

Legal Updates: Contract Basics



February 25, 2005

The Basics

- Definitions
- Why We Enter Contracts
- Sources of Contract Law
- Types of Contracts
- Elements of a Contract
- Remedies for Breach of Contract



Challenges, Problems, & Pitfalls

Important Contract Terms

Battle of the Forms

Who May Sign a Contract for Lehigh?



Contract:

“[a]n agreement between two or more persons which creates an obligation to do or not do a particular thing... A legal relationship consisting of the rights and promises constituting an agreement between the parties that gives each a legal duty to the other and also the right to seek a remedy for the breach of those duties.”

[Black's Law Dictionary, 6th ed.]

In other words ...

A contract is a legally
enforceable promise

Question # 1:

Why does Lehigh enter into contracts?

Why does Lehigh enter into Contracts?

There are almost as many reasons as there are departments and functions at Lehigh...

- Pursuit of our missions (education and research)
- Buy or sell goods
- Buy or sell services
- Employment of faculty, staff, teaching assistants, etc.
- Relationships with our students

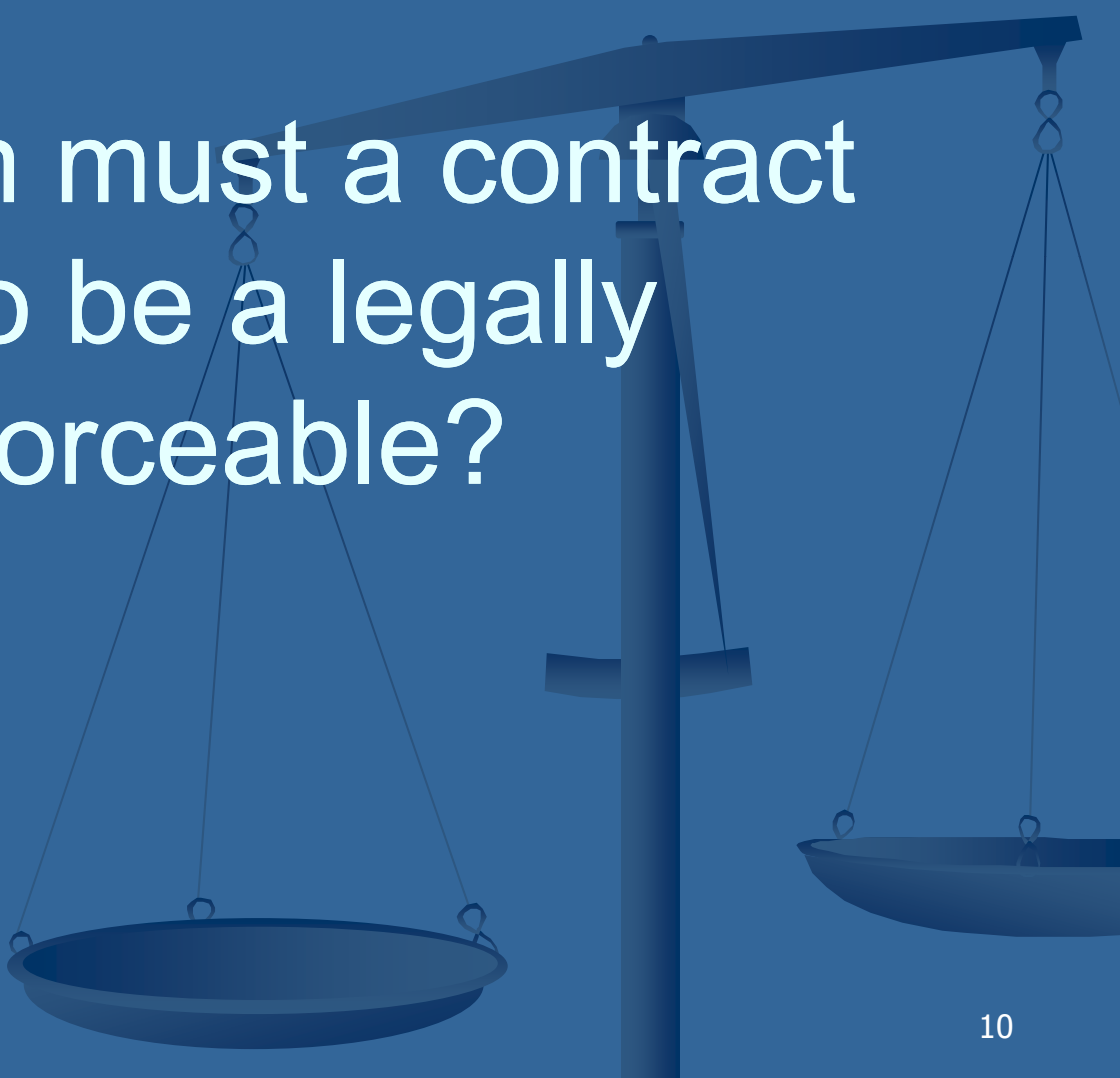
What are the Sources of Contract Law ?

- *Common law* : judge-made law, as distinguished from laws passed by legislature
- *Uniform Commercial Code (UCC)* : model code on commercial transactions adopted by all states (except Louisiana)

Contract law asks and answers the following questions:

1. Have the parties acted in such a way as to create legally recognizable expectations in one another;
2. If so, how should we characterize and understand those expectations;
3. Was the understanding of the parties faithfully carried out; and
4. If not, what if anything should the law do about it?

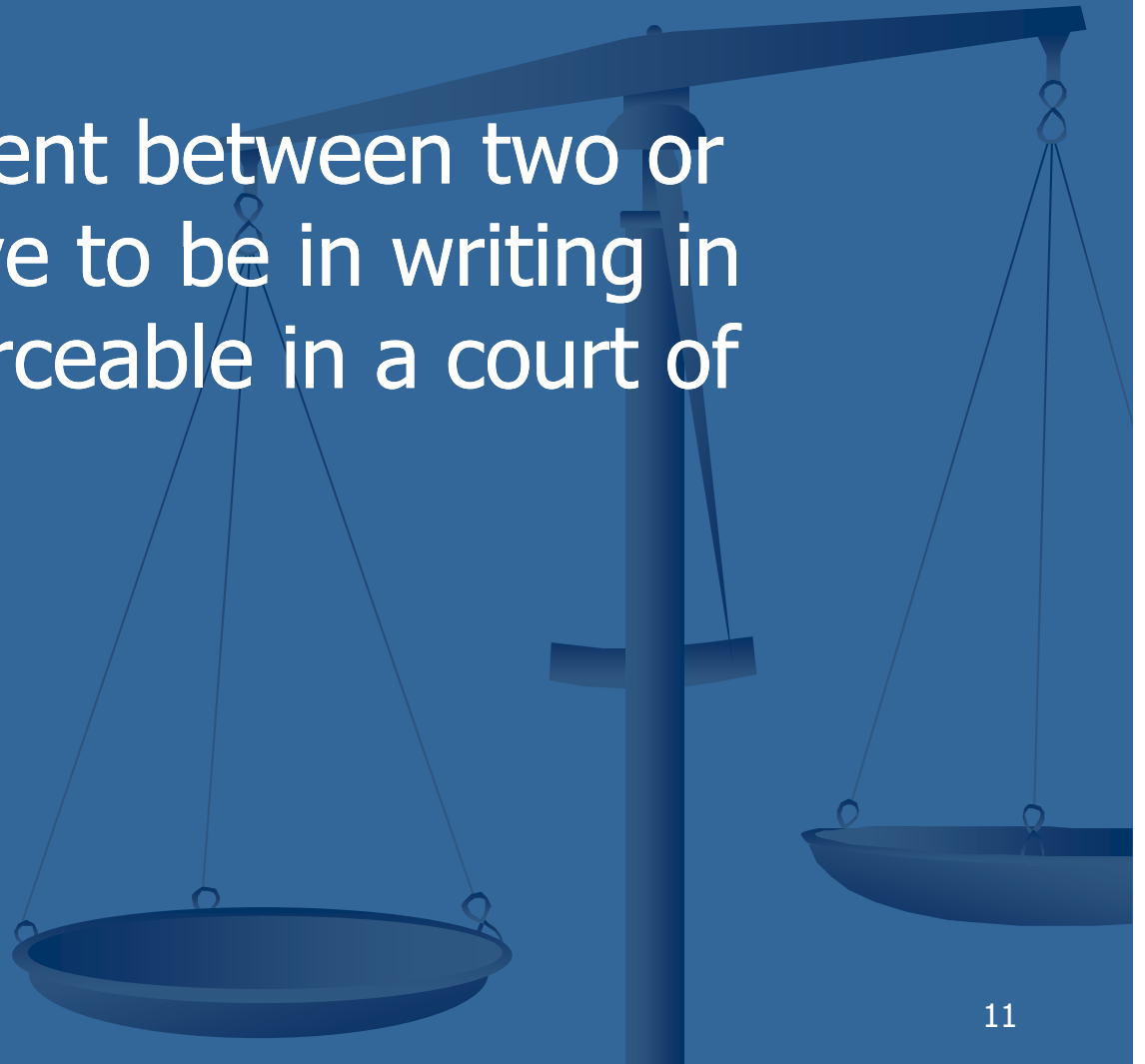
[Excerpt from "Concepts and Case Analysis in the Law of Contracts", 2Ed., Marvin A. Chirelstein, 1990]

A stylized blue scale of justice is centered on a dark blue background. The scale consists of a vertical post, a horizontal beam, and two pans hanging from the beam by strings. The scale is slightly tilted to the right.

What form must a contract
take to be a legally
enforceable?

Question #2

Does an agreement between two or more parties have to be in writing in order to be enforceable in a court of law?



A Contract Can Be Written or Oral

- Certain contracts must be in writing:
 - Contracts for the sale of goods over \$500
 - Contracts for the sale of real property
 - Contracts that are incapable of being performed within 1 year
 - Promises to answer for or discharge the debts of another (Guarantee)

Written and Oral Contract Terms



- Sometimes a contract may be in writing, but if a dispute occurs, an issue will be whether oral terms have modified written terms
 - This is why we have “merger” clauses in contracts, such as:

“This Agreement sets forth the entire understanding and agreement between the parties and supersedes all proposals or communications, oral or written, between the parties relating to the subject matter of the Agreement.”

Written and Oral Contract Terms (cont.)

- *Parol Evidence Rule* - when a “final” agreement between parties has been reduced to writing, evidence of any earlier oral or written expressions is not admissible to vary the terms of the writing...
 - UNLESS...one party can prove a material ambiguity or omission exists in the written terms ...THEN oral testimony about contract terms is considered

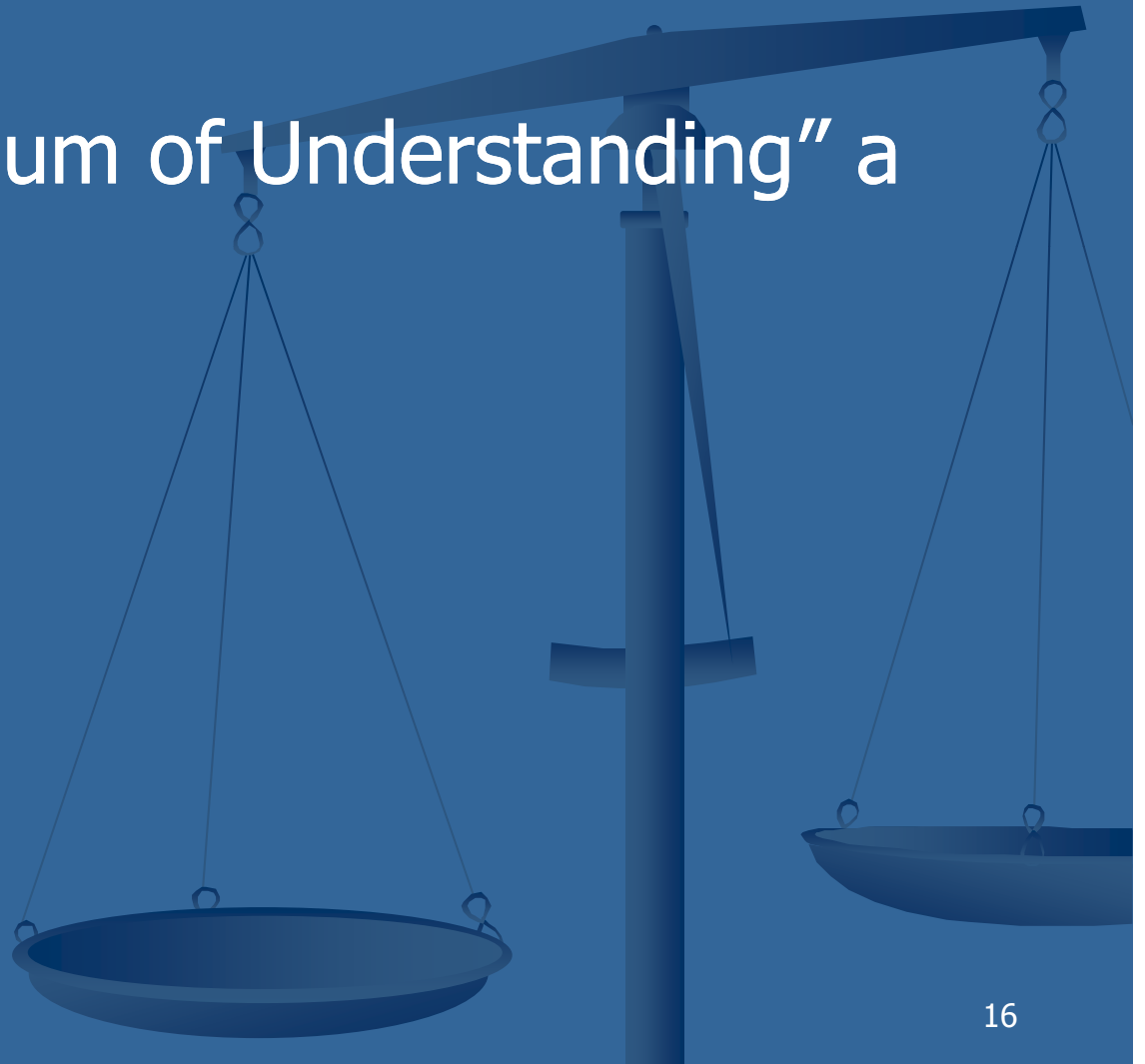
Written and Oral Contract Terms (cont.)

Evidence questions become crucial if there is a contract dispute

A contract is only as good as what you can later prove to be the terms of the contract

Question #3

Is a "Memorandum of Understanding" a contract?



Contracts can have many names...

- Contract
- Agreement
- Purchase Order
- Memorandum of Understanding
- Terms and Conditions
- Appointment Letter
- Handbook (“implied contract”)
- License
- Ticket



Or no name at all...

- a letter...
- a telephone call...
- an e-mail...



What are the Elements of a Contract?

- Offer
- Acceptance
- Consideration
- Mutuality



Offer:

- A proposal to do a thing or pay an amount, usually accompanied by an expected acceptance, counter-offer, return promise or act
- The offeror is the “master of his offer”.

Acceptance:

- Compliance by the offeree with terms and conditions of an offer
- A manifestation of assent to terms of offer in a manner invited or required by the offer
- The offer and acceptance must match (“mutuality” ...more on this soon...)

Acceptance:

Does not necessarily occur only by signature of a contract

Acceptance can occur by:

- Action
 - using goods
 - opening the package (software)
 - entering an establishment or participating in an activity
- Inaction –not returning goods

Acceptance:

Sometimes acceptance does not appear
“voluntary,” but it is still sufficient

Contracts of Adhesion:

- “Take it or leave it” terms
- Not bargained for

Consideration:

- Something of legal value; anything that induces you to give up something
- May be something other than money (i.e., a promise to do something; a promise to refrain from doing something)

Consideration:

What is the "value" of a contract?

Consideration:

The value of a contract:

It's not only what the University receives or pays, but also:

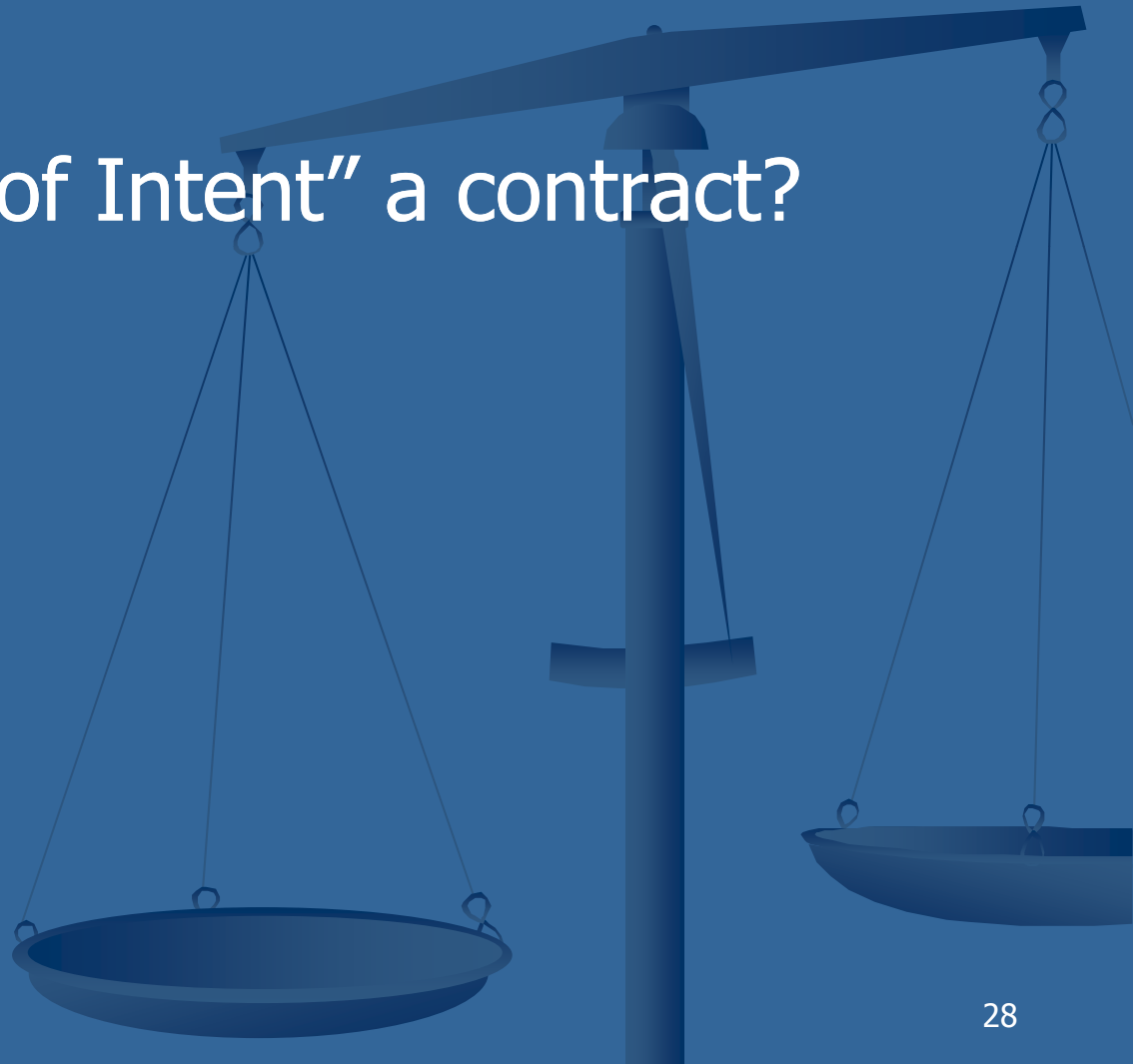
- What the University agrees NOT to do :
 - confidentiality clauses
 - non-compete clauses
- What risks and liabilities the University is exposed to

Mutuality:

- A “meeting of the minds” with respect to material contract terms
 - A signature is deemed to be sufficient to evidence this requirement
 - Therefore, it is crucial that you read carefully and understand all of the terms of a contract before you sign it

Question #4

Is a "Letter of Intent" a contract?



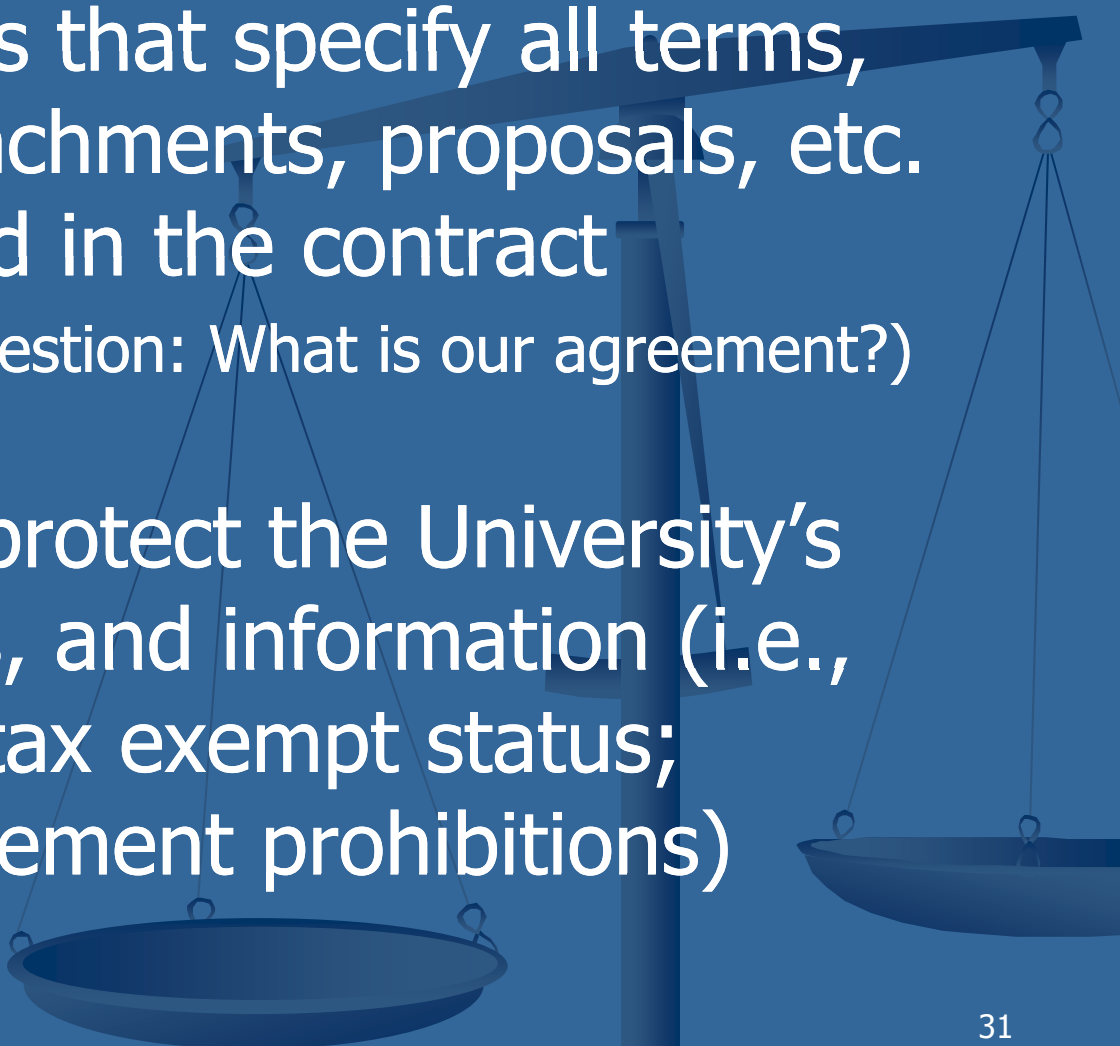
Additional Contract Elements:

- Both parties must be legally competent
 - Over 18 and mentally capable of understanding the agreement
 - Authority to negotiate for and bind the University

Information that you should include in University contracts...

- Clear and specific statements of the University's requirements and expectations
 - Type of performance expected
 - Quality, including inspection before acceptance
 - Timing of performance
 - Warranties or guarantees, if applicable

Contract Clauses to Include (cont.)

- Clear statements that specify all terms, documents, attachments, proposals, etc. that are included in the contract
 - (Answer the question: What is our agreement?)
 - Provisions that protect the University's interests, assets, and information (i.e., confidentiality; tax exempt status; publicity/endorsement prohibitions)
- 

Contract Clauses to Include (cont.)

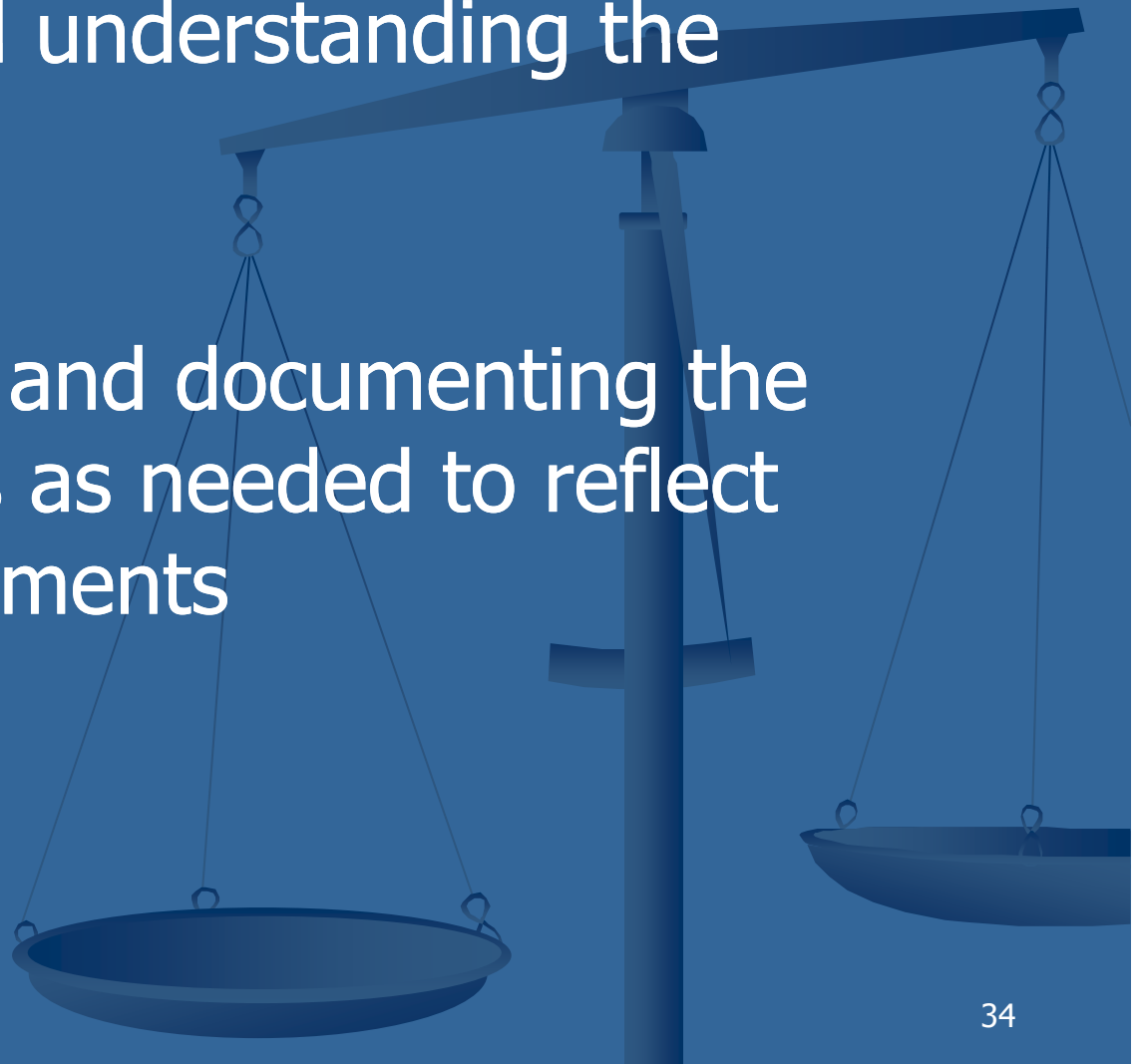
- Liability Protections
 - Defense & Indemnification
 - Insurance
- Termination
- Dispute Resolution
 - Litigation; Arbitration; Mediation
 - Governing Law
 - Forum – What court? Where?

Challenges, Problems & Pitfalls



Potential Contract Pitfalls

- Not reading and understanding the contract
- Not negotiating and documenting the contract's terms as needed to reflect Lehigh's requirements



Potential Contract Pitfalls



- Disclaimers or limitations on the other party's performance; disclaimers of warranties, etc.
- Any clause permitting the other party to change contract terms without the permission of the University in writing
- Failure to specify all terms, documents, etc. that are included in the contract or failure to show acceptance (i.e., signing or initialing changes)

Potential Contract Pitfalls (cont.)

- Reference to terms, documents or websites that the University has not been provided
- Indemnification, Liability Releases, Limits on Other Party's Liability

Potential Contract Pitfalls (cont.)

- Termination of Contract
 - Excessive opportunity for the other party to cure its breaches of the contract
 - Excessive or unreasonable penalties imposed on the University for terminating the contract
- Dispute Resolution in distant locations (other party's home city and state) and under laws of a distant state (other party's home state)

Questions #5 and #6:

What is “boilerplate” in a contract?

Is it different from “legalese”?

Is it necessary to read and negotiate “boilerplate” or “legalese”?

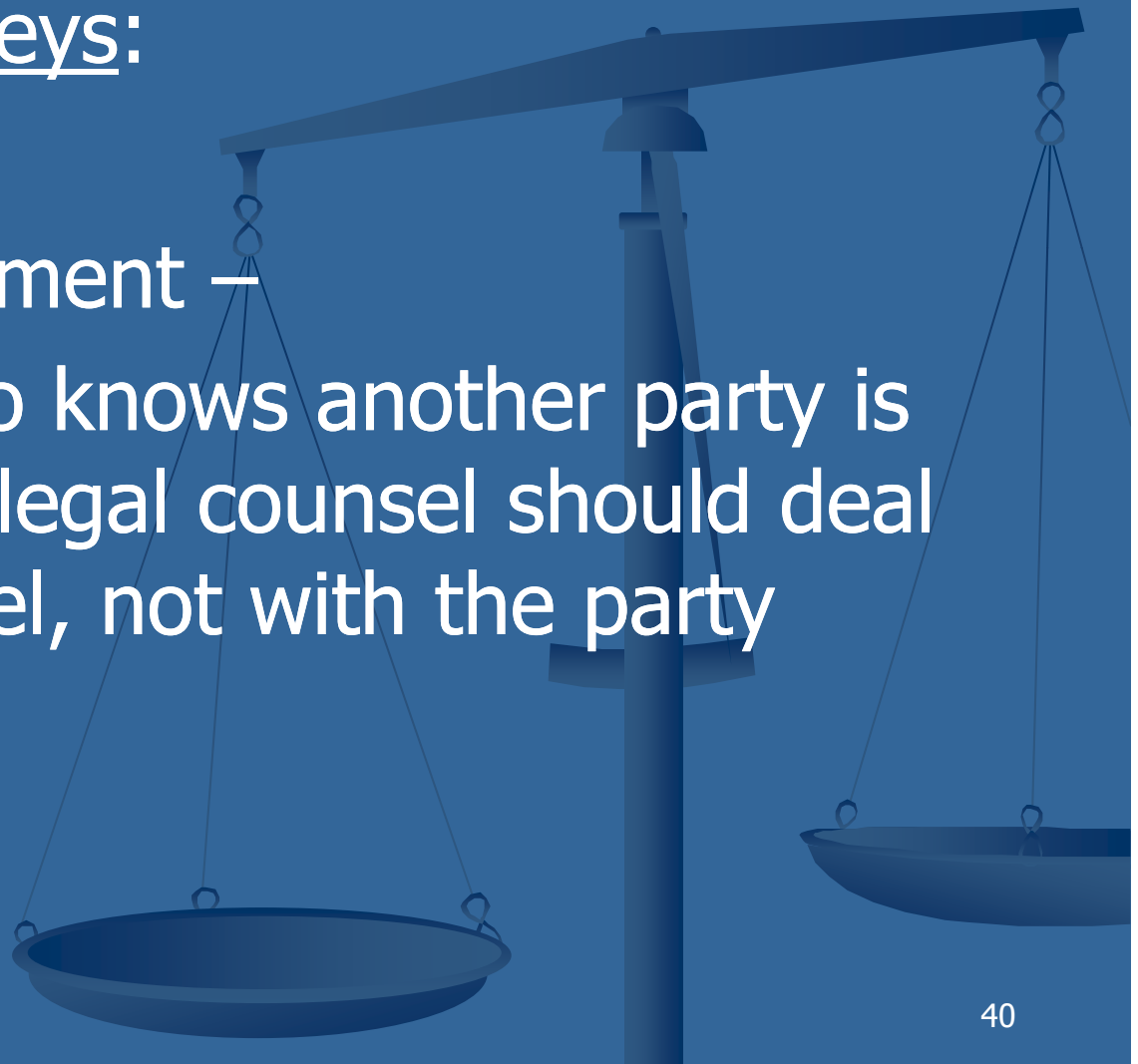
...the 70-page Confidentiality Agreement that was all “just boilerplate”...

Potential Contract Pitfalls (cont.)

The role of attorneys:

An ethical requirement –

An attorney who knows another party is represented by legal counsel should deal with that counsel, not with the party directly.



Potential Contract Pitfalls (cont.)

- Is a promise to make a gift (a pledge) a contract?
 - No consideration, so not a binding contract unless...
 - reasonable reliance by intended recipient and to its detriment
 - (e.g., starting construction on a building, inducing other donors to give)

Potential Contract Pitfalls (cont.)

“Always look a gift horse in the mouth ...”

- The “free” Velcro wall that cost \$750,000 ...
- Underground gas tanks and drycleaners

What if a contract is
breached?



Remedies for Breach of a Contract

■ Money Damages

- *Compensatory*: actual or real damages; compensate for the injury sustained and nothing more (“benefit of the bargain”)
- *Punitive*: damages to punish the defendant or set an example for similar wrongdoers
- *Nominal*: token amount of money because of technical wrong but no actual damages

Question #7

What are liquidated damages?

Remedies

- Money Damages (cont.)
 - *Consequential*: damage, loss or injury that doesn't flow directly and immediately from the act, but only from some of the consequences or results of such act
 - *Liquidated*: specific sum of money expressly stipulated by the parties in the contract to cover damages

Remedies

- Specific Performance

- Money damages aren't adequate to give the plaintiff the "benefit of the bargain"
 - Remedy used if the item is unique, such as a piece of property or artwork
- So, the defaulting party is required to perform its obligations under the contract

Things to Remember...

- Use University form contracts, even University Purchase Orders, whenever possible
- Beware of pressure tactics
- Be as specific as possible

Question #8

In deciding who will sign a contract on behalf of Lehigh, which is better:

- a) the Lehigh staff member who read and negotiated the contract signs?
- b) a Vice President signs who has never read the contract?

Question #9

What is apparent authority?



Who May Sign A Contract?

- Only those individuals who have been expressly delegated signature authority by the Board of Trustees or senior management
- Unauthorized individuals who sign contracts on behalf of the University expose themselves to possible personal liability

Questions #10 and #11:

When the word “Attest” appears next to the signature line of a contract, what does it mean?

What is the difference between “attest” and “witness”?

Battle of the Forms



- Modern business transactions are often conducted primarily through forms

Example: Lehigh decides to buy a computer

- Purchasing sends a purchase order to the vendor containing standard terms and conditions that are favorable to Lehigh
- After receiving the order, vendor sends a written acceptance or confirmation of the order on its form which contains the basic contract terms and a series of pre-printed terms that are favorable to the vendor

This is where the Battle Begins...

- If there is a contract dispute, which form will prevail?
 - Common law: the acceptance must mirror the precise terms of the offer and any variance from that constitutes a rejection of the offer or a counteroffer
 - UCC: says that, on premise that both parties recognize a contract despite their clashing forms, a contract is formed, unless the vendor specifically states that there shall be no contract unless his set of terms is accepted by the original offeror

...continues

- **If:** the offeree's (vendor) response contains terms *additional* to those contained in Lehigh's original offer (purchase order)
- **Then:** a contract exists consisting of the terms on which the offer and acceptance agree
 - The additional terms are merely a proposal for additions to the contract

...and ends

- **If:** the offeree's response contains terms which are *inconsistent* with the original offer
- **Then:** the court looks at the parties' conduct to determine whether they acted as though a contract was formed
 - If so, the conflicting terms cancel each other out and necessary terms are provided by the UCC or custom.

A note about the “plain language” movement in contracts ...

In the event a Claim is made upon the 2nd Party, the 2nd Party shall promptly give notice of such Claim to the 1st Party, and shall promptly deliver to such 1st Party all information and written material available to the 2nd Party relating to such Claim. If such Claim is first made upon the 1st Party, the 1st Party shall promptly give notice of such Claim to the 2nd Party. The 2nd Party will, if notified of the 1st Party’s election to do so within fifteen (15) days of the date of notice of a Claim, permit the 1st Party to defend in the name of the 2nd Party and Claim in any appropriate administrative or judicial proceedings and take whatever actions may be reasonably requested of the 2nd Party to permit the 1st Party to make such defense and obtain an adjudication of such Claim on the merits, including the signing of pleadings and other documents, if necessary; provided that the 1st Party shall defend the Claim with counsel reasonably satisfactory to the 2nd Party and provide the 2nd Party with evidence reasonably satisfactory to the 2nd Party that the 1st Party can satisfy the Claim if it is upheld. In addition to the liability for the ultimate settlement or judgment, if any, arising out of such Claim under this Agreement, the 1st Party shall be solely responsible for all the expenses incurred in connection with such defense or proceedings, regardless of their outcome. However, the 1st Party shall not be responsible for any expenses, including attorneys fees and costs, incurred by the 2nd Party to monitor the defense of the Claim by the 1st Party.