. If you think either might apply to an agreement you want to get out of, see a lawyer.

Mistake

Sometimes it seems unfair to hold a party to a contract they entered into by mistake, but this is a slender reed indeed on which to seek to avoid a contract. The other party=s fraud is very different from your mistake, assuming the other party didn't know about your mistake. The defense of **unilateral mistake** is almost impossible to prove, even if the mistake is about the most important terms of the contract. If allowed liberally, it would lead to a lot of abuse. People would claim they made a mistake in order to get out of a contract they didn't like, even though they had no valid legal defense. Therefore, courts hardly ever permit such a defense, and even then, mostly in specialized business cases.

Courts have permitted a mistake defense most commonly if there has been an honest error in calculations. The calculations must be material to the contract, and the overall effect must be to make

the contract unconscionable (discussed below), that is, unfairly burdensome. Such mistakes often happen when a unit of government puts public work out for bid. If a contractor mistakenly bids five million dollars to construct a bridge and a road, when the true cost to build the bridge alone was five million dollars, he or she might be able to raise this defense. Even then, however, if several months have elapsed and the government has materially relied on the mistaken figures before the mistake is discovered (for example, by taking a number of steps to move the process forward), then it would be unfair to the government to cancel the deal, and the defense would probably fail. (But see the discussion of reformation in the section on remedies in chapter 15.)

Of course, if you explicitly state your mistaken idea, the other party has a duty to correct you. Then the issue is no longer one of mistake but of fraud. In our car-sale example, suppose the car's heater worked, but not too well, and you, the seller, knew that. Under contract law, if you and your friend hadn't discussed it, you probably wouldn't have to tell your friend about it. But suppose your friend told you, "The best thing about this car is that it's so hard to find an Edsel with a perfect heater." Then you would be obliged to tell your friend that the heater was faulty. If you didn't, many states would permit your friend to set aside the contract, or would allow your friend to collect damages for repairs required on the heater.

Having said this, the best defense is a good offense. Don't assume anything important or questionable. Ask the questions now -- before you sign.

On the other hand, if *both* sides make a mistake, they share an erroneous basic assumption. Then, in order to avoid injustice, the court will sometimes set aside the contract, under the theory of a **mutual mistake**.

The classic case of mutual mistake occurred when someone sold a supposedly infertile cow for eighty dollars. It turned out soon afterward that the cow was pregnant, which made her worth $800. The court ruled that since both parties thought they were dealing with a barren cow, the contract could be set aside.

This does not mean that contracts always have a built-in guarantee against mistakes. As you can imagine, this is a very tricky and unpredictable area. After all, many people make purchases on the understanding that the object is worth more to one person than to the other. You wouldn't pay $80 for a cow if she were not worth at least $80.01 to you. That is, you figure you're somewhat better off with the cow than with the $80, given your circumstances and opportunities. (Economists call this amount the "marginal benefit.") Similarly, the seller would not sell her if she were worth more than $79.99 to the seller, given the seller=s circumstances and opportunities. Both people have to be getting some benefit to agree to the sale. In the case of the cow, both buyer and seller understood clearly -- but mistakenly -- that the cow could not get pregnant. It's as if they made the contract for a subject that turned out not to exist.

How serious does a mutual mistake have to be before a court will set aside a contract for that reason? To take our example, various courts would draw the line on mistake between $80.01 and $800 at different places, if they would be willing to draw it at all. Competent legal advice about the law in your state is crucial if you are considering voiding a contract because of a mistake.

Statutes of Limitations

You should also be aware of **statutes of limitations**. These are laws setting time limits during which a

lawsuit can be brought. The typical deadline for bringing a contract action is six years from the time the breach occurs. The idea of this policy is that everyone is entitled, at some point, to "close the book" on a transaction. It encourages people to move on and reduces the uncertainty that, for example, businesses would face if they could be sued for breaching contracts that no one alive in the organization remembers.

Changing Situations

Sometimes changing circumstances make a contract impossible to perform. Suppose that you hire a contractor to paint your house on Thursday, and it burns down Wednesday night through no fault of your own. Then the contract will be set aside, because there's no way to perform it. You won't have to pay the painter, under the doctrine of **impossibility of performance**. Both of you are out of luck. The same is true if the contract covers a specific kind of product, and it becomes unavailable because of an act of God, such as an earthquake or blizzard. Courts usually will not enforce such a contract.

For example, suppose you contract to deliver one hundred barrels of a specific grade of oil from a specific Arabian oil field by a certain date. Then an earthquake devastates the oil field, making recovery of the oil impossible. You're probably off the hook under these circumstances.

This doctrine is also known as **impracticability of performance**, which reflects the fact that it may apply even if performance is not literally impossible, but is still seriously impractical.

Sometimes changed circumstances radically change the costs of performing a contract, without making it literally impossible to do so. Courts probably would enforce the contract, on the grounds that the new circumstances were foreseeable, and that the possibility of increased costs was or could have

been built into the contract. For instance, suppose again that you contract to deliver one hundred barrels of Arabian oil. This time, fighting breaks out in the Persian Gulf, interrupting shipping and greatly increasing the cost of the oil. When a court considers these facts, it's likely to say that you should have foreseen the possibility of fighting and built that risk into the price. The contract will stand.

On the other hand, sometimes a change in conditions doesn't make performance impossible or impractical, but it does make performance meaningless. The legal term for this is **frustration of purpose**. One famous case decided around the turn of the century involved a man who rented an apartment in London to view the processions to be held in connection with the coronation of the King of England. Because of the King's illness, the coronation was canceled. The court excused the renter from paying for the room. Through no fault of his own, the whole purpose of renting it -- which the people who owned the room knew -- had disappeared. Such cases, though, are rare indeed. More typically, you take your chances when you make a contract in expectation of some third party's or outside force's action; many contracts have a term excusing the parties from performance if any of a number of specified events occur.

There are three important criteria for a contract to be set aside for frustration of purpose. First, the frustration must be substantial -- nearly total, and with almost no chance at improved benefit. Second, the change in circumstances must not be reasonably foreseeable. Third, the frustration must not have been your fault.

Sidebar

SHOULD THE BUYER STILL BEWARE?

The well-known Latin maxim *caveat emptor* -- "let the buyer beware" -- is a strict rule placing the risk in a transaction with the buyer. Under this rule each party is protected only by inspecting and analyzing a potential transaction, because there is no remedy if there is a hidden problem. In fact, this "ancient" law really predominated only in the 19th and early 20th centuries, when the idea of "the sanctity of the contract" reigned. More common are the principles of "just prices" and fair dealing in transactions. They are part of religious law, medieval law, and more recently statutory law -- particularly the consumer fraud acts prohibiting unfair or deceptive acts and practices. Having said that, every buyer should recognize that the first line of defense is common sense, and not depend on an expensive lawsuit and a sympathetic judge to save him or her from a bad deal or sharp practice.

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Unconscionability

On rare occasions, a court may let a party out of a contract because the court deems it "unconscionable" (from the word "conscience"). **Unconscionability** means that the bargaining process or the contract's provisions "shock the conscience of the court." An example would be selling thousands of dollars of rhumba lessons to a ninety-five-year-old invalid on social security. An unconscionable

contract is one that produces a result unfairly surprising due to hidden or obscure language, or, as in the example given above, is grossly unfair, perhaps due to a lack of bargaining power. Its terms suggest that one party took unfair advantage over the other one when they negotiated it. The courts are reluctant to use this weapon, but consumers have a better chance with it than anyone else, especially in installment contracts.

The important thing to remember is that you shouldn't rely on unconscionability in making a contract. Though courts sometimes will void contracts on these grounds, the application of unconscionability is uncommon, uneven, and unpredictable. Make the effort to understand all the terms of a contract and don't enter into it if it seems too one sided. After all, it's also "unconscionable" to let someone take advantage of you.

Sidebar

FILL IN THE BLANKS

There are many kinds of form contracts. One is the kind you simply have to sign if you want to get insurance or a loan, or if you're financing a car. These are called contracts of adhesion -- if you want the deal, you have to "adhere" or stick to the terms. "Click box" contracts for software or other computer-related merchandise, or access to websites, are also contracts of adhesion.

Another common kind of form contract is one with numerous blanks on it, which can be filled in with the names of the parties, the monetary terms, dates, etc. These are used commonly for the

sale of homes and for leases on real estate. There are two main points to be aware of regarding these forms, which can be purchased at stationery stores:

First, while they may be standardized, there's no such thing as a "standard contract." Many innocuous-looking forms are available in several different versions, each fulfilling the same function - for example, an apartment lease - but each subtly different. One might be a "landlord's" contract, where the preprinted terms are more favorable to the landlord, while a nearly identical one is a "tenant's" contract. In any event, don't let anyone tell you it's "standard." Insist on crossing out or changing any term you don't like. If the other party refuses to accept changes that are important to you, then don't sign the contract. In today's economy, there is usually more than one source for the product or service you want.

Second, fill in all the blanks! A contract with your original signature but containing blank spaces can be like a blank check if altered unscrupulously. Be sure all blanks are filled, either with specific terms or straight lines to indicate that nothing goes there. And insist on your own copy with the other side's original signature. If it's a computerized "click box" situation, print out a copy of what you're agreeing to. If you can't, at least consider this a red flag.

Third, if the contract involves a significant amount of money to you or your family, take it to a lawyer before you sign. This is especially important in real estate transactions, where there is typically plenty of room to bargain. There is no such thing as a "preliminary" agreement. An "agreement" is just that -- a contract.

PRACTICAL CONTRACTS

Sometimes you look at a form contract, throw up your hands, and decide not to read it. There doesn't seem to be much room to negotiate with a form contract. Believe it or not, it pays to read them. Failure to read a contract is virtually never a valid legal defense. In most states the courts have held that people are bound by all the terms in a contract, even if they didn't read the contract before signing it (unless the other party engaged in fraud or unconscionable conduct). Don't trust the other party to tell you what it means; even with good intentions, he or she could be mistaken. Also, be suspicious if the salesperson urges you to "never mind, it's not important." (Ask the salesperson, "If it's not important, is it okay to cross out the whole paragraph?") Where a substantial amount of money is at stake, take the time to sit down with the form, and underline parts you do not understand. Then find out what they mean from someone you trust.

At the same time, you have to be realistic about exercising your right to read a form contract. At the car rental counter at the airport, you probably don't have time to read the contract and get an explanation of the terms you don't understand. Even if you did take the time, with whom would you negotiate? The sales clerk almost certainly doesn't have the authority to change the contract (but see the discussion on page 13 on contracts of adhesion). Similarly, while you should know "what your getting into" when agreeing to the license terms of a commercially sold software program, no negotiation is possible. If you want the program, you have to agree.

Sidebar

GETTING OUT OF A CONTRACT

A contract may be set aside if competent parties have not made it voluntarily. It also may be set aside if there was grossly insufficient consideration. In addition, certain contracts must be in writing, or they are also unenforceable. Here is a list of other contract defenses discussed in this chapter.

- illegality;
- duress;
- undue influence;
- fraud;
- mistake.
- unconscionability;
- impossibility and impracticability of performance;
- frustration of purpose.

If you can prove any of these, the contract will probably be deemed void or voidable. In either case it is practically as if there never were a contract. If either party paid money, it would have to be returned.

---------- Don=t ever rush to sign on the dotted line because you=re afraid to lose the bargain of a lifetime. Rarely will a truly great bargain not be there tomorrow. For all the great deals you rush into that work out fine, the one you will remember is the one that went sour -- where they socked you with the fine print you didn't bother to read. A great bargain won't fall into your lap, anyway. It requires a lot of footwork, research, and comparison shopping. If you've done all that, it's unlikely that someone else is

right behind you who has done it also.

While working out the terms of a written contract, you may sometimes see or hear reference to a contract **rider**. A rider is a sheet of paper (or several pages) reflecting an addition or **amendment** (change) to the main body of a contract. Often it's simpler to put changes in a rider, which supersedes any contradictory parts of the main contract, than to try to incorporate the changes on the original form.

People are often intimidated by Afine print.@ It=s a good idea to get over that, because often the fine print contains terms that could greatly affect your personal finances beyond what the actual deal would lead you to believe. It may contain details about credit terms, your right to sue and your right to a jury in a lawsuit.

You don=t need a law degree to at least try to read the fine print. Often if you sit down with it, sentence by sentence, you'll find that you can understand a lot more than you expect, especially in states that have passed "plain English" laws requiring that consumer contracts use nontechnical, easy-to-understand words. You will at least, by expending the effort, identify which terms raise questions for you. The trick is not to be intimidated by the salesperson or the fine print in the contract.

Sidebar

READ THE FINE PRINT

Perhaps the most unpleasant part of making contracts comes after negotiating your best deal. It occurs

when a salesperson presents you with a form contract, which is often one or two pages of tiny print that you might not understand even if you could read it. But the law usually assumes that you read and, to a reasonable extent, understand any contract you sign.

Once you've divined the meaning of a contract, it's in your hands to decide whether the bargain is one you want to enter into. You never have to accept a contract. Every part of a contract is open for negotiation, at least in theory. Just because the salesperson gave you a form contract doesn't mean that you have to stick to the form. You can cross out parts you don't like. You can write in terms that the contract doesn't include, such as oral promises by a salesperson. (Make sure that all changes to the form appear on all copies that will have your signature; initial altered but unsigned pages and have the other party do the same.)

That doesn't mean the other side has to agree to your changes. You have no more power to dictate terms than they do. But if you get a lot of resistance on what seem to be reasonable issues, take a hard look at with whom you are dealing -- especially if they resist your request to put oral promises in writing.

Having said all that, there will be times when a contract is just too inscrutable to understand. ALegalese@ most often occurs in contracts that include some type of credit terms, such as when you buy something on installment payments. It's just this kind of legalese that could threaten your property rights in your house or other important property, so it pays to make sure you know what you're signing. The parts of this book on consumer credit and automobiles explain many of these terms. If you still have

questions, ask someone you trust (not the salespeople) to explain the terms to you. That could be someone experienced with the kind of contract you are considering, a state or local consumer agency, or a lawyer.

Sidebar

GET IT IN WRITING

When dealing with a written contract, a court will almost always treat the contract's terms as the final, complete contract. The court usually will not even consider oral promises that are not in the contract. The main exception to this is when oral promises are used fraudulently to induce one party into signing the contract in the first place. That is, the party is persuaded by the fraudulent oral promise to enter into a contract he or she otherwise would have avoided. The general rule prohibiting evidence of oral promises in all other cases protects both parties, since they know that once they sign the contract, they have clearly and finally set the terms.

Don't be swayed if the salesperson orally promises you an extended warranty or a full refund if you're not completely satisfied. Get it in writing. If the sales person refuses to put it in writing, walk away from the deal.

Many states now require plain-English consumer contracts, with potentially confusing sections

or clauses in precise, standard terms that nearly anyone can understand. Even if not legally required, more and more merchants are having contracts prepared this way for customer relations. Federal and state truth-in-lending laws require providers (or grantors) of credit to furnish specific information about credit contracts in clearly understandable form.

Finally, the legal doctrine regarding contracts of adhesion may protect you. As mentioned briefly earlier, these are contracts in which you have little or no bargaining power, as often is the case in many of the form contracts discussed above, such as loan documents, insurance contracts, and automobile leases. The consumer has some protection, however. Courts generally assume that such contracts have been drafted to provide maximum benefit to lender, lessor, or insurance company. So when a dispute arises over terms or language, the courts usually interpret them in the way most favorable to the consumer.

In one case, for example, a woman tried to collect on an airline trip insurance policy she had purchased. The insurance company held that the policy applied only to a trip on "scheduled airline" and that "technically" under some obscure regulations the woman's flight was not "scheduled," even though she had every reason to believe that it was. The court held in favor of the woman, saying the ordinary insurance buyer's understanding should apply.

There is a further protection for consumers. Even contracts that are not contracts of adhesion are interpreted or construed to favor the party who didn't draft them. Like the doctrines of unconscionability and fraud discussed earlier, this rule isn't something to depend on prior to signing a contract. Rather it's a defense that you and your lawyer may raise if a problem arises and the situation warrants.

In the last two chapters we've considered how you make a contract, and how certain contract defenses can help you avoid being held to an unfair or illegal contract. These contracts only scratch the surface of the topic of contract law, and don't deal with the millions of transactions between merchants that take place every day, or the more complex subjects in contract law that will require the assistance of a lawyer.

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